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PUBLICATION OF FINANCIAL SECTOR ASSESSMENT PROGRAM DOCUMENTATION—DETAILED ASSESSMENT OF OBSERVANCE—BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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EURO AREA

FINANCIAL SECTOR ASSESSMENT PROGRAM

July 2, 2025

DETAILED ASSESSMENT OF OBSERVANCE

**BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING
SUPERVISION**

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**Monetary and Capital
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This Detailed Assessment Report was prepared by Aditya Narain, Lyndon Nelson, Luc Riedweg and Emrah Sagkol in the context of an IMF Financial Sector Assessment Program (FSAP) mission in the euro area during November 2024–February 2025. Further information on the FSAP program can be found at

<http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

AC	Additional Criteria
A-CVA	Advanced Credit Valuation Adjustment
AQR	Asset Quality Review
AMA	Advanced Measurement Approach
AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
AMLCO	AML Coordination Office
AMLD	AML Directive
AMLSC	EBA AML/CFT Standing Committee
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BRRD	Bank Recovery and Resolution Directive - Directive 2014/59/EU
BSDD	Banking Supervision Data Division
CCP	Central counterparties
CCR	Counterparty Credit Risk
CEO	Chief Executive Officer
COREP	Common Reporting (in the EU)
CMDI	Crisis Management and Deposit Insurance
CMG	Crisis Management Groups
CRD	Capital Requirements Directive - Directive 2013/36/EU
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation - Regulation (EU) No 575/2013
CSRBB	Credit Spread Risk in the Banking Book
CVA	Credit Valuation Adjustment
DG	Directorate General
DGSD	Deposit Guarantee Schemes Directive
EBA	European Banking Authority
EC	Essential Criteria
ECA	European Court of Auditors
ECB	European Central Bank
EDIS	European Deposit Insurance Scheme
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pension Authority

EMIR	European Market Infrastructure Regulation
ESA	European Supervisory Authorities
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESG	Environmental, Social and Governance
ESMA	European Securities and Market Authority
ESRB	European Systemic Risk Board
EUDPR	Data Protection Regulation for EU institutions, bodies, offices and agencies
EU	European Union
EUR	Euro
EUReCA	EU's Central Database for AML and CFT
EVE	Economic Value of Equity
FAP	Fit and proper
FATF	Financial Action Task Force
FHC	Financial Holding Company
FICOD	Financial Conglomerates Directive
FINREP	Financial Reporting (in the EU)
FIU	Financial Intelligence Unit
FRTB	Fundamental Review of Trading Book
FSAP	Financial Sector Assessment Program
GHG	Greenhouse Gas
GL	Guidelines
G-SIB	Global Systemically Important Bank
G-SII	Global Systemically Important Institution
HQLA	High quality liquid assets
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and communication technologies
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMAS	Information Management System
IMF	International Monetary Fund
IMI	Internal Model Inspections
IMS	Internal Measurement Systems
IPU	Intermediate EU Parent Undertaking
IRB	Internal Ratings-Based
IReF	Integrated Reporting Framework

IRRBB	Interest Rate Risk in the Banking Book
ITS	Implementing Technical Standard
JCFC	Joint Committee on Financial Conglomerates
JST	Joint Supervisory Team
KPI	Key Performance Indicator
LCR	Liquidity Coverage Ratio
LEI	Legal Entity Identifier
LSI	Less Significant Institution
MBSF	Members of the Board in the Supervisory Function
MCM	Monetary and Capital Markets Department
MEL	Minimum Engagement Level
MFHC	Mixed Financial Holding Company
MIS	Management Information System
ML/TF	Money Laundering and Terrorism Financing
MoU	Memorandum of Understanding
MREL	Minimum Requirements for Eligible Liabilities
MVC	Market Value Changes
NACE	Statistical Classification of Economic Activities in the EU
NCA	National Competent Authority
NCB	National Central Bank
NDA	National Designated Authority
nGAAP	National Generally Accepted Accounting Principles
NBFI	Non-Bank Financial Institutions
NII	Net Interest Income
NP	National Parliaments
NPAP	New Product Approval Policy
NPE	Nonperforming Exposure
NPL	Nonperforming Loan
NRA	National Resolution Authority
NSFR	Net Stable Funding Ratio
O-SII	Other Systematically Important Institutions
P2R	Pillar 2 Requirements
P2G	Pillar 2 Guidance
PMO	Project Management Office
PPP	Periodic Penalty Payments
QFR	Quality Findings Report
RAF	Risk Appetite Framework

RCAP	Regulatory Consistency Assessment Program
RDARR	Risk Data Aggregation and Risk Reporting
RTF	Risk Tolerance Framework
RTS	Regulatory Technical Standard
SA-CVA	Standardized Approach for CVA
SB	Supervisory Board
SEP	Supervisory Examination Program
SFTR	Securities Financing Transactions Regulation
SI	Significant Institution
SOT	Supervisory Outlier Test
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
SSMFR	SSM Framework Regulation - Regulation (EU) No 468/2014
SRMR	SRM Regulation - Regulation (EU) No 806/2014
STE	Short-term Exercise
TFEU	Treaty on the Functioning of the European Union
TLTRO	Targeted Longer-Term Refinancing Operations
TRIM	Targeted Review of Internal Models
UTP	Unlikely-to-Pay
WCCA	Written Coordination and Cooperation Arrangement

SUMMARY AND MAIN FINDINGS

A. Summary

1. Banking supervision has significantly strengthened since the last Financial Stability Assessment Program (FSAP). The European Central Bank (ECB), in cooperation with the national competent authorities (NCAs), is exclusively responsible for the prudential supervision of credit institutions (banks) established in the participating EU member states. Together the ECB and the NCAs form the Single Supervisory Mechanism (SSM) which became operational in 2014. The SSM has made significant progress in raising the quality of supervision of Significant Institutions (SIs) since 2014 and implementing the recommendations of the 2018 assessment of the compliance with the Basel Core Principles (BCP). Banking supervision is underpinned by a clear mandate and independence from government or industry interference in individual supervisory decisions. The SSM is a highly capable supervisor supported by excellent risk analysis and a robust skill set in all aspects of supervision. It conducts an intrusive approach to supervision, uses a broad range of tools and relies on a fully articulated supervisory framework. In areas that the SSM chooses to make a priority (e.g., credit risk, liquidity risk, banks' internal models, operational risk and resilience, and climate-related financial risk), it delivers a thorough assessment and has been effective in improving bank risk management. Banking systems, both globally and in the euro area, have been exposed to a series of severe shocks and the SSM has been agile in responding to these events. On average, banks in the euro area maintain solid capital and liquidity positions, well above regulatory requirements. The SSM is also extremely transparent in its approach to supervising banks.

2. Nonetheless, the SSM continues to face a number of legal and operational challenges. Like many supervisors, SSM resources are stretched, with resource pressure in some key areas (e.g., Information and communication technologies (ICT) risk, approval of internal models). The dependency on NCA staff is both a strength but also an additional vulnerability which affects the planning and delivery of supervisory tasks, with more than half the NCAs not being able to meet their own staffing commitments to the SSM. The ECB banking supervision business lines' consultation on the budget proposal is also pro forma and late stage. Moreover, the governance of the SSM is complex and highly centralized. Lastly, the SSM has to navigate a complex legal framework. The ECB must apply different national laws transposing EU Directives, which may not be fully harmonized (e.g., in the areas of governance of banks) or add various national elements on the minimum common criteria (e.g., in the areas of licensing). This fragmentation can provide opportunities for regulatory arbitrage and lead to an unlevel playing field. The SSM has, however, made the best use it can of this complex legal framework. Significant steps have been taken to harmonize the options and discretions exercised by supervisory authorities. When the ECB applies national laws, in the areas of licensing, fit and proper assessments (FAP) and sanctions, there is extensive cooperation with NCAs through a range of experts' network. To address these issues, the FSAP recommends further delegating decision-making, improving governance of budgetary processes, ensuring alignment of resources to current and expected future workload, and further reducing regulatory fragmentation.

3. The adoption of the banking package— the Capital Requirements Regulation 3 (CRR 3) and the Capital Requirements Directive 6 (CRD 6)— in the EU is a major milestone, but some gaps remain with international standards.

Although it is not mandatory under the Basel standards, the application of the Basel capital requirements to all EU credit institutions (beyond the scope of internationally active banks) helps strengthen banks' safety and soundness and financial stability. Recent developments have, however, moved in contrasting directions. While the final elements of the Basel III reforms have been transposed into EU legislation, unlike in some other peer jurisdictions, the deviations from the Basel prudential standards at the time of the last FSAP have not been rectified, new permanent and temporary deviations were introduced in CRR 3 and the implementation of the fundamental review of the trading book (FRTB) was postponed (in response to decisions taken in other jurisdictions). While acknowledging that CRD 6 will improve the national supervision of third-country branches— an area where there is still however room for improvements, and grant competent authorities the power to assess the acquisition of material holdings, the FSAP noted that several issues identified in the last BCP assessment persist (e.g., narrow definition of related-party transactions, limited sanctioning powers of the ECB). More broadly, some in the private and public sectors have interjected into the current debate on the future of the EU economy that financial regulators should explicitly consider the competitiveness of the EU financial sector in their decision making. Adopting and implementing robust prudential standards should remain the primary focus of financial regulators in the euro area, and gaps with international standards should be addressed.

4. There is room for the SSM to be even more risk-based, proportionate in its approach to supervision, and impactful.

To ensure a level playing field and consistency in the supervisory assessment, the SSM has chosen a highly codified supervisory approach resulting in some form of standardization of supervisory processes. The SSM acknowledges that it needs to adapt and has started to take action to reduce the administrative burden and improve supervisors' agility. Some key initiatives, such as simplifying the SREP process planning and the implementation of a risk tolerance framework are expected to foster risk-based supervision further but are still in their early days and have yet to deliver substantially. Other supervisory processes such as those relating to fit and proper assessment and internal models' approval could also be streamlined and made more risk-focused. The comprehensive and intensive supervisory approach also generates many findings and, consequently, presents a challenge to follow up and ensure effective remediation. In this regard, the ECB has started to use more actively its escalation policy, including through enforcement actions. Apart from climate-related financial risks, the SSMs own enforcement tools have, however, rarely been used. Supervision of concentration risk is based on an overall robust process, but further attention should be given to sovereign risk concentrations. Capital add-ons reflecting high sovereign concentration risks are indeed not used in a systematic fashion and have only been imposed in a few instances. Regarding the ECB oversight of Less Significant Institutions (LSI) supervision, the use of moral suasion vis-a-vis NCAs has been effective in disseminating best supervisory practices in the LSI sphere, but more work is needed to improve supervisory convergence and ensure the consistency of supervisory priorities across member states.

5. The ECB has been a leader in incorporating climate-related financial risks in its supervisory approach. A wide range of initiatives to improve the supervision of climate-related financial risks have been taken by the ECB, including climate stress tests, thematic reviews and firm-specific work. The ECB has issued a number of binding supervisory decisions relating to risk management and governance of climate-related and environmental risks (which include nature-related risks as an example of emerging risk considered under the BCP). The ECB issued supervisory expectations on the prudent management of climate-related and environmental risk, grounded in current prudential rules. The ECB held continuous dialogues with institutions and issued various cycles of operational letters setting out shortcomings in their management of these risks. Where institutions were found to be in breach of prudential requirements and to be exposed to uncovered risks, the ECB adopted binding decisions which included the potential imposition of periodic penalty payments (PPP) in case banks were to fail to meet the requirements in the decisions within the given deadline. While these are commendable efforts in reflecting climate-related financial risks in risk management and supervision, the ECB should ensure that in a context of budget stabilization it maintains sufficient supervisory focus on all aspects and drivers of traditional risk categories – in addition to climate risk.

B. Main findings

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

6. The ECB is jointly responsible with the NCAs for the safety and soundness of banks across 21 member states. The distribution of tasks within the SSM is clearly established in the legislation, and interactions between the ECB and NCAs are sound and mature. The legal framework for banking supervision is well established in regulations and supervisory guidance. It gives the ECB powers to authorize SIs and LSIs, conduct ongoing supervision of SIs and undertake timely corrective action. The ECB, in its role as the banking supervisor for the euro area and the central organ of the SSM, is unique as it is the only supranational supervisor amongst its peers. Although it does not set prudential regulations, it is responsible for their enforcement.

7. The SSM is a successful example of supranational banking supervision but has to navigate a complex legal framework. While the establishment of the SSM has led to a significant improvement in the level of supervision across the euro area, one of its byproducts is a more complex legal framework than in a traditional single-jurisdiction supervisory framework. The SSM needs to apply directly applicable EU law provisions (EU Regulations, such as the SSM Regulation (SSMR) and the CRR) and EU Directives (such as the CRD), which need to be transposed by Union member states. In this second case, the ECB is required to apply different national laws, which may not be fully harmonized (e.g., in the areas of governance of banks) or add various national elements on the minimum common criteria (e.g., in the areas of licensing). The transposition of Union Directives into national laws does at times lead to differences in national frameworks. This may be on account of the need to align with other elements of the national framework such as commercial or corporate laws, codes, or practices. These differences and the consequent lack of harmonization in national legislation can be challenging for the ECB, which aims to ensure consistency in

supervision and improve the level-playing field among SSM banks. Lastly, the ECB may apply member states' national law provisions beyond EU level acquis in several areas (e.g., approval of mergers involving SIs, approval of appointment of key function holders).¹ There are also gaps in the existing EU framework (no EU-wide related-party transactions framework, limited range of sanctioning powers for the ECB). The SSM has, however, made the best use of this complex legal framework. Significant steps have been taken to harmonize the options and discretions exercised by supervisory authorities. When the ECB is using national powers, in the areas of licensing, fit and proper assessments and sanctions, there is extensive cooperation with NCAs through a range of experts' network.

8. The SSM is an independent supervisor with a clear decision-making process, but further simplification is warranted in decision-making. The governance arrangements of the SSM alongside the independence of the ECB as central bank considerably strengthen the operational independence of the ECB banking supervision function and insulate it from industry and government pressures. 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 adoption, mainly under the “non-objection procedure”. To facilitate the decision-making process, certain types of supervisory decisions are delegated to the Senior Managers of the ECB Banking Supervision, but nearly half of decisions are still adopted by the Supervisory Board through written procedures.

9. Resources are stretched, and the ECB has limited control over the allocation of NCA staff dedicated to the supervision of SIs. Although the ECB's banking supervision function is funded by fees levied on the supervised entities, its annual budget allocations may be constrained by the ECB's internal budget discipline policies. The ECB's Governing Council decision to not increase further the headcount from 2023 for both the central banking and the supervisory arm has put pressure on the ability to hire staff in requisite numbers with the skills needed, although headcount increases are possible for new or expanded tasks, as evidenced by the budget increase given the new mandate related to the implementation of Digital Operational Resilience Regulation (DORA). Like many supervisors, SSM resources are stretched, with resource pressure in some key areas (e.g., approval of internal models, ICT risk). A way forward would be for the budgetary function to have early-stage consultation with the banking supervision business lines on the budget, which is proforma and late stage. The access to NCA staff is both a strength but also an additional vulnerability which affects the planning and delivery of supervisory tasks, with more than half the NCAs not being able to meet their staffing commitments to conducting the offsite supervisory activities of the SSM.

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

10. The legal and regulatory framework provides the SSM with a set of instruments and tools to ensure that the licensing process of new credit institutions is sound. It retains adequate

¹ See [comprehensive list of national powers](#). The EU acquis is the collection of common rights and obligations that constitute the body of EU law, and is incorporated into the legal systems of EU Member States.

powers to require applicants and potential shareholders to submit all information required. While general requirements for granting authorizations are included in EU legislations and guidelines, licensing criteria based on different national legislation are also applicable in the licensing process of the SSM, which adds an extra layer of complexity for the ECB. Overall, entry into the euro area banking system is a carefully vetted process for domestically or foreign-owned entities. However, although the European Banking Authority (EBA) Guidelines on authorization emphasize the importance of having realistic and plausible business plan assumptions, no specific supervisory approach applies after the licensing phase to new and potentially fast-growing institutions which have a higher likelihood of failure during their first few years. In addition, the ECB does not have the mandate to authorize and supervise euro area branches of non-EU or European Economic Area (EEA) banks, which can lead to arbitrage booking either in subsidiary or branch form. Although CRD 6 will improve the regulation and supervision of third-country branches, such branches will remain licensed and supervised by NCAs outside the SSM unless they are converted into subsidiaries (they will be supervised by the ECB if they qualify as SIs). The process to require the establishment of subsidiaries is rather complicated and led by NCAs, without any possibility for the ECB to influence the outcome. Furthermore, the ECB has noted that the article in the CRD that regulates third country cross-border provisioning of services (including requirements to book in either a branch or subsidiary) opens up the possibility for a range of exemptions and different implementation at the national level. Currently, there is also limited aggregated information available at the EU or EA level on the type and importance of activities of these branches, as well as on their risk profile and booking models. The last such mapping was conducted by the EBA in 2021, but several improvements are expected with the implementation of CRD 6.

11. EU legal provisions empower the ECB to approve changes to the ownership or controlling structure of credit institutions. In some cases, the ECB needs to rely on national legislation in the exercise of its powers, but these are not always consistent (e.g., not all member states have reporting requirements for the notification of supervisors as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder). Moreover, EU legislation does not require reversal or modification of transfers when it takes place without necessary notification to, or approval from, the supervisor, or where the approval of the change in ownership was based on false information. In a few instances, the transfer of ownership has been realized without notification to or authorization of the ECB.

12. CRD 6 will bring about significant changes and grant competent authorities the power to assess the acquisition or divestiture of material holdings in financial or non-financial sector entities. This is an important development. As regards the acquisition of material holdings in non-banks and banks outside the EU, the ECB can currently intervene only in case the provisions exist in national laws, which are neither consistent nor complete across member states. A point to note is that the BCP references both acquisitions and investments whereas the CRD refers only to acquisitions of holdings.

Methods of Ongoing Supervision (CPs 8-10)

13. The SSM operates a sound supervisory framework for the safety and soundness of the banking sector. It has a broad range of legal powers to enforce prudential standards and uses an array of tools and techniques to implement its risk-based approach. The supervisory approach is structured around the Supervisory Review and Evaluation Process (the SREP), which is a holistic, forward-looking assessment of the overall viability of a bank. Overall, the SSM is a highly capable supervisor supported by excellent risk analysis and a robust skill set in all aspects of supervision. It has taken steps to address several key concerns raised during the 2018 FSAP. It conducts an intrusive approach to supervision, uses a broad range of tools and relies on a fully articulated supervisory framework with extensive inputs from the SSM on broader risks to individual banks and the system as a whole. It carries out extensive benchmarking to ensure consistency. In areas that the SSM chooses to make a priority, it delivers a thorough assessment and has been effective in improving bank risk management. The SSM is extremely transparent in its approach to supervising banks. Delivering at this level, given a highly complex context (inherently more complex than for most other supervisors who are only tasked with exercising their role in a single jurisdiction), is a challenge which the ECB has so far been able to successfully overcome.

14. The cost of the existing supervisory approach is that it is resource-intensive and can be burdensome and challenging to be agile. To ensure consistency in the supervisory assessment, the SSM has built over the years a substantial catalogue of internal guidance, methodologies, procedures and support for supervisors resulting in some form of standardization of supervisory processes. This is combined with a high volume of processes and checks and balances. While a detailed and inclusive planning process exists on the demand side, there are challenges in setting those demands against a realistic resource base given it needs to balance budgetary discipline, some skill shortages and NCAs that have their own budget constraints and resource demands. Areas of overlap between horizontal reviews and onsite inspections have been observed while, conversely, certain risk dimensions may not be sufficiently covered (e.g., transactions with related parties). In terms of supervisory outputs, the assessors also noted the stickiness of the SREP scores (over time) and limited differentiation (amongst institutions).

15. There is room for the SSM to be even more risk-based, proportionate in its approach to supervision, and impactful. The SSM acknowledges that the SREP needs to adapt to reduce the administrative burden. Some key initiatives, such as simplifying the SREP process planning and a risk tolerance framework which mark a significant break for the SSM towards a more risk-based approach, are still in their early days and have yet to deliver substantially. The SSM is also prioritizing improving communication with banks, which is much needed and welcome as SREP letters are often lengthy and very legalistic, making it difficult for supervisors to prioritize issues for banks. The assessors also received feedback that Pillar 2 requirements and what banks needed to do to reduce them were not always clear. The comprehensive and codified supervisory approach also generates many findings – some of the most severe were outstanding for long periods of time and, consequently, presents a challenge to follow up and ensure effective remediation. The ECB has taken several initiatives to better monitor the evolution of findings and measures, but more work is

needed. Reducing the stock of open measures would require specifying more clearly what is required or expected from banks in the SREP letters and resorting to more persuasive measures, notably in the case of banks struggling with the same issue for several years. The SSM's Early Warning System produces good-quality outputs but the crisis procedures are largely framed in the context of a single institution's idiosyncratic failure and may not be suitable in situations where several firms are impacted simultaneously—for example, in an operational resilience or cyber situation.

16. Regarding the ECB oversight of LSI supervision, considerable progress has been made since the last FSAP. The use of moral suasion vis-a-vis NCAs and benchmarking to identify outliers (rather than direct intervention and the use of formal instructions) have been effective in being more proportionate (through the high risk/ high impact approach) and disseminating best supervisory practices in the LSI sphere. Further work may be warranted in some areas. A few NCAs are not using the SREP module in the SSM's Information Management System (IMAS), priorities defined by some NCAs may slightly differ from those agreed for the SSM, and the in-depth assessment conducted by the ECB of the SREP scores and Pillar 2 requirements (P2R) and Pillar 2 guidance (P2G) for LSI suggest that further work is needed to further improve supervisory convergence. The ECB's oversight of the supervision of Financial Market Infrastructures (FMI) classified as LSI could be strengthened, including through benchmarking and further harmonizing the approach to calibrating Pillar 2 requirements.

17. Institutions routinely furnish information that the ECB requires to carry out its supervisory functions, but more flexibility in defining supervisory reporting is warranted. Under the current EU framework, supervisory reporting requirements are specified by the EBA, while competent supervisory authorities such as the SSM retain the possibility to collect additional data if not available under the EBA reporting framework, as needed for supervisory purposes. The process to revise and enhance the standardized suite of regulatory returns at the EU level is lengthy as it requires amending the Implementing Technical Standard (ITS) on supervisory reporting. Additional data collections undertaken by the ECB, such as the Short-Term Exercise (STE), face two limitations. First, the ECB cannot collect additional data in areas already covered by the ITS for supervisory reporting, nor can it require the reporting of that data in a different format nor in a different breakdown. Second, the STE are less standardized compared to ITS reporting, which may lead to a generally lower data quality. Given these intrinsic limitations, it is critical to strike a better balance between harmonizing reporting requirements and ensuring flexibility in responding to evolving data needs. If data were collected at granular level, there would be several ways of combining such data to generate supervisory reports, as desired by each competent authority. However, the implementation of an Integrated Reporting System in the EU, which would help achieve this objective, is a medium-term project and the implementation of one key component (the central data collection point) has already been delayed.

18. The ECB has been a leader in incorporating climate and environmental (or nature) related financial risks in its supervisory approach. A wide range of initiatives to improve the supervision of climate-related financial risks have been taken by the ECB, including climate stress

tests, thematic reviews and firm-specific work. The ECB published in 2020 its supervisory expectations on how institutions should develop their approach to the financial risks from climate change and embed it into their governance and risk management frameworks, scenario analysis, and disclosures. In 2022, it set staggered and institution-specific deadlines (leading up to year-end 2024) for institutions to have fully embedded the ECB's supervisory expectations on climate-related and environmental risks (which include nature-related risks as an example of emerging risk considered under the BCP). Upon setting these deadlines, the ECB announced it would closely monitor, and if necessary, take enforcement action. The monitoring and follow-up on these deadlines are among the activities included in the supervisory work program under supervisory priorities 2024-2026. They regularly assess banks' effectiveness in remediating shortcomings in relation to climate risk governance, risk management framework, scenario analysis, and disclosure. The ECB has issued a number of binding supervisory decisions, including the potential imposition of periodic penalty payments when banks fail to implement appropriate risk management and governance systems in relation to climate-related financial risks.

19. The supervisory work on climate-related financial risks, including the use of enforcement tools, has been resource intensive. The ECB should ensure that in a context of budget stabilization it maintains sufficient supervisory focus on all aspects and drivers of traditional risk categories – in addition to climate risk. This balance appears to have not been met – temporarily – in a few Joint Supervisory Teams (JSTs) that focused almost exclusively on climate-related issues over some period of time.

Corrective and Sanctioning Powers of Supervisors (CP 11)

20. The SSM has a wide range of corrective measures available, although there is scope for harmonizing the conditions for adopting supervisory and early intervention powers. There would be merit in including all supervisory and early intervention powers currently included in different pieces of legislation (SSMR, CRD and Bank Recovery and Resolution Directive (BRRD)) under a single provision in a directly applicable EU legislation, subject to the same conditions, with a view to ensuring that the ECB can always intervene promptly with appropriate flexibility even if an infringement or likely infringement of prudential requirements has not yet materialized.

21. There continue to be limitations in the sanctioning powers directly available to the ECB in Union law, but progress has been achieved. The ECB can directly impose pecuniary penalties only on SIs that breach directly applicable acts of EU law. In case of breaches of national law implementing Union directives, breaches committed by natural persons, or when a non-pecuniary penalty has to be imposed, the ECB can only request the relevant NCA to open national sanctioning proceedings. However, CRD 6 enlarges the list of breaches for which administrative penalties shall be made available in member states (e.g., capital requirements breaches), while introducing PPPs as an enforcement tool.

22. Notwithstanding these shortcomings, the ECB has made the best use of the existing framework. The ECB has made considerable effort to improve the enforcement and sanctions processes for taking corrective and enforcement actions and imposing penalties. It has streamlined

the processes for taking corrective and enforcement actions and imposing penalties. This has involved the early involvement of NCAs as soon as a referral is received and the use of an informal consultation of an expert group on Enforcement and Sanctions. The average length of proceedings has started to come down and will help in reducing the dependence on moral suasion for influencing bank behavior.

23. The ECB intends to use more actively its escalation policy, including through enforcement actions, which could help in influencing wider deterrence in the banking system.

An escalation framework has been introduced to expedite the internal processes and decision making and to facilitate the full and timely use of its tools by supervisors, e.g., from moral suasion through the imposition of PPPs. The use of enforcement tools such as PPPs is still in its early stages and is currently structured more thematically—i.e., it is looking to escalate climate-related issues and issues related to risk data aggregation and risk reporting in an effective and consistent manner with the support of a central helpdesk functionality organized through a Project Management Office (PMO). This contrasts with an individual supervisor going through the escalation ladder on an idiosyncratic risk basis. Apart from climate-related financial risks, enforcement tools have rarely been used.

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

24. The ECB has an extensive network of cooperation, information sharing and collaboration arrangements with domestic and foreign supervisory authorities that are working well but could nevertheless be improved. Opportunities exist for undertaking joint inspections with foreign supervisors as envisaged in the Memorandum of Understandings (MoUs) and investigating the impediments to information flow from some peer supervisors. The ECB participates effectively in different types of groupings and colleges as home and host supervisor and has formal and informal cooperation and information sharing arrangements that help facilitate its supervisory tasks. Similar arrangements with the People's Republic of China, where some SIs operate and which is a home country for major global systemically important banks (G-SIBs), have not yet been concluded, which was pointed out in the last assessment as well.

25. The SSM undertakes intensive supervision of banks and banking groups on both a standalone and consolidated basis. In the case of bank-led financial conglomerates for which the ECB is the coordinator, it assesses 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. The ECB also ensures that the cross-sectoral requirements that apply to financial conglomerates are fulfilled (i.e., the supplementary supervision which complements sectoral supervision of banks and insurance firms). The assessors saw limited examples of joint supervisory work with insurance supervisors, for example, joint onsite inspections.

26. In the case of large and complex mixed activity groups—distinct from financial conglomerates as defined in the EU legislation, it can be challenging to assess activities and entities in the wider group that could have an impact on the banking entity. In that respect, the ECB has observed that large and complex groups, including those that provide financial technology

('FinTech') are increasing their financial activities in the EU. Those mixed activity groups can offer a range of different financial and non-financial services and may comprise regulated banks. As these groups may deliberately structure their activities to avoid establishing a financial holding company (FHC) with a view to escaping prudential consolidated supervision, further work is needed to ensure that competent authorities are adequately informed regarding all direct and indirect financial activities conducted by large and complex mixed-activity groups and share relevant information.

Corporate Governance and Internal Control and Audit (CPs 14, 26)

27. The ECB has significantly strengthened its supervision of corporate governance of banks since the last assessment. More guidance has been issued both for the industry and the supervisors by the European Supervisory Authorities (ESA) and the ECB, including via guidelines, handbooks, and updating the supervisory manual. Supervision in this area, which is a key module of the SREP, is both comprehensive and intrusive, and goes into depth and great detail. This enhanced focus on internal governance and suitability is regularly communicated to the banking sector. The fit and proper approval process has been substantially delegated but still occupies a lot of supervisory resources at both the ECB and NCA level and could benefit from further deploying risk-based approaches. EU law and guidelines pertaining to internal control and internal audit are generally comprehensive, and the SSM regularly assesses internal control and audit function of SIs.

28. Despite the creditable supervisory efforts, the lack of harmonization still remains an issue as governance practices, and supervisory responsibilities and powers, as available in national laws, vary significantly across member states. Some of the requirements that are not harmonized or addressed in all national laws relate, for example, to the minimum number of independent directors, the requirement of independent audit committees, and diversity requirements. CRD 6 will help towards greater harmonization as certain key function holders (e.g., CFO and head of internal control function) become subject to a supervisory assessment, and the primary responsibility of banks in appointing suitable candidates is strengthened. It also refers to the necessity to have deadlines for the supervisory processes, and introduces more clarity on some procedural aspects. It still does not require the suitability assessment to be completed by the bank prior to the taking up of the appointment in all cases, or of prior approval by the supervisor for key positions in the largest banks.

Prudential Requirements, Regulatory Framework, Accounting and Disclosure (CPs 15-28)

29. The SSM provides substantial coverage of risk management based on CRD/CRR and additional EBA guidelines and, where relevant, has been very active in publishing its own guides to provide more transparency to banks, but further enhancements are necessary. The SSM has made significant progress in assessing risks that could materialize over longer time horizons. Both climate risk and digitalization are SSM priorities and have been the subject of targeted reviews and enhanced supervision. Recovery plans are updated at a minimum annually and reviewed by supervisors with feedback provided within six months of submission. Remediation measures are usually timed to coincide with the subsequent submission of the recovery plan. In

most cases, this timing is adequate, but for some risks – for example, that of contingent liquidity requirements and access to central bank funds, the risks may warrant a shorter timeframe. With the transposition of CRD 6, legal requirements concerning the Chief Risk Officer (CRO) will be harmonized. Lastly, there has been substantial progress in working arrangements with the Single Resolution Board (SRB). The use of stress test scenarios is typically focused on recovery and capital and does not consider a broader range of scenarios, such as, for example, reputation, and operational.

30. The adoption of the banking package—CRR 3 and CRD6—in the EU is a major milestone, but gaps with international standards for capital requirements remain. Although it is not mandatory under the Basel standards, the application of the Basel capital requirements to all EU credit institutions (beyond the scope of internationally active banks) helps strengthen banks' safety and soundness and financial stability and eliminate the potential for regulatory arbitrage between banks. Recent developments have, however, moved in contrasting directions. While the final elements of the Basel III reforms have been incorporated into EU law – unlike in other peer jurisdictions – existing deviations detailed in the 2014 Regulatory Consistency Assessment Program (RCAP) conducted by the Basel Committee have not been corrected (Danish compromise as to the non-consolidation of insurance companies, SME support factor, limited scope of credit valuation adjustments (CVA)). In addition, new ones were introduced in CRR 3, and the FRTB implementation has already for now been postponed by one year (in response to decisions taken in other jurisdictions). The impact of the EU specific adjustments on capital requirements is material. Regarding the institutions' systemic importance, while an EBA methodology has been introduced to identify and designate Other Systematically Important Institutions (O-SII), there is no harmonized EU methodology for the calibration of O-SII buffers that would avoid unwarranted heterogeneity in the way they are determined and ensure full consistency in the resilience of O-SIIs. Available data suggest significant differences in O-SII buffers across the euro area.

31. Credit risk and market risks models are widely used by SIs for regulatory purposes. Over the years, the ECB has been very active to ensure that regulatory requirements are complied with, and model outcomes are reliable. Most of the work on internal model reviews has, however, been reactive by nature, as it is usually triggered by institutions' model change applications. The ECB is also facing significant resource constraints in internal model validation and follow up on the JST side. Regarding sovereign exposures, the CRR which allows banks (subject to supervisory approval), to use the standardized approach on a permanent basis for material exposures does not comply with the Basel Framework and may facilitate cherry picking where banks are using both approved Internal Ratings-Based (IRB) and standardized approaches for their sovereign exposures in the same exposure class.

32. Supervision of credit risk has continued to progress, resulting in a much-reduced level of nonperforming loans (NPLs) in banks, but further improvements are needed. First, in the EU framework, there is no explicit requirement for a bank's board of directors or senior management to approve credit risk exposures exceeding a certain amount or percentage of a bank's capital. Second, the SSM cannot impose reclassification as NPL. The power to require specific provisioning policy

does not allow the ECB to impose specific provisions for specific exposures, e.g. to provide a certain outcome. However, as competent authority, the SSM has the power to influence a bank's provisioning level within the limits of the applicable accounting framework and to apply capital adjustments (deduction or similar treatment) where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective. Insufficient provisioning coverage may result in a lower credit score and overall SREP score as well as a higher Pillar 2 requirement (P2R) in accordance with the SREP methodology. The ability to introduce a P2R add-on or deduction (on top of the P2R resulting from the SREP) in case of a provisioning shortfall is a welcome development. It provides a fallback option to ensure appropriate prudential treatment of problem loans and further supports supervisors' efforts to use moral suasion on classification and provisioning levels. The use of the P2R add-on is, however, limited to instances in which banks book accounting provisions that are lower than minimum levels of provisions for NPLs based on a uniform provisioning calendar. The assessors have not seen evidence of the P2R add-on or capital deduction being used when provisions are considered insufficient from a prudential perspective. The SSM may, however, use a number of escalation tools - such as discussing with auditors and requiring certain disclosures.

33. Supervision of concentration risk is based on an overall robust process, but further attention should be given to sovereign risk concentrations. The various forms of concentration risks (e.g., credit concentration, market concentration, funding concentration, etc.) are defined in the EBA SREP Guidelines. While there is detailed guidance for supervisors, there are no supervisory guidelines applying to banks that specify the expectations for the management of all forms of concentration risks. Specifically, there is no requirement or explicit supervisory expectations that all material concentrations have to be regularly reviewed and reported to a bank's board. While there are deviations from the Basel large exposures standard identified in the 2022 RCAP including a potentially material finding in the trading book, the ECB has indicated that this deviation is not used by any bank. Banks' sovereign exposures in the euro area widely differ across banking systems and across banks. In the process of determining Pillar 2 capital requirements, the assessment of excessive concentration risk does not include concentration to sovereign exposures in a systematic fashion. Indeed, concentration to sovereign exposures is not included in the concentration risk indicators for the phase 2 score of the SSM SREP and only assessed in phase 3, if deemed relevant by the JSTs. Capital add-ons reflecting high sovereign concentration risks are not regularly used and have only been imposed in a few instances.

34. The EU framework for related party transactions is neither comprehensive nor consistent. The definition of related parties in the CRD and the EBA Guidelines is not as comprehensive as those required by the Basel standard, and there are no regulatory limits in EU laws. While more detailed provisions may be included in some national frameworks, they are not harmonized across member states. Related party policies, processes and transactions may be looked at in the course of ongoing supervision of internal governance by the ECB, but there has not been any horizontal or thematic review so far that could help develop benchmarks for materiality or for supervisory expectations to be more formalized.

35. Country risks are generally considered part of credit risk. The EBA SREP Guidelines now address these risks in a more harmonized way and include these risks under the credit risk as a sub-category. Since 2019, the ECB is also using a specific module called “country risk assessment tool” for the assessment of country risk of emerging markets. These risks have also come into greater supervisory focus given the recent geopolitical developments. While there is now detailed guidance for supervisors, the ECB should consider laying out its supervisory expectations for the industry more clearly.

36. There are fully articulated frameworks within the EU for market and interest rate risk in the banking book (IRRBB) which receive appropriate attention from the SSM. Market risk is growing since the UK’s departure from EU and IRRBB can be significant given the business models of the SSM banks. There is a strong emphasis and attention on market risks and IRRBB throughout supervisory processes. There is ample evidence that SSM supervisors are regularly making findings and adjusting capital requirements. Since the last assessment, the SSM has stepped up its oversight of valuation, spearheaded by its on-site campaign. The EU framework has been able to keep pace with developments in international standards relating to IRRBB thanks to updates in the EBA Guidelines but also sensible use of stress tests.

37. The SSM delivers a thorough assessment and mitigation of liquidity risk and has progressed substantially since the previous FSAP, but there are areas for further improvement. The SSM responded well to the 2023 liquidity problems in some banks – including a sensible and well managed move to weekly reporting. Supervision is still based on a policy platform that was judged by the Basel Committee to be largely compliant. The SSM should prioritize the remediation of contingency funding issues identified when reviewing banks’ recovery plans rather than waiting for banks to share their annual updates. Further work (including a simulated event) would be beneficial in preparing the SSM for sudden changes in depositor behavior, in particular, how the supervisor would respond to a social media sourced mobilization of depositors. The SSM should continue to develop its approach to intraday liquidity (although good first steps have been taking in published best practices and conducting a deep dive) and in particular consider a specific policy towards collateral in an intraday context.

38. The SSM has made substantial progress in the field of operational risk and resilience since the last FSAP. The prioritization of Cyber and Operational Resilience has provided an appropriate focus on this important risk. This has been supported by significant legislative change. DORA in particular has provided a robust framework for supervisors with a ground-breaking approach. Of course, there remain substantial implementation challenges – not least resourcing to satisfy a piece of legislation that is very demanding on supervisors.

39. Existing EU legislation does not provide the ECB the power to influence the scope of the external audit or establish the standards for such an audit. Neither the CRR nor the CRD empowers a competent supervisory authority to reject the appointment of an external auditor, nor do they provide for specific powers vis-à-vis external auditors. Banking supervisors do not have legal power to access external auditors’ work papers. The overall EU financial reporting and external audit regime, however, appears robust and ensures broad consistency with the relevant Core Principle.

40. The EU has introduced a comprehensive disclosure framework to promote transparency, both through qualitative and quantitative disclosure requirements. The EBA and ECB publish a wide range of information and data on the banking system. The ECB is monitoring SIs' actual practice, through both sample testing and thematic reviews.

41. The EU framework has increasingly envisaged an enhanced role for prudential supervisors in Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) and the ECB recognizes its role in supervising the prudential implications of ML/TF. In keeping with its prudential mandate, the ECB has been developing its supervisory expectations and practices via a 'vigilant approach' to ensure that it covers them appropriately in its ongoing supervision. It has introduced its own guidance for supervisory assessment of ML/TF risks in SREP, including prudential warning signals, which incorporate its experience from horizontal assessments. As regards broader abuse of the financial system, ECB supervision covers risks emanating from other types of criminal abuse of the financial system, including internal, external and transactional fraud in the context of its supervision of internal controls as well as operational risks.

42. There is scope for further work to supervise ML/TF risks from a prudential perspective. Even though the national AML authorities are responsible for supervision of correspondent banking accounts from the AML perspective, the ECB should play a greater role in monitoring the policies and processes for the selection, access to, and conduct of these accounts from the perspective of reputation and operational risk. While the cooperation and information exchange between ECB and AML/CFT authorities has improved significantly, the ECB has also noted some heterogeneity in the inputs received from the different AML authorities in member states. In this regard, there is scope for undertaking more deep dives and thematic reviews on prudential areas identified with AML/CFT risks including through joint work with AML/CFT authorities. The new AML authority (AMLA) is expected to ensure more effective cooperation and information exchange between all relevant AML/CFT authorities and the relevant non-AML/CFT financial supervisory authorities. However, given that the direct supervision of AMLA will be limited to a few entities, some complexity in the system will remain and issues of potential overlap of authority will need to be ironed out (see CP 29 for further details).

INTRODUCTION AND METHODOLOGY²

A. Introduction

43. This assessment of the implementation of the Basel Core Principles for Effective Banking Supervision (BCP) in the euro area has been completed as a part of the FSAP mission undertaken by the International Monetary Fund (IMF) during November 2024 and February 2025, at the request of the euro area 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

² The assessment team comprised Aditya Narain, Lyndon Nelson, Luc Riedweg (IMF) and Emrah Sagkol (IMF).

represent an analysis of the state of the banking sector or the crisis management framework, which are addressed in other parts of the FSAP.

44. 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. Since November 2014, banking supervision in the euro area has been conducted in the context of the SSM, which comprises the ECB and the NCAs of the 20 euro area member states plus Bulgaria, which opted in to become an SSM participating Member State via close cooperation. The assessment focused on the ECB, which has overall supervisory responsibilities for the euro area banking system and for the efficient operation of the SSM, and did not cover the specificities of regulation and supervision of other financial intermediaries. More specifically, this assessment focused on the supervision of SIs, the tasks conferred on the ECB for which it has exclusive competence for all banks (granting and withdrawal of banking licenses, approval of acquisitions of qualifying holding, fit and proper assessments), as well on the ECB's oversight role in relation to the supervision of LSIs undertaken by NCAs. The assessment is based on the information available at the time it was completed in February 2025. The supervision of LSIs and the role of national AML/CFT authorities were not assessed as they fall into the scope of individual member country assessments. The supplementary supervision of financial conglomerates was not reviewed given the focus of the BCP on banks and banking groups.

45. This is the second detailed assessment of the BCP conducted for the euro area. While several SSM member countries have undergone FSAP exercises since the establishment of the SSM, no other detailed assessment has been conducted. Nevertheless, this assessment leverages off the work and material provided to the teams that covered banking regulation and supervision during these FSAPs.

B. Information and Methodology Used for Assessment

46. The ECB requested to be assessed according to the Revised BCP Methodology issued by the Basel Committee of Banking Supervision in April 2024. The current assessment was thus performed against the revised standard incorporating new content and more testing methodology as compared with the previous BCP assessment carried out in 2018. It is important to note, for completeness' sake, that the two assessments will not be fully comparable, as the revised BCP have raised the bar to measure the effectiveness of a supervisory framework (see Box 1 for more information on the 2024 Revised Core Principles).

47. The ECB chose to be assessed and rated against both the essential criteria and the additional criteria of the BCP, the highest standards of supervision and regulation. 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, using a

five-part rating system explained below. The assessment of compliance with each CP requires a judgment on whether the criteria are fulfilled in practice. Evidence of effective application of relevant laws and regulations is essential to confirm that the criteria are met.

48. As required by the assessment methodology, grades are solely based on the regulatory framework and supervisory practices in place at the time of the BCP assessment. The FSAP acknowledged and discussed several provisions included in CRD 6 in relation to the supervision of third-country branches, supervisory independence, acquisition of material holdings, and corrective and sanctioning powers. These regulatory developments, which are important in light of previous FSAP recommendations on these issues are not reflected in the grading as the new provisions included in CRD 6 are not yet implemented.³ The assessors noted regulatory, policy or procedural changes, indicated whether in their view they go in the right direction, explained what remains to be done until full deployment implementation, with the caveat that without seeing evidence of implementation, comments can only reflect the potential.

49. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with officials of ECB banking supervision, NCAs, 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.

50. 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 support and responded to the extensive and detailed requests promptly and accurately prior to and during the mission at a time when staff was burdened by many initiatives related to European and global regulatory changes. The assessment team was impressed by the commitment of the supervisors with whom they met. They are experienced and knowledgeable professionals. In terms of cooperation with the FSAP team, the authorities have set a very high bar for future FSAPs in peer jurisdictions.

51. The standards were evaluated in the context of the euro area financial system's structure and complexity. The BCP methodology requires that a proportionate approach be adopted, both in terms of the expectations on supervisors for the discharge of their own functions and the standards that supervisors impose on banks. The assessment must recognize that supervisory practices should be commensurate with the complexity, interconnectedness, size, risk profile, and cross-border operations of the banks being supervised.

52. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science. As noted above, judgments are required. Further, the assessment team evaluated the euro

³ EU Member states have up to 18 months from the entry into force of CRD 6 (June 2024) to adopt measures of national law to transpose the directive. In addition, the EBA has a mandate to develop several technical standards (e.g., a common methodology to assess acquisitions of material holding) and ECB's internal procedures and processes will be revised (e.g., FAP internal guidance). It is necessary for the purposes of the BCP assessment to verify implementation in practice.

area supervisory and regulatory framework in the context of the considerable transition challenges created by the implementation of the SSM. Nevertheless, the assessment of the current legal and regulatory framework and supervisory practices against a common, agreed methodology should provide bank supervisors with an internationally consistent measure of the quality of banking supervision in relation to the CPs, which are internationally acknowledged as minimum standards, and point the way forward.

53. Assessing a cross-national supervisory framework imposed additional methodological challenges. The ECB is responsible for the supervision of credit institutions in the euro area, but not for all aspects of banking supervision; supervision of potential abuses of financial services, including money laundering and the financing of terrorism, is not under the ECB's mandate. In addition, while several regulatory aspects of the CPs have been harmonized in the euro area, different national legal frameworks apply in many cases. The ECB and the NCAs provided detailed information on the various national law frameworks, which confirmed the wide diversity of approaches. This assessment does not aspire to convey a detailed picture of the regulatory framework in each of the 21 banking union member states; rather, it uses the national information as a source for a more general assessment of regulatory adequacy and supervisory effectiveness.

54. To determine observance of each CP, the assessment has made use of five rating categories: compliant, largely compliant, materially noncompliant, noncompliant, and non-applicable. A rating 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" rating 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. A rating of "materially non-compliant" applies in the case of severe shortcomings when, despite the existence of formal rules and procedures, there is evidence that supervision has not been effective, practical implementation is weak, and that the shortcomings are sufficient to raise doubts about the authorities' ability to achieve compliance. A principle is rated "non-compliant" 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 where the criteria are not relevant to the jurisdiction's circumstances.

Box 1. The 2024 Revised Core Principles

The revised Core Principles reflect regulatory and supervisory developments, structural changes in banking, and lessons learnt from FSAP assessments since the last revision in 2012. The update took account of the lessons learned from: countries' implementation of the Core Principles as updated in 2012; the impact of, and policy responses to, the COVID-19 pandemic; and FSAP assessments completed since 2013. Several thematic topics also informed the revisions to the Core Principles, including evolving risk considerations related to: (i) financial risks; (ii) operational resilience, including cyber security risks; (iii) systemic risk and macroprudential supervision; (iv) risks from structural transformations driven by climate change and the digitalization of finance; (v) the sustained growth of nonbank financial intermediation; and (vi) evolving corporate governance and risk management practices, including sound risk culture and sustainable business models.

There is a greater emphasis on systemic risk and sound risk management practices. Supervisors continue to be 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. Expectations regarding supervisory assessment of risk have been raised to incorporate more clearly the analysis of banks business models, and risks brought by the wider group, as well as considerations on 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 banks are exposed. Amendments were introduced to reinforce the need for group-wide approach to supervision, and requirements regarding operational risk and operational resilience have been significantly updated to ensure that banks are better able to withstand, adapt to and recover from severe operational risk-related events, such as pandemics, cyber incidents, technology failures and natural disasters.

The revised BCP reinforce aspects that were already present in the previous methodology, highlighting their materiality for effective supervision. In particular, the BCPs continue to emphasize the powers that supervisors should have to address safety and soundness concerns, and the expectation on the actual use of the powers, in a forward-looking approach through early action. This includes a heightened focus on powers and independence, and expectations concerning capacity for timely, consistent, and conclusive supervisory actions; adequacy of liquidity arrangements; and the interface between daily supervisory practices and crisis management measures. As a reflection of the enhanced expectations, 6 additional criteria have been upgraded to essential criteria.

The BCP are universally applicable and accommodate a wide spectrum of banks and financial systems. The revised standard reinforces the concept of proportionality, in terms of both the expectations on supervisors for the discharge of their functions and the complexity of standards that supervisors impose on banks, and standards emphasize that proportionality should not be understood as dilution of standards, but as maintaining stringency of approach through proportionate methods and ensuring appropriate responses to the global diversity of banks and banking systems.

INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW⁴

55. The euro area is home to a large, complex, and globally interconnected financial system, where banks are the dominant players (Figure 1). Several banks and insurers are classified as globally systemically important. The interbank and cross-border connections of the euro area banking system are extensive, although they have contracted since the global crisis. The euro area hosts the two international central securities depositories (ICSDs) and several central counterparties (CCP), and euro area institutions are also heavy users of CCP located elsewhere. Banks are the most important single source of financing for households, nonfinancial corporates, and the public sector. Since the global financial crisis, nonbanks, and financial markets are playing a greater role, particularly in funding larger nonfinancial corporates.

56. Within the SSM, banks (technically, “credit institutions”) are categorized as SIs or LSIs. The ECB directly supervises the SIs. These currently comprise 114 banking groups, including 7 G-SIBs, altogether which cover more than 80 percent of euro area banking assets. The NCAs directly supervise the LSIs (around 2,000 in number), but under the general oversight of the ECB to promote a more consistent supervisory approach across the SSM.

57. The SSM is one of 3 pillars intended to sustain the European banking union. The second pillar of banking union, the single resolution mechanism (SRM) is mandated to ensure the orderly resolution of failing banks and banking groups. The Banking Union still lacks its intended third pillar: a European Deposit Insurance Scheme (EDIS). The European Commission adopted a proposal in 2015 to establish EDIS, but this has not been implemented.

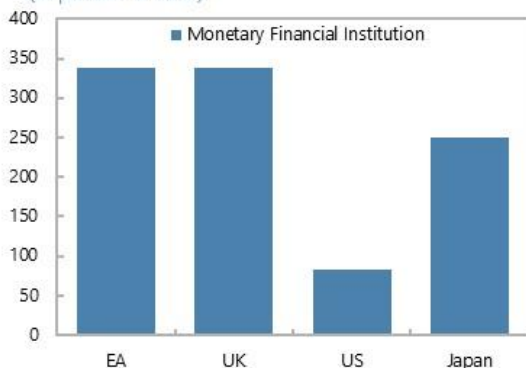
58. The Single Rulebook establishes a unified regulatory framework for the EU banking sector. It encompasses key legal acts such as the BRRD, CRR, CRD, and the Deposit Guarantee Schemes Directive (DGSD). Numerous Delegated Regulations, Technical Regulations and Guidelines have been developed by the EBA who oversees their consistent implementation in the banking sector.

⁴ This part of the assessment draws from other FSAP documents.

Figure 1. Euro Area: Banking Sector Overview

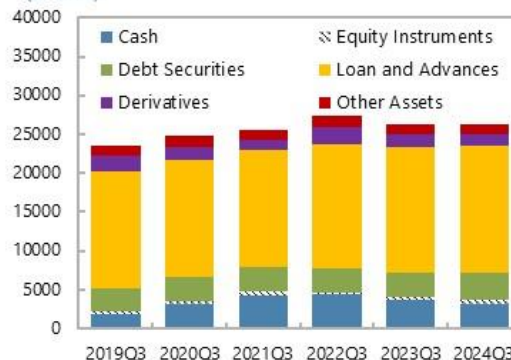
The euro area financial system is large.

Structure of the Financial System
(in percent of GDP)



Lending has traditionally dominated asset holdings

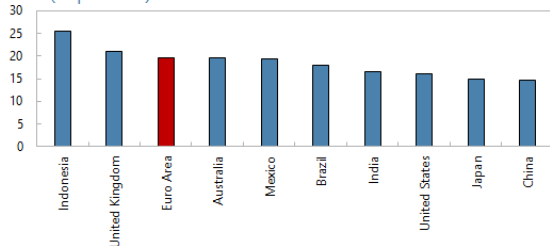
EA Bank's Assets Allocation
(Bil EUR)



Sources: EBA; Haver Analytics; and IMF staff calculations.

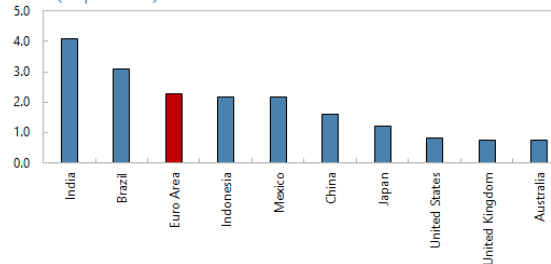
Bank solvency in the euro area remains healthy...

Regulatory Capital to Risk-Weighted Assets
(In percent)



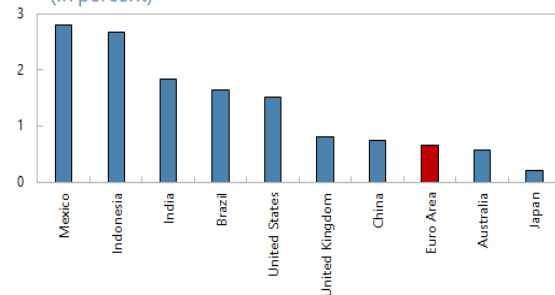
...supported by low NPL ratios.

Non-performing Loans to Total Gross Loans
(In percent)



European banks lag some of their peers in profitability

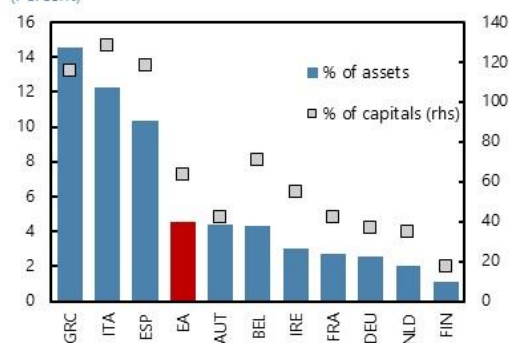
Return on Assets
(In percent)



Sources: BDE, ECB, Haver Analytics, and IMF staff calculations.

Exposures to sovereign risks varies across banking systems

MFIs Domestic Sovereign, 2024Q3
(Percent)



Sources: ECB; and IMF staff calculation.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION⁵

59. The euro area economy has remained resilient in the face of multiple shocks. Despite recurring shocks, including heightened geopolitical tensions, Europe's economy continues to remain resilient with record-low unemployment, declining inflation, and a stable financial system. GDP growth is projected at 0.8 percent this year and 1.2 percent in 2026 (April 2025, WEO). Higher tariffs, trade policy uncertainty, and geopolitical tensions weigh on activity especially in 2025, more than offsetting an anticipated lift from fiscal policy support and easing monetary policy. Inflation is projected to return to the 2 percent target in the second half of 2025. With the loosening of monetary policy, credit standards have started to ease from their restrictive levels driven by mortgage lending; but borrowing costs remain high) and credit standards tightened for firms during 2024Q4 and 2025Q1. Quantitative tightening is expected to progress in an orderly way and warrants careful monitoring of liquidity conditions in banks, non-bank financial institutions (NBFIs), and core funding markets, especially as financial conditions are likely to remain volatile given heightened trade policy uncertainty. Commercial real estate (CRE) remains vulnerable to further asset price declines. More broadly, stretched valuations and risk premia are vulnerable to an even sharper correction as investors reassess global growth and inflation outlook. If fiscal headroom erodes, banks' exposures to highly indebted sovereigns could act as a transmitter of shocks and adversely affect the availability of credit to the real economy. Growing interlinkages of banks to complex and opaque NBFIs could pose significant challenges and act as amplifiers of systemic risk.

60. In the euro area, macroprudential policy is a shared competency between the national authorities and the ECB. The FSAP took place amid an ongoing review of the EU macroprudential framework for banks. The multilayered EU institutional framework for macroprudential policies places the European Systemic Risk Board (ESRB) in charge of macroprudential oversight, while national authorities set the policies in coordination with the ECB, which has only a "top-up power" for macroprudential tools. The SSMR confers to the national authorities and the ECB specific tasks relating to macroprudential instruments for the banking sector set out in the CRR and CRD IV. The ECB is a competent authority as well as a designated authority for macroprudential purposes. Some instruments can be activated only by the microprudential supervisor (i.e., the national competent authority or NCAs) and other instruments can also be introduced by the macroprudential authority (i.e., the national designated authority (NDA)). In addition to these tools, member states (and not the ECB) can use borrower-based instruments, such as limits on loan-to-value, debt-service-to-income, or loan-to-income ratios for real estate lending, if these are legislated under national law and not in the CRD/CRR.

61. Financial sector regulation in the euro area in general covers all relevant areas (banking, insurance, and securities). Large parts of the regulatory framework are rooted in the

⁵ This section draws from other documents produced for the FSAP. A complete analysis of the macroeconomic framework is contained in Article IV reports.

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.

62. International Financial Reporting Standards (IFRS) are required for publicly traded companies. Regulation 1606/2002 mandatorily applies IFRS to the consolidated accounts of publicly traded companies, including in cases where only debt securities of that company are listed on the market. member states are allowed 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. Several banks in the euro area apply national GAAP.

63. The EU adopted new rules regarding auditing standards in 2014. An EU directive (2014/56/EU) sets out the framework for all statutory audits, strengthens public oversight of the audit profession and improves cooperation between competent authorities in the EU. Regulation No 537/2014 specifies requirements for statutory audits of public interest entities (PIEs), such as listed companies, banks, and insurance undertakings. member states may apply national auditing standards, procedures or requirements as long as the Commission has not adopted an international auditing standard covering the same topic.

64. Bank resolution within the Banking Union falls under the scope of the SRM. The institutional arrangements for the SRM are defined in the Single Resolution Mechanism Regulation (SRMR). The SRM is composed of the SRB and the National Resolution Authorities (NRAs), collaborating with each other while fulfilling their respective tasks. The SRB is entrusted with centralized resolution powers over SIs and cross-border groups. It can issue binding 'resolution schemes' instructing NRAs on the use of the resolution powers in the BRRD in accordance with the SRMR. NRAs are responsible for the resolution planning for LSIs that are not part of a cross-border group.

65. Although many aspects of deposit protection are harmonized by the Deposit Guarantee Schemes Directive (DGSD), deposit guarantee schemes remain national. The DGSD sets common minimum eligibility criteria for coverage, a common level of coverage (EUR 100,000 per depositor per bank), and target levels for ex ante funding (0.8 percent of covered deposits). Some differences in national implementation could complicate bank resolution or deposit insurance payout. There are differences in coverage for temporary high balances due, for example, to the sale of a house, and in the coverage of depositors in non-EU branches. One Member State takes advantage of a provision allowing it to set a lower ex ante fund size than the 0.8 percent standard. The BRRD and SRMR empower resolution authorities to require Deposit Guarantee Schemes to contribute to the costs of resolution in lieu of insured deposits, up to the costs they would have borne in a payout. In 2022, after failing to agree on a roadmap to complete the banking union, including the introduction of EDIS, the Eurogroup asked the European Commission to develop a more limited package of reforms focused on to the EU Crisis Management and Deposit Insurance (CMDI) frameworks. The CMDI package includes a number of proposed reforms to the DGSD, including a proposed harmonization of the minimum level of protection of temporary high balances.

DETAILED ASSESSMENT

A. Supervisory Powers, Responsibilities and Functions⁶

Principle 1	Responsibilities, objectives and powers. ⁷ An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorise banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.
Essential criteria	
1 EC 1	The responsibilities and objectives of each of the authorities involved in banking supervision 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. ⁸
Description and findings re EC1	<p>The ECB, in cooperation with the NCAs, is exclusively responsible for the prudential supervision of credit institutions (banks) established in the participating EU member states⁹. ECB Banking Supervision (henceforth referred to as ECB; the full form European Central Bank will be used when the central bank is referenced) is a supranational supervisory authority. Together the ECB and the NCAs form the Single Supervisory Mechanism (SSM), which became operational on November 4, 2014. The ECB is responsible for the effective and consistent functioning of the SSM.</p> <p>The objectives and responsibilities of the SSM and the respective tasks of the ECB and the NCAs in the SSM are defined in the SSM Regulation (henceforth SSMR) and the SSM Framework Regulation (henceforth SSMFR). Banks are categorized as SIs or LSIs on the basis of their size, the importance for the economy of the Union or a specific Member State, and the importance of their cross-border activities.¹⁰ Significant banks or banking groups are under the direct supervision of the ECB. NCAs are responsible for assisting the ECB, with the preparation and implementation of any acts relating to the tasks referred to in the SSMR.</p>

⁶ Please note that while this table replicates the methodology in the BCP standards as included in the Basel Framework (BCP), the numbering of footnotes follows this document and not the latter.

⁷ Reference documents: BCBS, Sound Practices: implications of fintech developments for banks and bank supervisors, February 2018; BCBS, Report on the impact and accountability of banking supervision, July 2015; BCBS, Principles for the supervision of financial conglomerates, September 2012; [SCO40].

⁸ If countries have shared or transferred prudential tasks to a supranational supervisor, the roles and responsibilities that have been shared or transferred are clearly set out in law and publicly disclosed. Any residual powers or responsibilities that are retained must be publicly disclosed so that there is clarity on the division of responsibility.

⁹ The participating EU member states are the 20 member states whose currency is the euro and one Member State whose currency is not the euro, which has established a close cooperation with the ECB. Currently, Bulgaria has established close cooperation with the ECB in line with Article 7 of the SSMR.

¹⁰ The ECB supervises directly 113 banking groups in 21 member states (August 2024).

	<p>LSIs or their banking groups are under the direct supervision of the NCAs. For these LSIs, the ECB is responsible for exercising oversight over the functioning of the system.¹¹ However, the ECB may, on its own initiative and after consulting with the NCAs or upon request by an NCA, decide to exercise directly itself all relevant powers for one or more LSIs, including in the case where financial assistance has been requested or received indirectly from the EFSF or the ESM. Such direct oversight has been invoked twice in the history of the SSM.</p> <p>The SSMR and the SSMFR are published in the Official Journal of the European Union and available on the ECB Banking Supervision Website. In addition, the ECB published its Supervisory Manual in 2018 and an update in 2024, which aims at explaining to the public how the SSM functions and at giving guidance on the SSM's supervisory practices.</p> <p>In carrying out its prudential tasks, as defined in the SSM Regulation, the ECB has at its disposal: the tools and powers provided for in the SSM Regulation; the tools and powers mentioned in relevant Union law (e.g. Regulation (EU) No 575/2013 on prudential requirements for credit institutions or 'CRR', as amended; the national transposition of Directive 2013/36/EU on access to the activity of credit institutions (henceforth 'CRD'), as amended; Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions (henceforth SRMR); the national transposition of Directive 2014/59/EU establishing the framework for the recovery and resolution of credit institutions (henceforth 'BRRD'); the national transposition of Directive 2002/87/EC on supplementary supervision of financial conglomerates (henceforth 'FICOD').</p> <p>In the EU, Level 1 framework legislation includes Regulations and Directives adopted by the Parliament and the Council under the ordinary legislative procedure. The European Supervisory Authorities (ESA) then work in conjunction with the EU Commission to develop the "Level 2" measures through which framework legislation is implemented. The ESA are also responsible for the production of non-binding "Level 3" guidelines and other measures to ensure consistent implementation and application of the single rulebook.</p> <p>Where Union law is composed of directives, the ECB has to apply the tools and exercise the powers mentioned in the national law transposing these directives. The ECB can also exercise powers granted directly to NCAs by national law (so-called national powers) provided that these powers fall under the ECB's tasks enumerated in Article 4 of the SSMR and underpin the ECB's supervisory functions under Union law.¹² In the (as of now) sole case in which the</p>
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¹¹ The NCAs supervise under the general oversight of the ECB 1,937 institutions. In addition, the ECB is competent to decide on LSI common procedures (granting and withdrawal of banking licenses, approval of acquisitions of qualifying holding).

¹² The ECB, in cooperation with the European Commission, clarified in 2017 that the ECB is directly competent to exercise powers related to activities of SIs in countries outside the EU, powers related to outsourcing, powers vis-à-vis shareholders and powers concerning credits to related parties, as well as to approve: acquisitions by SIs of holdings in non-banks or banks outside the EU, mergers/demergers involving SIs, asset transfers/divestments by SIs, SIs' statutes, the appointment of key function holders, the appointment of external auditors, specific banking activities relating to licensing including the general authorization that is required to issue covered bonds and strategic decisions. It was also clarified that the NCAs remain responsible for: authorizing third-country branches, approving mergers from a competition law or macro-prudential perspective, supervising external auditors, imposing or enforcing conditions attached by regulation to banking activities, such as product rules.

	<p>direct exercise of a national power by the ECB was challenged, the Court stated that powers available under the relevant national law and resulting from the European legal framework governing the prudential supervision of credit institutions, whether because of an obligation or an option for the Member State to legislate, can be exercised by the ECB directly based on Article 9(1) 2nd sub-paragraph of the SSM Regulation.¹³</p> <p>The transposition of Union Directives into National Laws does at times lead to differences (or highlights existing ones), in national frameworks. This may be on account of the need to align with other elements of the national framework such as commercial or corporate laws, codes or practices. These differences and the consequent lack of harmonization in national legislation can be challenging for the ECB, which aims to ensure consistency in supervision and improve the level-playing field among SSM banks. An infringement process exists which can be initiated by the European Commission to discuss with member states their intents and plans to address the material differences arising in the transposition process, but this is a delicate and time-consuming process. The differences may also be addressed by subsequent Union legislations – for example, the new Banking Package adopted in 2024 (CRD6/CRR3) will harmonize further <i>inter alia</i> supervisory powers concerning bank mergers, sanctions and periodic penalty payments.</p> <p>Where the relevant Union law is composed of Regulations and where these Regulations explicitly grant options for member states, the ECB also applies the national legislation exercising those options. In addition, the CRR and CRD provide for options and discretions granted to member states and to competent authorities. With regard to SIs, the ECB is competent to decide only on those options and discretions granted by Union law to NCAs. The ECB has harmonized the exercise of options and discretions available in Union law for SIs by means of a Regulation. Finally, the ECB has published a recommendation on the common specification and a guideline on the exercise of options and discretions available in Union law addressed to NCAs to harmonize around 50 options and discretions for the supervision of LSIs.</p> <p>The SSMR empowers the ECB to adopt guidelines, and recommendations and take decisions subject to and in compliance with Union law. Moreover, the ECB may also adopt regulations to the extent necessary to organize or specify the arrangements for carrying out its tasks. In addition, to the extent necessary to carry out the tasks conferred upon the ECB by the SSMR, the ECB has the possibility to instruct national authorities to make use of their powers granted by national law, when the SSMR does not confer such a power on the ECB. As regards the supervision of LSIs, the ECB may issue regulations, guidelines or general instructions to NCAs in accordance with the SSMR.</p> <p>Importantly, the ECB is subject to technical standards developed by the EBA and adopted by the European Commission (in the form of Commission regulations). The EBA's main task is to contribute to the creation of the European Single Rulebook in banking through the development of Technical Standards and Guidelines. The ECB applies the EBA Guidelines within its remit (unless it has declared its non-compliance under the EBA's comply or explain</p>
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¹³ ECJ, Case T-667/21 (BAWAG v ECB), 28 February 2024, paras. 23 to 47, in particular para. 41.

	mechanism). To date, the ECB has not declared non-compliance except in one case temporarily during the Covid period.
1 EC 2	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.
Description and findings re EC2	<p>The primary objective of ECB banking supervision is to promote the safety and soundness of banks and the stability of the financial system, as laid out in the SSMR. In carrying out its tasks related to this objective, it is also enjoined to have 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.</p> <p>The SSM Regulation further specifies that, when carrying out its supervisory tasks, the ECB should pursue only the objectives set by the SSM Regulation. It also sets up a framework in order to separate the supervisory function of the ECB from its monetary policy function, so that each function is exercised in accordance with its respective objectives, with the aim of avoiding conflicts between them. The separation principle covers, among other 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 of the ECB.</p>
1 EC 3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks. The supervisor has the power to increase the prudential requirements for individual banks based on their risk profile and systemic importance.
Description and findings re EC3	<p>The ECB does not have the authority to set minimum prudential standards but does have the primary responsibility, together with the NCAs, to enforce them. European banking law, particularly the CRR and CRD, specify the rules that banks must follow relating, for instance, to capital, risk management or governance, and define the corresponding powers of the supervisory authorities. These rules are complemented by delegated acts, detailed technical standards and other measures developed by the EBA, which are to be applied by all competent banking supervisory authorities including the ECB.</p> <p>However, on the basis of supervisory review, the ECB may increase the prudential requirements for SI banks and banking groups based on their risk profile and impose specific additional own funds requirements, specific publication requirements, specific liquidity requirements and other measures made available to competent authorities by relevant Union law.</p>
1 EC 4	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, and published in a timely manner.
Description and findings re EC4	In carrying out its prudential tasks, as defined in the SSM Regulation, the ECB applies all relevant EU laws, in particular the CRR and, where applicable, the national legislation transposing the CRD. The CRR and the CRD were adopted in 2013 and amended subsequently, most recently in 2024. Updates to the CRR/CRD typically follow a public consultation and a legislative process. Where the relevant Union law is composed of Regulations and where these Regulations explicitly grant options for member states, the ECB also applies the national legislation exercising those options.

	<p>The SSMR provides that the European Commission publish every three years a report on the application of the SSM Regulation, accompanied by proposals for potential review. The review is based on desk research as well as inputs from the SSM and other stakeholders, including the EBA and industry associations. Two reviews have been published so far (2017 and 2023). These reviews have called for greater harmonization of laws, particularly to deal with fit and proper assessments, sanctioning powers and AML, all areas in which the ECB was subject to national laws.</p> <p>In addition, the ECB is subject to technical standards developed by the EBA and adopted by the European Commission (in the form of regulations). EBA technical standards and guidelines are subject to formal public consultations. The ECB participates in and contributes to the development of draft regulatory technical standards (RTS) or implementing technical standards (ITS) by the EBA. It can also draw the attention of EBA to a potential need to submit to the Commission draft standards amending existing regulatory or implementing technical standards. The ECB has defined supervisory approaches in policy stances and published supervisory expectations to ensure a consistent application of supervisory law and a level playing field.</p> <p>The ECB may also adopt regulations to the extent necessary to organize or specify the arrangements for carrying out its tasks specified in the SSMR. Before adopting a regulation, the ECB is required to conduct open public consultations and analyze the potential related costs and benefits unless justified based on disproportionate costs or urgency.</p>
1 EC 5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access¹⁴ to a bank's board, management, staff and records (including records that are held by relevant service providers and can be accessed either directly or through the supervised bank); (b) review the overall activities of a bank (including activities performed by relevant service providers), whether domestic or cross-border; and (c) supervise the foreign activities of banks incorporated in its jurisdiction.
Description and findings re EC5	<p>a. The supervisory and investigative authority of the ECB is laid out in Chapter III of the SSMR. It empowers the ECB to require credit institutions, financial and mixed financial holding companies and mixed activity holding companies established in the SSM area to provide all information that is necessary in order to carry out the tasks conferred on it by this Regulation. It includes information to be provided at recurring intervals and in specified formats for supervisory and related statistical purposes. The ECB may also request all information from persons belonging to these entities or third parties to whom those entities have outsourced functions or activities.</p> <p>In addition, 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:</p> <ul style="list-style-type: none"> • require the submission of documents;

¹⁴ For this purpose, "access" includes supervisory access in person to the bank's premises, and to senior executive staff and the board (both individual members and as a whole) in person or virtually as needed.

	<ul style="list-style-type: none"> • examine their books and records and take copies or extracts from such books and records; • obtain written or oral explanations from them or their representatives or staff; • interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation. <p>The ECB may also conduct all necessary on-site inspections, subject to prior notification to the national competent authority and may, for that purpose, enter any business premises and land of the legal persons subject to an investigation. Where the proper conduct and efficiency of the inspection so require, it may carry out the on-site inspection without prior announcement to those legal persons.</p> <p>b,c. As laid out in the SSMR, the ECB carries out supervision on a consolidated basis over credit institutions' parents, including (mixed) financial holding companies from the euro area and is also involved in the consolidated supervision of cross-border institutions and groups, either as a home supervisor or a host supervisor in colleges of supervisors. If the parent of a significant credit institution is established outside the euro area but in the EU/EEA, the ECB participates in the college of supervisors, while the NCA is an observer. Within the SSM, the ECB participates in EU or international supervisory colleges for significant banking groups as the competent authority.</p> <p>Further, the ECB may conclude MoUs with the competent authorities in the European Union in order to describe, in general terms, how they will cooperate with one another in the performance of their supervisory tasks. This is specifically required with the competent authorities of each non-participating Member State that is home to at least one global systemically important institution.</p> <p>In addition, the ECB may also develop contacts and enter into administrative arrangements with supervisory authorities of third countries (i.e. countries outside the EU/EEA), subject to appropriate coordination with the EBA. As mentioned in the SSMFR, the ECB also benefits from all existing cooperation arrangements with other authorities entered into by an NCA prior to November 4, 2014 that cover at least in part the supervisory tasks transferred to the ECB. Since then, the ECB has developed its own network of MoUs with other supervisors in the EU and around the world.</p> <p>The ECB has direct supervisory competence with respect to credit institutions, financial holding companies, mixed financial holding companies established in the euro area, and branches in the euro area of credit institutions established in the EU/EEA that are significant, while for less significant branches of EU/EEA parents, the host authority is the respective NCA. If a college with the home authority, being a non-participating Member State, is established, an on-site inspection of branches is possible under the CRD.</p> <p>Subsidiaries of all foreign banks in the SSM are authorized by the ECB and supervised by the ECB when classified as significant. Credit institutions from third countries only establishing a branch or providing cross-border services in the Union remain supervised by the NCAs. The</p>
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	<p>authorization, regulation and supervision of third country branches is being revamped under the CRD 6 and is discussed in CP 5 and CP 13.</p> <p>On average, around 30 on-site inspections are conducted by the ECB outside the euro area every year.</p>
1 EC 6	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is engaging or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardise 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 licence; 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>a,b. The ECB has been empowered by the CRD and the SSMR to take and to require a bank to take a broad range of corrective actions and measures on the SIs under its direct supervision. These are detailed in CP 11.</p> <p>ECB can take (a) supervisory measures, (b) adopt enforcement measures and/or (c) impose effective, proportionate and dissuasive sanctions that ensure compliance with the prudential requirements not only by the supervised entity subject to the specific measures but also by other supervised entities reflecting the general deterrence effect of sanctions. These actions may be taken together.</p> <p>Supervisory Measures aim to ensure that supervised entities take the necessary measures at an early stage to address problems in complying with prudential requirements. They can be taken in the form of (a) ECB decisions or (b) operational acts. The former are legally binding and can be directly enforced. Operational Acts are taken by the Joint Supervisory Teams outside the formal decision-making procedure and are not legally binding.</p> <p>The CRD empowers competent authorities to take necessary measures at an early stage to address relevant problems if the institutions do not meet the requirements of the CRD or CRR or if they have evidence that the institution will breach these requirements within the following 12 months. The breach may be either intentional or negligent.</p> <p>Additional supervisory measures are at the disposal of the ECB under Article 16(2) of the SSM Regulation, including, among others, requiring institutions to hold additional own funds, requiring institutions to reinforce governance arrangements and procedures, requiring institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements; restricting or limiting the business, operations or network of institutions or requesting the divestment of activities that pose excessive risks to the soundness of an institution, requiring institutions to limit variable remuneration etc.</p> <p>Enforcement Measures aim at compelling supervised entities to restore compliance with prudential requirements and can only be imposed in the case of ongoing breaches.</p>

	<p>Pecuniary enforcement measures directly available to the ECB are the PPPs. For ongoing breaches not laid down in ECB decisions or regulations, other enforcement measures are available to the ECB, either directly or indirectly, by way of instructions addressed to NCAs. The toolkit for this depends on the national law.</p> <p>Sanctions aim at punishing the misconduct of a supervised entity and deterring future infringements by the entire banking system. They can be initiated in the case of an ongoing breach or after the breach has ceased to occur. Breaches of directly applicable Union law and breaches of ECB decisions or regulations can be directly punished by way of imposition of sanctions. Breaches of national law transposing relevant directives committed by SIs may be sanctioned by the NCA upon the request of the ECB.</p> <p>The pecuniary penalties are elaborated in the SSMR as is the principle to be applied – that the penalties applied should be effective, proportionate and dissuasive. CRD 6 has enhanced the range of measures and penalties that are available to the ECB and NCAs and expanded on the situations in which these can be applied.</p> <p>The ECB may request the NCAs to open proceedings and use their powers under national law if the breach concerns national provisions implementing EU directives. NCAs are required to report to the ECB all cases of administrative penalties imposed by them on LSIs (see CP 11 for further details).</p> <p>c. As further elaborated in CP 5, the ECB is the exclusive competent authority for the authorization of credit institutions. The ECB decides after receiving the national competent authority's proposal. Similarly, as elaborated in SSMR and SSMFR, the ECB is also the exclusive competent authority for the withdrawal of the authorization of credit institutions.</p> <p>d. The ECB cooperates and collaborates with relevant authorities (primarily the SRB) to achieve an orderly resolution of the bank and is mandated to discharge several responsibilities in this process.</p> <p>In terms of the provisions of the CRD and the BRRD, the ECB has the power to intervene at an early stage in order to require an institution to take the necessary corrective measures to address relevant problems. The assessment of whether an institution 'infringes or is likely to infringe in the near future' and the requirements applicable to it is carried out by the ECB on the basis of the outcome of supervisory assessments.</p> <p>The available early intervention measures are described in the BRRD and include requirements for actions by the management bodies and competent authorities. The latter includes requiring one or more members of the management body or senior management to be removed or replaced; require changes to the institution's business strategy; require changes to the legal or operational structures of the institution; and acquire, including through on-site inspections and provide to the resolution authority, all the information necessary in order to update the resolution plan and prepare for the possible resolution of the institution and for valuation of the assets and liabilities of the institution (see CP 11 for further details on early intervention measures).</p>
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	<p>As regards the resolution of SIs, banks for which the ECB is the direct supervisor and for other cross-border banks, the SRB assumed its full powers in 2016. The SRB adopts a resolution scheme only when it assesses that a number of conditions are met. The ECB assesses one of the conditions for SIs and banks under its direct supervision, namely whether the condition that the entity is failing or is likely to fail is met and communicates this assessment to the Commission and the SRB without delay.</p> <p>Once a significant credit institution or group is in resolution and under the control of the SRB, the general obligation for the ECB to provide the resolution authority on request with all the information relevant for the exercise of its tasks under the national laws implementing the BRRD continues to apply.</p> <p>In addition, the BRRD envisages certain tasks to be performed by the banking supervisor; for example, the competent authority has to assess in agreement with the resolution authority the credibility that a business reorganization plan in the context of the bail-in instrument, if implemented, will restore the long-term viability of the institution. Besides the general possibility for the ECB to require an institution to maintain detailed records of financial contracts, the ECB or the resolution authority may request a trade repository to make the necessary information available for the fulfilment of their tasks. The ECB may have to adjust certain supervisory procedures; for example, in case the sale of a business tool or bail-in instrument is used, the assessment of the acquisition and/or a resulting qualifying holding has to be performed within timelines that do not delay the application of those resolution tools or prevent achieving the relevant resolution objectives. In case a bridge institution is set up by the resolution authority, it may submit a request to the competent authority for a temporary exemption of the conditions for authorization. In these cases, the NCA would always receive the request for authorization, but the ECB would grant authorization and it could become the competent authority for the bridge bank. The resolution authority will also request that the ECB publishes on its website a copy of the resolution order or instrument or a summary note, and in particular the effects on retail customers and the terms and period of suspension or restriction.</p> <p>As regards the resolution of LSIs, the supervisory responsibility for LSI crisis management lies with the NCAs. When an LSI approaches the point of non-viability, the need for intensified cooperation and information sharing arises as the ECB is responsible for license withdrawals. In the early stages of a crisis triggered by a deterioration of an LSI's financial situation, the relevant NCA informs the ECB through an official notification. After a notification of financial deterioration is submitted, crisis management contact groups are generally set up.</p> <p>In case a Member State provides extraordinary public financial support by using the government financial stabilization tools laid down in the BRRD, the competent ministry or government and the resolution authority have to consult the respective central bank and the ECB in order to determine that the application of the resolution tools would not have a significant adverse effect on the financial system.</p>
1 EC 7	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. The supervisor has access, whether directly or through the supervised bank, to all necessary information for conducting such a review irrespective of where it is available.
Description and findings re EC7	<p>Regarding SIs, ECB supervision is performed both on a solo and on a consolidated basis. The assessment of the significance of banks and banking groups is done at the highest level of consolidation in the SSM area.</p> <p>In relation to significant banks or groups, the ECB carries 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. The ECB chairs supervisory colleges of groups of SIs with a parent in a participating Member State and takes part in supervisory colleges concerning SIs with a parent outside the SSM area. The NCAs have the right to participate in the college as observers.</p> <p>Similarly, the supervisory powers conferred on the ECB pursuant to the SSM Regulation allow the ECB to require credit institutions as well as financial holding companies and mixed financial holding companies in the SSM area to take necessary corrective measures. The ECB may also use vis-à-vis these entities, the powers conferred on the supervisor by the national law transposing Union law or request the NCA to make use of its purely national powers in accordance with the SSM Regulation.</p> <p>In cooperation with the NCAs, the ECB is also competent to assess notifications of the acquisition of qualifying holdings in credit institutions in line with the common procedures laid down in the SSM Regulation and the SSM Framework Regulation.</p> <p>The ECB has the investigatory powers detailed in the SSMR to access information directly or via the parent company. It may require all information necessary from credit institutions, financial holding companies, mixed financial holding companies, mixed-activity holding companies (in the participating member states), persons belonging to the above entities, and third parties to whom the above entities have outsourced functions or activities. This would cover the ability to get information on affiliates of the parent company.</p> <p>The ECB may conduct general investigations of any person referred to above and require the submission of documents, examine the books and records, obtain written or oral explanations, and interview any other person who consents to it.</p> <p>Finally, the ECB may conduct on-site inspections at the business premises of the legal persons referred to above and any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating supervisor.</p>
Assessment of Principle 1	Largely Compliant
Comments	The ECB, in its role as the banking supervisor for the euro area and the central organ of the SSM, is unique as it is the only supranational supervisor amongst its peers. Although it does not set prudential regulations, it is responsible for their enforcement. It is jointly responsible with the NCAs for the safety and soundness of banks across 21 member states and draws its power not only from the Union laws but also has to depend on the exercise of powers by NCAs according to National laws, which are not always fully harmonized. It draws heavily on

the NCA human resources for conducting its supervisory tasks, which provides it with a diversity of skills and experience but requires greater effort in developing a common supervisory culture. The report on the Assessment of the European Central Bank's Supervisory Review and Evaluation Process Report (henceforth the Expert Group Report) has made useful recommendations on improving supervisory culture in this context.

Yet, despite this challenging landscape, it has made remarkable progress in just a decade in achieving its objectives. It has also been receptive to the recommendations made by the previous IMF assessment and has moved to implement many of them (e.g., the inclusion of systemic investment firms within the scope of its prudential supervision). Its supervisory powers, and its ability to take meaningful corrective and enforcement actions, are being expanded with every iteration of the CRR/CRD. Specifically, CRD 6 updates the current banking regulatory framework in a more harmonized fashion in key areas including new risk concerns (e.g., Environmental, Social and Governance (ESG) factors), supervisory powers (e.g., in the case of third country branches), sanctioning and enforcement powers (e.g., the broader ability to impose periodic penalty payments). Regarding the main prudential requirements (e.g., capital, liquidity, large exposures), many of the options and discretions available to the competent supervisory authorities in the SSM under EU legislation have been harmonized, though there still remain several that are in the scope of the member states.

The various updates have been noted in the relevant CPs but have not all been considered as completed actions as the new provisions in CRD 6 are not yet transposed into national laws and regulatory standards remain to be developed by the EBA. Even after that, gaps will still exist with international standards in some areas (e.g. transactions with related parties, as detailed in CP 20). Further, the ECB continues to exercise supervisory powers granted under national legislation and apply different national laws which, despite some progress, remain unharmonized in several areas (e.g., licensing criteria (CP 5), governance of credit institutions (CP 14)). Lastly, some of the enforcement and sanctioning powers that are essential for credible and effective supervision have not been made available to the ECB or across the EU but are available to NCAs within the SSM in line with Article 132 (3) of the Treaty for the Functioning of the EU (CP 11). However, in such instances, the ECB can only ask the NCA to open proceedings. Only when these gaps too are addressed will it be possible to assess whether a full harmonization of prudential requirements and supervisory powers ensuring complete consistency in exercising supervisory tasks is in the rulebook and has been implemented in practice across all the member states.

The SSM has a clear mandate to preserve the safety and soundness of banks. The ECB, and the participating NCAs, are an important voice in the major international bodies for banking supervision and financial stability like the FSB and the Basel Committee on Banking Supervision (BCBS) and have been strong proponents of implementing robust standards (including the BCP) across the membership of these bodies. There is a continued need to be vigilant that this focus is not lost in the context of the current debate on the future of the EU economy, where some commentators in the private and public sectors have called for financial regulators to explicitly consider the competitiveness of the EU financial sector in

	<p>their decision making. Going forward, as the memories of the global financial crisis fade, preserving the primacy of the SSM's objective will be paramount.</p> <p>The assessors have assessed in CP 1 whether the required supervisory powers, including corrective action powers are available in the legal framework, while the practical use of the corrective action powers is discussed in CP 11.</p>
Principle 2	Independence, accountability, resourcing and legal protection for supervisors. ¹⁵ 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	
2 EC 1	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 set prudential policy and take any supervisory actions or decisions on banks under its supervision.
Description and findings re EC1	<p>The expectation of operational independence and the arrangements for accountability and governance of the SSM and the ECBs banking supervision function are prescribed in legislation and are publicly disclosed.</p> <p>The expectation of operational independence is enunciated in the SSM Regulation, which 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> The SSMR further exhorts the institutions, bodies, offices and agencies of the Union and the governments of the member states and any other bodies to respect that independence.</p> <p>The accountability arrangements and the reporting responsibilities of the ECB in its supervisory function are also enshrined in the SSMR. The ECB is primarily responsible to the European Parliament and the Council and is required to submit an annual report on its functions and working, present the report in public to the Parliament and respond either orally or in writing to any questions thereon. The practical arrangements of this accountability are described in the Interinstitutional Agreement concluded with the European Parliament and in the Memorandum of Understanding with the Council. The report is also forwarded directly to the national parliaments (NP) of the participating member states. National parliaments may address to the ECB their observations on that report and request the ECB to reply in writing to any observations or questions. The Chair of the SSM deposes before Parliament Members of NPs who can ask the ECB written questions in respect of its tasks and may also invite the Chair or a Member of the Supervisory Board for an exchange of views in National Parliaments regarding SIs in the respective Member State.</p>

¹⁵ Reference document: BCBS, Report on the impact and accountability of banking supervision, July 2015.

The SSMR also requires that the Commission cover the effectiveness of independence and accountability arrangements and the appropriateness of the governance arrangements as part of its review of the SSM to be conducted every three years. The operational efficiency of the management of the ECB while exercising its supervisory tasks may also be examined by the European Court of Auditors (ECA). The reports of the EC and the ECA are published.

The internal governance rules of the ECB and its banking supervision function are laid down in the SSM Regulation, the SSM Framework Regulation, the ECB Rules of Procedure, and the Rules of Procedure of the Supervisory Board.

The governance arrangements of the SSB and the connection with an independent central bank considerably strengthen the operational independence of the ECB banking supervision function and insulate it from industry and government pressures. Potential pressures from individual Member State governments on behalf of their institutions or national interests, as well as conflicting interests with the central bank, are mitigated to a large extent by the composition and the procedures of the Supervisory Board of the SSM. The Board is composed of representatives of each of the national competent authorities, each carrying one vote.

The SSMR requires the ECB to carry out its supervisory tasks without prejudice to, and separately from, its tasks relating to monetary policy and any other tasks. Moreover, these supervisory tasks should not interfere with the ECB's tasks in relation to the ESRB or any other tasks. The ECB's supervisory tasks may not alter the ongoing monitoring of the solvency of its monetary policy counterparties. Furthermore, the staff involved in carrying out supervisory tasks should be organizationally separate from the staff involved in carrying out other tasks conferred on the ECB and subject to separate reporting lines. The one exception is the Vice Chair of the Supervisory Board, who is chosen from among the ECB's Executive Board, has a term that is longer than the Chair of the SB and is part of the key decision-making bodies of both the central banking and banking supervision functions of the ECB.

The ECB's Rules of Procedure regulate organizational and procedural aspects related to the Supervisory Board and its interaction with the Governing Council to maintain this separation. The Governing Council's deliberations on supervisory matters are to be kept apart from those on other issues, with separate agendas and meetings. The SSM Regulation furthermore requires the ECB to adopt and publish any necessary internal rules to ensure the separation between the supervisory function on the one hand and monetary policy functional areas and other tasks of the ECB on the other, including rules regarding professional secrecy and information exchanges.

The ECB does not set prudential policy, which is laid out in the CRR, CRD and its national transpositions, and the technical standards and guidance of the EBA. As mentioned in CP1, the ECB may only adopt regulations to the extent necessary to organize or specify the arrangements for carrying out its tasks specified in the SSMR. Where there are gaps in

	<p>existing guidance and standards, it conveys its supervisory expectations through its own guidance which although non-binding, does have considerable traction with the industry.</p> <p>It has full discretion to take supervisory actions and decisions as laid out in the Union laws and within the limitations of the national laws of its member states in some cases. There are also situations in which it is dependent on the Member State to take supervisory actions under its national law at its request.</p> <p>As a rule, the legally binding decisions related to the performance of the ECB's supervisory tasks are prepared by the Supervisory Board before being submitted to the Governing Council for 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 (up to ten days). Any objections by the Governing Council must be on account of conflicts with Monetary Policy. A Mediation Panel and procedure have been prescribed in the SSMR to deal with such conflicts but these have not had to be invoked so far. The decisions of the ECB banking supervision have also been challenged in the courts, which have so far upheld its actions and the primacy of Union law.</p> <p>As elaborated in EC 4, to facilitate the decision-making process and ensure the efficiency and effectiveness of banking supervision, certain types of supervisory decisions have been delegated to the Senior Managers of ECB Banking Supervision by the Governing Council. The delegation frameworks are published in the Official Journal of the European Union and available on the ECB Banking Supervision Website.</p>
2 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 (are) removed from office during their term only for reasons specified in law or if they are not physically or mentally capable of carrying out the role or have been found guilty of misconduct. The reason(s) for removal is (are) publicly disclosed.</p>
Description and findings re EC2	<p>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 National Central Bank (NCB) if the NCA is not the NCB.</p> <p>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 the SSM Regulation and the ECB Rules of Procedure and Decision ECB/2014/4 on the appointment of representatives of the ECB to the Supervisory Board. The appointments are expected to respect the principles of gender balance, experience, and qualification.</p> <p>The Chair is chosen based on an open selection procedure, on which the European Parliament and the Council are kept duly informed from among individuals of recognized standing and experience in banking and financial matters and who are not members of the Governing Council. The Interinstitutional Agreement with the European Parliament and the MoU with the Council provide that the ECB should specify and make public the criteria for the selection of the Chair and describe arrangements which ensure a proper involvement of the European Parliament and Council in the procedures.</p>

	<p>The Vice-Chair of the Supervisory Board is chosen from among the members of the Executive Board of the ECB, who in turn is appointed like other members by the European Council. Their term of office is eight years, not renewable.</p> <p>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.</p> <p>The term of office of the Chair and the four ECB representatives is 5 years, non-renewable. The term of office of the Vice-Chair is 5 years and may be extended, but not beyond the end of their mandate as members of the Executive Board, which is eight years. There is no fixed term for the NCA members of the Supervisory Board.</p> <p>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.</p> <p>If the Vice-Chair, being at the same time a member of the Executive Board, no longer fulfils the conditions required for the performance of his duties or has been guilty of serious misconduct, the Court of Justice of the European Union may, on application by the Governing Council or the Executive Board, compulsorily retire him (from his function as a member of the Executive Board). In such cases, the Council may, following a proposal by the ECB approved by the European Parliament, adopt an implementing decision to remove him from his office as Vice-Chair.</p>
2 EC3	<p>The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. The supervisor regularly communicates its supervisory priorities publicly.</p>
Description and findings re EC3	<p>The SSMR lays out the objectives of ECB banking supervision and 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”.</p> <p>The accountability framework is transparent. The annual report of the ECB banking supervision provides an account of the activities during the past year and is submitted to the European Parliament, the Council of the European Union, the European Commission and the Eurogroup. It is also published on the website of the ECB. The Chair of the Supervisory Board appears regularly before the Parliament and attends regular hearings and exchange of views in the European Parliament and in the Eurogroup in the presence of all member states participating in the European Union.</p> <p>The ECA is also entitled to carry out audits on the operational efficiency of the management of ECB’s supervisory tasks. These reports are also published. The most recent report (2023)</p>

	<p>covered the supervision of credit risk and concluded that the ECB had stepped up its efforts in supervising credit risk and, in particular, non-performing loans. However, more needed to be done for the ECB to gain increased assurance that credit risks are properly managed and covered. It was also critical of the inability to escalate supervisory measures in a timely fashion despite control weaknesses and of the impact on the supervisory effort due to staffing shortages caused by budget stabilization measures of the ECB and the failure of the NCAs to meet their commitments. The ECB's response to the ECA report has been published.¹⁶ [1]</p> <p>In addition, the European Commission publishes (in principle every three years) a report on the application of the SSM Regulation with a special emphasis on monitoring the potential impact on the smooth functioning of the internal market. The most recent report (2023) concluded that the SSM had developed into a mature organization and was functioning well. However, it was facing challenges in acquiring skills for specialized areas. It also underscored the importance of improving communication and cooperation with external stakeholders while acknowledging that harmonization in certain legislative areas remained a work in progress.</p> <p>The ECB communicates its priorities, activities, outcomes and concerns to the public. The published top priorities for 2023-2025 were strengthening resilience to geopolitical shocks, addressing digitalization challenges and stepping up work in climate change-related areas. The recently released supervisory priorities for 2025-27 focus on banks' resilience to immediate macro-financial threats and severe geopolitical shocks; the importance of timely remediation of known material shortcomings, and the need to tackle challenges stemming from digital transformation and new technologies. In addition, the Chairs and other members of the Supervisory Board give regular speeches and talks in the public domain. The ECB also responds to public enquiries and in 2023, it responded to 1,355 questions on banking supervision-related topics.</p>
2 EC4	<p>The supervisor has effective internal governance and communication processes that enable timely supervisory decisions to be taken at a level appropriate to the significance of the issue and expedited procedures in the case of an emergency. The allocation of responsibilities within the organisation as well as the delegation of authority for particular tasks or decisions are clearly defined. Supervisory processes include internal checks and balances to support effective decision-making and accountability. The governing body is structured to avoid any real or perceived conflicts of interest.</p>
Description and findings re EC4	<p>The internal governance rules of the ECB and its banking supervision function are laid down, in particular, in the SSM Regulation, the SSM Framework Regulation, the ECB Rules of Procedure, and the Rules of Procedure of the Supervisory Board.</p> <p>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 Banking Supervision staff. The Supervisory Manual has also been published on the ECB Banking Supervision website and has been updated in 2024. In addition, there is a general obligation</p>

¹⁶ See: ECB-Replies-SR-2023-12_EN.pdf

to exchange information within the SSM, as introduced by Article 21 of the SSM Framework Regulation.

In accordance with the processes laid down in the Supervisory Manual, operational acts (i.e. the majority of the day-to-day supervisory interaction with supervised credit institutions) are taken by SSM staff without the involvement of the Supervisory Board and the Governing Council. A template is provided for such communications with banks so that the non-binding nature of these communications is well understood.

Legally binding decisions are approved by the Supervisory Board which then submits the draft decision to the Governing Council, for adoption under the non-objection procedure.

In order to streamline the decision-making process a delegation framework was introduced in 2017 that has enabled the delegation of the adoption of many supervisory decisions to ECB senior managers. The 'fit and proper' decisions, which formed the bulk of the ECB decisions, were delegated first as well as decisions amending the significance of supervised entities or groups. Since then, the delegation framework has been extended to cover the decisions made based on national powers, passporting, qualifying holdings and most recently, certain macroprudential decisions so that by now, over half of all supervisory decisions are taken by delegation. The decision-making process is further streamlined by adopting uncontroversial decisions by written procedure (if not delegated) and by standardizing and simplifying the documentation to be submitted to the decision-making bodies. In emergency situations (for instance, a crisis), the decision could likely be approved by the Supervisory Board in a videoconference, which may include the Governing Council or be held back-to-back with a Governing Council videoconference where the decision is adopted. This emergency process may also be combined with the postponement of the hearing after the adoption of a provisional decision.

As regards the avoidance of conflicts of interest, as mentioned in EC 2, the Governing Body is composed of the NCA representatives, four ECB representatives and the Chair and Vice-Chair. It is an avenue that can act as a communication channel for contact with NCAs and aims to mitigate the pursuit of individual national interest by granting each member only one-vote. It has adopted a Code of Conduct that 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. Members are 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). The Code requires Supervisory Board members to comply with the rules on private financial transactions adopted by the ECB for its own staff. However, for Supervisory Board members who are representatives of NCAs, compliance with and monitoring of rules on private financial transactions is subject to any applicable national procedural rules. An [enhanced Code of Conduct](#) for all high-level ECB officials was published in 2022 which imposes additional restrictions on the private financial transactions of high-level ECB officials, including Governing Council, Executive Board and Supervisory Board members and further harmonizes post-employment rules

2 EC5	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.
Description and findings re EC5	<p>The ECB is considered to be an employer of choice and is able to attract qualified professionals for its openings. The professionalism and integrity expected of ECB staff are laid out via the Code of Conduct and employment framework. ECB has a strong ethics rulebook for staff which details guidance on avoiding conflicts of interest and on the appropriate use of information obtained through work. Prior to a candidate's appointment, the appointing authority should assess whether there may be a conflict of interest resulting from the candidate's previous occupational activities or their close personal relationship with members of staff or officials of the ECB. Members of staff who become aware of a conflict of interest when performing their professional duties are required to immediately inform their line manager. The Code prohibits solicitation or acceptance of gifts or any other advantage. It requires staff to ensure the proper conduct of procurement procedures, obtain authorization for acceptance of any awards or honors and for engaging in any external activity while prohibiting the receipt of payment from any third party. It also lays out post-employment restrictions including cooling-off periods which vary based on their role, level and duration of employment and the nature of the prospective employment.</p> <p>It also covers professional standards and lays out expectations for handling the confidentiality of information received by staff in the course of their work, dealing with external parties and maintaining in-house relations, as well as respecting the separation principle between supervisory and monetary policy. It provides the principles to guide staff in their undertaking of financial transactions, including circumstances in which authorization or reporting is required. As mentioned in EC 5, to set the tone at the top, the financial interests of the members of the Supervisory Board are updated and displayed annually on the ECB website.</p> <p>The Code of Conduct imposes upon the ECB staff the duty to adhere to the highest standards of professional ethics and act with loyalty to the Union and the ECB and lays out the disciplinary actions that could be attracted in the event of failure to do so. These are listed in the Conditions of Employment and range from written reprimands to dismissal.</p> <p>Since the last BCP assessment, the Ethics Framework was amended with the introduction of a section devoted to whistleblowing, setting out how assessment of and follow-up on information on breaches reported through this channel should take place. Moreover, the amendment introduced general rules for whistleblower protection, including against retaliation, through both corrective and interim protective measures.</p> <p>In addition, the Governing Council of the ECB adopted Guidelines in 2015 which laid down the principles of a common ethics framework for the SSM. This aimed at safeguarding the SSM's credibility and reputation as well as public confidence in the integrity and impartiality of the members of the bodies and the members of staff of the ECB and of the NCAs of the member states participating in the SSM. These Guidelines were updated in 2021 and as verified by the ECB, the revised guidelines have been implemented to a wide extent by all NCAs.</p>

2 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 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 to conduct supervisory tasks subject to the necessary confidentiality restrictions; (d) a budget and programme for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (eg supervisory colleges).
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 reports to the Governing Council.</p> <p>The ECB's annual expenditure in relation to its supervisory tasks comprises all operating expenses, including those related to support functions. These include the annual expenditure, which comprises all the necessary expenses such as salaries and benefits, rent and buildings, consultancy, statistical services, IT services, business travel and training required for the ECB to effectively carry out SSM-related tasks.</p> <p>The resource needs for supervisory tasks have proven to be higher than originally anticipated. The SSM-related headcount was augmented in 2015. Further, in 2019 a permanent SSM headcount pool of 50 FTEs was established for the Chair and Vice Chair to provide banking supervision with short-term versatility to support SSM/supervisory priorities. More recently the headcount growth has started to level off as part of the overall ECB's cost stabilization commitments, although headcount increases are still possible for new or expanded tasks, as evidenced by the budget increase given the new mandate related to the implementation of DORA. At the time that this assessment was finalized, additional budget had been secured to implement DORA, but hiring had not taken place.</p>

	<p>However, the headcount needs have continued to grow from several areas of risk (like internal model reviews, all dimensions of IT risks, and climate); the addition to the list of Supervised entities, and new business lines like investment firm supervision. The NCAs provide an important source of skilled resources to the JSTs and to the onsite inspections, but more than half of them have been unable to meet their commitments in recent years. There is also a variability in the skills and experience of the staff released by the NCAs. The resultant pressure on staffing has been noted by the ECA in its 2023 report which has recommended that the ECB should improve the efficiency of the supervisory assessment process and safeguard the operational independence of the ECB as a supervisor by: (i) Setting and putting in place ECB supervisory staffing levels based on needs, independent of the ECB central banking staffing strategy; (ii) Urging NCAs to comply with their commitments to provide staff by making rigorous use of existing escalation procedures.</p> <p>While there has been a significant increase in the expenditure on staff in 2023, this has been driven more by salary adjustments, actuarial adjustments from the valuation of post-employment benefits, an internalization of consultancy costs and, to a lesser extent, by an increase in headcount. Discussions with staff suggest that the annual budget process would benefit from earlier inputs from banking supervision on their staffing needs and would help better meet the expectation of this criteria that <i>“a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks supervised.”</i> At the same time, the ongoing efforts to better prioritize the supervisory tasks by the articulation of the Risk Tolerance Framework and the introduction of the Multi Year Assessment should also help in reducing the pressure on staffing.</p> <p>b. The ECB's salary and benefit structure (applying to all staff) has so far proven sufficiently attractive to hire and retain supervisory staff. The starting salary is set at the outset of a campaign based on the level of qualification and experience needed for each position. In addition, the ECB remuneration package includes expatriation and family-related allowances, comprehensive medical and pension schemes, access to the European School, relocation support and other benefits based on an individual's particular circumstance.</p> <p>c. To supplement its internal resources, the ECB uses external consultancy support services to provide either specialized expertise or integrated consultancy under qualified internal guidance to complement internal resources during workload peaks. As regards core supervisory tasks, these services concern developments in IT systems, asset quality reviews (AQR) and on-site supervision tasks, including cross-border missions. Other consultancy costs concern areas that support the ECB Banking Supervision function and are primarily related to the running and evolutionary maintenance of IT systems. In recent years, there has been a tendency to internalize resources, in particular in relation to the on-site missions. The external consultants are subject to the same professional secrecy requirements as ECB staff members when they provide services related to the discharge of supervisory duties.</p> <p>d. ECB and NCA staff follow a common, jointly developed SSM training program, which helps to increase consistency in supervisory practices and promote a common supervisory culture. General training available at the ECB complements the offerings. The number of banking supervisors trained increased from roughly 1,200 in 2016 to 11,000 in 2024. It will</p>
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	<p>be important to continue to strengthen the training management and deepen the training offerings especially given the variability in staff and skills that comes from being dependent on a broad pool of supervisors from different NCAs as well as the emerging new areas of focus which require urgent attention like climate and cyber.</p> <p>e. The SSM has made the digital agenda a priority and invested in a portfolio of supervisory technologies (SupTech), which are in the development phase. Meanwhile, the crucial day to day technology platforms (like the IMAS, which is the single platform for supervisory processes and data) also need to be constantly upgraded. The Expert Group report has also mentioned the imperative of doing this as a priority. Nevertheless, the ECB faces a number of competing priorities under its single technology budget, which leads to a lack of ex-ante earmarking of financial resources across the various projects within the ECB (including for supervisory IT projects). The SSM Tech Strategy 2024-2028, as recently approved by the Supervisory Board, aims to maximize the impact and use of existing applications; enhance supervisory risk assessment by augmenting analytical capabilities; and automate workflows and improve SSM collaboration.</p> <p>f. ECB has a travel budget that allows for travel to meet its supervisory tasks as well as the international cooperation forums and standard setting engagements and this has also been helped by the ability to participate remotely where possible. However, the verticals and the on-site function have been constrained in international travel to some extent, including for climate conscious reasons, putting pressure on their ability to meet increasing business needs..</p>
2 EC7	<p>As part of their annual resource planning exercise, supervisors regularly take stock of existing staff skills and projected requirements/needs over the short and medium term, considering relevant emerging risks and practices as well as supervisory developments. Supervisors review and implement measures to bridge any gaps in numbers and/or skillsets identified.</p>
Description and findings re EC7	<p>For the ECB's direct supervision, the Strategic Planning Office of Directorate Supervisory Strategy& Risk (D/SSR), along with the relevant business areas and NCAs, coordinates the allocation of SSM resources and expertise. The JSTs carry out the operational planning under ECB coordination. However, as mentioned in EC 6, the business lines would benefit from an earlier consultation on the overall annual budget to be able to plan for gaps in numbers and skill sets.</p> <p>The ECB benefits from the assistance of the NCAs and, consequently, from the skills and competencies available at the national level. The staffing of JSTs by NCAs is based on commitments made by the NCAs, which are regularly monitored through surveys and discussed bilaterally and multilaterally. For the direct supervision of LSIs, the NCAs plan and carry out their ongoing supervisory activities in line with the SSM's overall strategy, using their own resources and decision-making procedures.</p> <p>A knowledge-sharing platform called SSMnet comes with a user profile functionality which includes contact details, job titles and, on a voluntary basis, further information (expertise, past experience, education), which helps in selecting staff for appropriate tasks. NCAs are encouraged to participate in staff exchanges of varying durations with the ECB and among</p>

	<p>themselves at different levels of the organization. The SSM swap program offers another opportunity for staff exchanges between ECB Banking Supervision and partnering SSM institutions in the form of external secondment. Participants in the program exchange their roles for one to two years, immersing themselves in the host country and becoming integral members of the host institution's team. Staff exchanges promote the multinational nature of JSTs and allow them some flexibility when they require extra support or specific expertise. ECB and NCA staff also follow a common training program, which helps to increase consistency in supervisory practices and promote a common supervisory culture.</p> <p>From 2017 onwards, managers, JST coordinators and supervisory staff have started rotation in order to aid their personal and professional development and at the same time to avoid regulatory capture by the supervised entity. In 2023, 48 staff members moved to a new Joint Supervisory Team.</p>
2 EC8	In determining supervisory programmes and allocating resources, supervisors consider the risk profile and systemic importance of individual banks and the different risk mitigation approaches available.
Description and findings re EC8	<p>The ECB employs a technique (the cluster model) for allocating its resources to JSTs based on the size, complexity and risk of the banks. The cluster model is also used to determine the intensity of supervision with which JSTs supervise banks on a recurrent basis. For the ECB's direct supervision, the Strategic Planning Office of D/SSR, along with the relevant business areas and NCAs, coordinates the allocation of SSM resources and expertise.</p> <p>The JSTs carry out the operational planning under ECB coordination. For each significant bank, they produce a Supervisory Examination Program (SEP), which sets out the main supervisory tasks and activities for the following 12 months, their tentative schedules and objectives and the need for onsite inspections and internal model investigations. The SEP activities draw upon the existing regulatory requirements laid out in the CRD, the Supervisory Manual and the supervisory priorities.</p> <p>Setting the SEP entails assessing the relevance of each risk and the resulting risk tolerance. Taking the risk tolerance levels into account, supervisors are empowered to produce work programs that consider the supervisory priorities as well as the most pressing issues identified for the individual SI and that ensure efforts are directed to areas where supervisory action is viewed to be most effective. As such, the activities contained in the resulting JST work programs are tailored to the risk profile of the SI and may include on-site missions and horizontal activities. For European cross-border institutions, the supervisory planning process contains the relevant procedures according to CRD, including the functioning of the colleges of supervisors and the joint risk assessments and joint decisions.</p> <p>On-site inspections are planned and staffed in close cooperation with the NCAs, which provide more than 85 percent of the heads of mission and team members. Horizontal activities for the next supervisory cycle involve a sample of SIs and that address selected key risks and vulnerabilities in the banking sector previously identified in the annual review of the supervisory priorities.</p>

	<p>NCA's are consulted with regard to the planning of supervisory activities and particularly with regard to the planning of on-site missions. The integrated nature of the planning process ensures that both the planning of horizontal activities/general offsite activities and on-site inspections mutually inform each other. The work programs are monitored, and the Supervisory Board is kept informed about the progress.</p> <p>The final responsibility for the supervisory planning of LSIs remains with the respective NCA, though the ECB also receives annual information from NCAs by end-March with respect to their priorities for LSIs supervision in the coming year.</p>
2 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.¹⁷</p>
Description and findings re EC9	<p>The ECB enjoys 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 (Protocol (No 7) on the privileges and immunities of the European Union).</p> <p>Nevertheless, the actions of the ECB are subject to judicial control by the Court of Justice of the European Union, which may annul ECB decisions. Actions may be brought by any legal or natural person, within a time limit of two months, against an act addressed to that person or which is of direct and individual concern to them.</p> <p>The ECB should, in accordance with the general principles common to the laws of the member states, make good any damage caused by it or by its servants in the performance of their duties. According to the case-law of the Court of Justice, any applicant would need to prove a "sufficiently serious" violation of Union law by the ECB and a causal link between the conduct of the ECB and the damages claimed. So far, actions for damages brought against the ECB in the context of its supervisory tasks have been dismissed.</p> <p>This liability of the ECB is without prejudice to the liability of the national competent authorities from the member states participating in the Single Supervisory Mechanism to make good any damage caused by them or by their servants in the performance of their duties in accordance with national legislation.</p> <p>The staff of the ECB and the staff of NCAs in the SSM are protected against lawsuits from actions taken in their official capacity in accordance with the Statute of the European System of Central Banks, which states that "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." Further, in terms of Protocol (No 7) on the privileges and immunities of</p>

¹⁷ The term "supervisor and its staff" is to be understood as covering the head of the authority, the governing body, employees and any professional service providers who carry out tasks for the supervisory authority. As the protection is provided in respect of actions taken and/or omissions made while discharging duties in good faith, it is not removed when the term of appointment, engagement or employment is ended.

	<p>the EU, ECB staff and members of its organs 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>NCA staff participating in internal bodies of the ECB, such as the Supervisory Board or JSTs, enjoy functional immunity in the EU according to the Protocol (No 7) on the privileges and immunities of the EU: “Representatives of member states taking part in the work of the institutions of the Union, their advisers and technical experts shall, in the performance of their duties and during their travel to and from the place of meeting, enjoy the customary privileges, immunities and facilities.”</p> <p>There are no provisions under Union law for any direct liability of ECB staff members towards third parties for damages caused in their official capacity. ECB staff members are not liable for any damages caused to the ECB or to third parties because they enjoy, in the territory of each Member State of the Union, immunity from legal proceedings in respect of acts performed by them in their official capacity pursuant to Article 11(a) in conjunction with Article 22 of the Protocol (No 7) on the privileges and immunities of the European Union (‘the Protocol’) annexed to the Treaties. However, the scope of protection of this immunity does not extend to legal proceedings brought in third countries that are not parties to the Protocol. They would only be shielded against legal proceedings in such a third country, if this were provided under public international law or the national law of that third country.</p> <p>The ECB deploys external contractors (consultancy or audit firms) to support its banking supervision activities. These service providers would not be covered by this immunity and there is no explicit provision in the ECB’s contracts with its external providers, including those tasked with banking-supervision related preparatory services, concerning financial compensation to be provided by the ECB for the costs of defending a lawsuit brought by a third party during or after the end of the contracted work. The ECB believes that (a) the contractors typically only provide inputs to supervisory work for consideration by ECB staff; and (b) it would be able to support a contractor if a lawsuit was brought by a supervised entity for actions taken by the contractor in the course of its work, but there has not been any such instance so far.</p>
Assessment of Principle 2	Largely Compliant
Comments	<p>The governance arrangements of the SSM and the Supervisory Board and the connection with an independent central bank considerably strengthen the operational independence of the ECB banking supervision function and insulate it from industry and government pressures, and a good balance is provided by the strong accountability requirements. The legislative framework provides explicit expectations that the various stakeholders will safeguard the independence of the ECBs banking supervision function, and this is borne out in practice. At the same time, national FSAPs have identified continuing challenges in some NCAs with regard to operational independence, and this together with the lack of any term limits of the NCA members of the SSB, can potentially impact the supervision function. CRD 6 recognizes this vulnerability and has addressed this to some extent as it will require member states to ensure that the governance bodies of competent authorities are functionally independent of other public and private bodies. No member of a competent</p>

authority's governance body who is appointed after January 11, 2026, should remain in office for more than 14 years. Further, these members should be appointed on the basis of published criteria that are objective and transparent, and they should be able to be dismissed if they no longer meet the criteria of appointment or have been convicted of a serious criminal offence.

The legal framework also places explicit emphasis on the separation between the banking supervision and the monetary policy function, which is a best practice. The aim is to ensure that the ECB's supervisory tasks should neither interfere with, nor be determined by, its tasks relating to monetary policy. Procedures have been laid out to ensure that the discussions and the agenda of the meetings of the Governing Council on the two areas are kept separate. The staff of the banking supervision function are to be organizationally separate from the rest of the ECB, with the exception of the Vice-Chair, who has key decision-making functions in both areas.

Overall, the decision-making process at the SSM is centralized and complex. While a framework has been adopted to delegate more decisions to Senior Management of the ECB banking supervision, which provides greater efficiency and autonomy, there is room to further delegate decision making considering that 50 percent of decisions are still adopted by the Supervisory Board through written procedures.

SSM resources are stretched, with pressure in some key areas (e.g., ICT risk, internal models). Although the banking supervision function is to be funded by fees levied on the supervised entities, the resources for supervision are allocated within the broader organizational priorities of the ECB. More recently, the stabilization of the central bank budget has been extended to the SSM, putting pressure on the ability to hire staff in requisite numbers with needed skills. This can pose a challenge to the budgetary autonomy that is required by the principle. This was pointed out by the ECA in their recent report, which recommended that the ECB, as a supervisor, have the operational independence to set supervisory levels based on needs, independent of the ECB central banking strategy. A way forward would be for the ECB budgetary function to receive inputs from the banking supervision business lines to help prepare the budget and then have early-stage consultation on the budget proposal, which is currently viewed by the latter as proforma and late stage. This would also help them in prioritization of their work and managing delivery expectations.

The SSM draws heavily on the NCA human resources for conducting its supervisory tasks, which provides it with a diversity of skills and experience but at the same time, requires greater effort in developing a common supervisory culture. The access to NCA staff is both a great strength but also a challenge and affects the planning and delivery of commitments at both ends. In recent years, more than half the NCAs have not been able to meet the commitments they make. There is also a variability in the skills and experience of staff made available by the different NCAs. Stretched supervisory resources put greater pressure on prioritization, and there are ongoing efforts to ameliorate these stresses through key initiatives such as simplifying the SREP process planning and introducing a risk tolerance framework. Meanwhile, the NCAs are also under similar pressures and are looking for more risk-focused delegation, and a simplification of supervisory processes with reduced focus on

	<p>standardization, given the gains that have already been made to ensure a level playing field and consistency in the supervisory assessment. Investing in technological solutions to aid in this effort is ongoing but is also dependent on the single budget of the central bank.</p> <p>Finally, ECB staff are subject to a strong code of ethics and are covered in the territory of each Member State by legal immunity from their actions taken during their duty, both while they are in service and after their employment ends. The ECB should provide assurance that they would be supported in the costs of defending their actions in all jurisdictions where they work and extend similar protection to external consultants/ service providers who are periodically engaged to perform supervisory tasks.</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. ¹⁸
Essential criteria	
3 EC1	Arrangements, whether 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>The CRD, the SSMR, the SSMFR, the FICOD all lay out various provisions covering the cooperation of the ECB with the national authorities and the European System of Financial Supervision (ESFS) on a range of topics covering microprudential and macroprudential supervision, consolidated supervision, crisis preparedness and management and statistical data, among others.</p> <p>Cooperation with member states: Cooperation underlies the core of the SSM by design and requires frictionless sharing of responsibilities and exchange of information and even staff with the ECB and the NCAs. The main decision-making body in the SSM is the Supervisory Board, an internal ECB body which includes the Chair, Vice-Chair, four ECB representatives and one representative per NCA of each participating Member State with an additional representative from the central bank (without additional voting right) in member states where the competent authority is not a central bank. The JSTs (Joint Supervisory Teams), involving staff drawn from the ECB and the NCAs, are the building blocks of the SSM. The appointment of Heads of Missions for on-site inspections is done in consultation with the NCAs. In addition to ongoing supervision, the NCAs have a central role in the preparation of decisions relating to “common procedures.” NCAs in participating SSM member states are also regularly involved in the discussion of general and overarching supervisory issues through networks of national experts.</p> <p>The collaboration with the NCAs extends to the collection of supervisory data and is carried out by them (for SIs and LSIs) and shared with the ECB. Discussions on overarching reporting procedures and related issues take place through dedicated substructures of the ECB Statistics Committee and informally through visits of ECB staff to NCAs, among other regular</p>

¹⁸ Principle 3 is developed further in Principle 12 [BCP40.27], Principle 13 [BCP40.30] and Principle 29 [BCP40.66].

communications. In certain cases, when horizontal analyses or consistency projects on the internal models are performed, institution-specific information may be shared with selected members of NCAs' horizontal functions outside the country of the institution.

Cooperation also extends to non-euro area member states. 'Close cooperation' arrangements can be undertaken with the latter as a prerequisite to euro accession and are intended to allow member states whose currency is not the euro to participate in the SSM. The current 'close cooperation' with the Bulgarian National Bank was established in July 2020, at that time together with the Croatian National Bank which adopted the euro in 2023. It followed a comprehensive assessment of the Bulgarian banking sector and national legislation. Since then, Bulgaria has become part of the SSM to allow member states whose currency is not the euro to participate in the SSM. This implies that BNB addresses decisions to banks upon instructions of the ECB. However, the close cooperation does not allow the ECB to co-lead joint inspections with the BNB, (BNB invites the ECB as observer) which could have otherwise provided greater insight into the quality of the assessment.

Following the simplified approval rules from the transmission framework of 2022, ECB managers are empowered to clear without recourse to a non-objection procedure the sharing of confidential supervisory information with non-SSM, EU/EEA, and third-country authorities on a 'need to know' basis. The SSMR also mandates the ECB to conclude MoUs with the NCAs of the non-participating SSM member states, including those that are home to at least one G-SII. The MoU with the 6 EU non-participating NCAs was concluded in 2022. Further cooperation is ensured with the relevant authorities of Denmark, Finland, Norway, Sweden, Estonia, Iceland, Latvia, and Lithuania for the supervision of significant cross-border branches. MoUs have also been concluded between the ECB and the competent authorities of several SSM member states for the performance of their supervisory tasks in relation to the supervision of third-country groups and third-country branches. In their most recent report in 2023 on the review of the SSM Regulation, the Commission concluded that the close cooperation with the NCAs was working well and that the "cooperation between the ECB and the competent authorities in non-participating member states has been smooth.

Cooperation with the European System of Financial Supervision (ESFS): The SSMR enjoins the ECB to cooperate closely with the EBA, ESMA, EIOPA, and the ESRB and other authorities that form part of the ESFS.

The EBA is the key partner for the ECB given its role in preparing RTS and guidance on implementing EU directives addressed to competent authorities (which includes the ECB for SIs within the SSM). The ECB is subject to the 'comply and explain' regime of the EBA in this regard. In addition, coordination between the two is key, given the common interests of both institutions in setting supervisory priorities, promoting supervisory convergence, and conducting stress tests for the banking system; albeit the EBA covers a broader membership. The ECB has entered into an agreement with the EBA in order to share information on the key risks that might affect the banking system. The ECB also has non-voting member status on the EBA's Board of Supervisors, but the EBA does not have the same privilege though it can be invited to participate as an observer in the ECB's Supervisory Board. In addition, ECB

	<p>staff are members of the various EBA technical groups and contribute to the formulation of technical standards.</p> <p>The ECB has an MoU with ESMA to formalize cooperation and information-sharing mechanisms in relation to CCP and supervised entities and has also agreed on a template to be used between national authorities responsible for markets in financial instruments and the ECB. The ECB cooperates and exchanges supervisory information on supervised entities with National Market Authorities (NMAs) of EU member states provided there is a legal basis, there is a “need to know” because the information is necessary for the NMA to discharge its supervisory duties, and there is no overriding reason to refuse. The ECB has agreed with ESMA a model MoU, which the ECB is prepared to sign on a bilateral basis with an NMA upon an expression of its interest. The ECB has concluded an MoU with the Italian CONSOB, the Netherlands AFM, the German BaFin, the French AMF, and the Spanish CNMV.</p> <p>The ECB also has a joint MoU with EBA and EIOPA to facilitate the definition and exchange of regulatory data within the financial sector but there is so far no MoU on other supervisory cooperation or information sharing with EIOPA despite the presence of significant insurance and reinsurance entities and the prevalent bancassurance business model in Europe. However, the FICOD establishes a legal framework for supplementary supervision of regulated entities (credit institutions, insurance and reinsurance undertakings, investment firms, asset management companies, and alternative investment fund managers) that are part of groups qualifying as financial conglomerates. This framework for supplementary supervision aims to provide systematic monitoring of the risks stemming mainly from the interrelation between the insurance activities and the banking/financial activities within the same group. It establishes the criteria for identifying a competent authority to be the “coordinator” of supplementary supervision of regulated entities belonging to a financial conglomerate and defines the tasks to be performed by it. The ECB is currently the coordinator for 28 financial conglomerates and has concluded individual coordination arrangements for the supplementary supervision of those financial conglomerate with the other relevant competent authorities, notably national insurance supervisors.</p> <p>Cooperation on AML/CFT: The ECB exchanges information with national AML/CFT authorities in the EEA based on a multilateral agreement signed (the AML Agreement), which now has 51 signatories. In addition, the ECB currently participates as an observer in 64 AML/CFT Colleges. The ECB and the AML/CFT authorities exchange information that is relevant for the completion of their respective tasks either on their own initiative or upon request. The ECB also contributes to the EBA’s European Reporting system for material CFT and AML Weaknesses. It is participating in policy streams led by the new AML Authority (AMLA) on drafting level 2/ level 3 texts, and a MoU on cooperation is in the works. More details are provided in CP 29.</p>
3 EC2	<p>Arrangements, whether formal or informal, are in place for the supervisor to coordinate, within its mandate, with relevant authorities with responsibility for macroprudential policy when undertaking actions related to monitoring, identifying and addressing systemic risks that have the potential to affect the stability of the banking system.</p>
Description and findings re EC2	<p>Within the SSM, the ECB shares the responsibility for macroprudential supervision with the relevant National Designated Authorities (NDAs) and NCAs. NDAs/NCAs may apply two sets</p>

	<p>of macroprudential tools: (i) the tools to tackle systemic risks in the banking sector, enshrined in the CRR/CRD and transposed into national law; and (ii) the other macroprudential tools laid down in national legislation, either relating to the banking sector or to the other components of the financial system. In terms of the SSMR, NDAs/NCAs that intend to use the macroprudential tools enshrined in the CRR/CRD must consult the ECB via a notification procedure before taking a final decision on their activation. In addition, the ECB can apply higher requirements or more stringent measures aimed at addressing systemic or macroprudential risks within the scope of the tools established in the CRR/CRD if deemed necessary. The SSMFR also requires NDAs/NCAs and the ECB to exchange information as early as possible regarding their identification of systemic risks for the financial system and, where possible, of the details of the macroprudential tools that they intend to apply. The ECB views these arrangements to work well, as this allows both the national and supra-national considerations to be taken into account and also helps counter any possible “inaction bias”.</p> <p>Within the ECB, the coordination between the microprudential and macroprudential perspectives is ensured via the quarterly meetings of the Macroprudential Forum, where the Supervisory Board and the Governing Council members exchange views, share information, and find common positions.</p> <p>Within the EU, the ESRB is responsible for macroprudential oversight of the financial system and for the prevention and mitigation of systemic risk, issuing warnings and recommendations when necessary. Its priorities are decided through an annual bottom-up process drawing from several different elements, including the macroeconomic situation and macroprudential considerations. The General Board of the ESRB is chaired by the President of the ECB, and the Chair of the Supervisory Board is a non-voting member. A representative of the Supervisory Board also participates in the ESRB’s Advisory Technical Committee. This allows for the interaction between the ESRB and the ECB, as well as the NCAs/NDAs, and an exchange of views regarding the issuance of warnings/ recommendations. The ECB supports the ESRB by providing timely information and analysis on the banking sector.</p> <p>The exchange of confidential supervisory information with national macroprudential authorities in the EU/EEA is based on Article 56 of the CRD, and the transmission framework of 2022 has simplified the approval rules for the clearance of transmissions to national macroprudential authorities by empowering managers to transit confidential supervisory information to national macroprudential authorities without recourse to a non-objection procedure with the Governing Council.</p>
3 EC3	<p>Arrangements, whether formal or informal, are in place for cooperation, including analysis and sharing of information and undertaking collaborative work, with relevant foreign supervisors of banks. There is evidence that these arrangements work in practice, where necessary.</p>
Description and findings re EC3	<p>Cooperation via colleges of supervisors is the key tool for the effective supervision of significant banking groups with cross-border operations.</p> <p>Where SIs have subsidiaries outside the euro area, the ECB is the consolidating (home) supervisor and chairs the relevant supervisory college, while the NCAs of the participating</p>

	<p>member states where the parent, subsidiaries, and significant branches are established have the right to participate as observers, as stipulated in the CRD. When the consolidating supervisor is not in the euro area, both the ECB and the NCAs participate in the college as (host) members/observers in line with the rules laid down in the SSMFR.</p> <p>The participation of third-country authorities in EU colleges depends upon the evaluation of the equivalence of the confidentiality regime applicable to them. Under the CRD, the members of the colleges should reach an agreement on this. The ECB relies, as a rule, on the positive evaluation by the EBA of the equivalence of their confidentiality regime to the EU confidentiality regime.</p> <p>When the consolidating supervisor is a third-country authority, the ECB and the NCAs participate in the college as (host) members/observers, in line with the rules in the SSMFR.</p> <p>In addition, each year, the ECB participates in the Trilateral Principal Level Exercise, involving resolution authorities, supervisory authorities, central banks and finance ministries of the United States, the United Kingdom and the banking union. This is a series of regular exercises and exchanges among the principals of these key financial sector authorities to enhance understanding of each jurisdiction's resolution regime for global systemically important banks and to strengthen coordination on cross-border resolution.</p> <p>As the consolidating supervisor in line with the CRD, the ECB has negotiated bank-specific Written Coordination and Cooperation Arrangements (WCCAs) with members and observers of each college to facilitate the exchange of information in normal times and in emergencies within these colleges. The ECB currently participates in 47 supervisory colleges. The College Working Group, an internal group composed of representatives of JSTs is dedicated to coordinating college-related issues.</p> <p>The ECB is empowered by the CRD to enter into administrative arrangements with the supervisory authorities of third-countries, to provide the basis for information exchange and cooperation on matters such as authorization procedures, the establishment of branches and subsidiaries, and the conduct of onsite inspections. The ECB has published around 30 MoUs on the ECB Banking Supervision website, and negotiations are ongoing to conclude supervisory MoUs with various other authorities from third countries.</p> <p>Feedback from the industry and a perusal of the agenda and meeting documents of the colleges suggest that the arrangements are working well, though not all peer jurisdictions are equally forthcoming with information exchanges. Joint work such as on-site inspections is envisaged but rarely undertaken, and the reason provided for this is the pressure on resources and conflicts in schedules.</p>
3 EC4	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.
Description and findings re EC4	The CRD establishes a broad duty of cooperation within the EEA and subjects the staff of competent authorities (and, individually, the persons working on behalf of the authorities,

	<p>such as auditors) to a strict obligation of professional secrecy. For staff of ECB Banking Supervision and members of governance bodies, the confidentiality rule is laid down in the SSMR. The possible uses of confidential information by the receiving authority are limited. In particular, the information may only be used for specified supervisory purposes and exchanged with a number of other institutions only in the discharge of specified purposes.</p> <p>Information sharing with authorities outside the EEA is permitted by the CRD, provided that, under its national law, the receiving authority is subject to a confidentiality duty at least equivalent to that in the EU. Where these requirements are not met, information may be disclosed only in summary or aggregate form or in certain judicial or administrative proceedings where this does not concern third parties involved. In addition, the information shared may be used only for the supervisory tasks of the recipients. The onward sharing of information received from one authority has to be authorized beforehand. The CRD foresees explicitly information exchange with international organizations, such as the IMF and the WB.</p> <p>As mentioned in EC 3, cooperation and exchange of information with third country authorities (e.g. their admission to the colleges of supervisors) depends upon the equivalence of the confidentiality regime to which they are subject, i.e. only if the information disclosed is subject to a guarantee that professional secrecy requirements at least equivalent to those referred to in the CRD are complied with. Such exchange of information should only be for the purpose of performing the supervisory tasks of those authorities or bodies. In this respect, the ECB has declared that it complies with the relevant EBA recommendations identifying those third-country authorities whose regime can be considered equivalent to that under Union law.</p> <p>In the case of third-country authorities not yet deemed by the EBA to have an equivalent confidentiality regime, where legally feasible, the ECB negotiates specific clauses under which, except when disclosure is required under the law, the authority receiving information from the ECB can only share it with third parties with the ECB's consent.</p> <p>Since the Data Protection Regulation for EU institutions, bodies, offices and agencies (EUDPR) applies to the ECB, the transmission of personal data occurs only under the strict conditions of the EUDPR and is outside the scope of supervisory MoUs.</p>
3 EC5	<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 to third parties confidential information received 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) to disclose confidential information in its possession. If the supervisor is legally compelled to disclose confidential information it has received from another supervisor, it 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 EC5	<p>Confidential information received from another authority falls under the professional secrecy provisions described in EC 3 and is covered by relevant Articles in the CRD, the SSMR and the statutes of the Eurosystem of Central Banks (ESCB) and ECB. The CRD stipulates that the supervisory authorities, including the ECB, receiving confidential information can use it only for the performance of their duties and only for certain designated purposes, as set out in Article 54. The SSMR also makes it clear that these restrictions apply to members of the Supervisory Board, staff of the ECB and staff seconded by participating member states carrying out supervisory duties and continue even after their duties have ceased. Further, the ECB is required to ensure that individuals who provide any service, directly or indirectly, permanently or occasionally, related to the discharge of supervisory duties are subject to equivalent professional secrecy requirements.</p> <p>Onward sharing of confidential supervisory information is only permitted in selected circumstances (CRD Articles 55–59). In general, the information originating in another Member State can only be disclosed with the express agreement of the originating authority. Member states may, where permitted by their national laws, authorize the disclosure of certain information to other departments of their central government administrations responsible for law on the supervision of institutions, financial institutions and insurance undertakings and to inspectors acting on behalf of those departments. However, such disclosures may be made only where necessary for reasons of prudential supervision, and prevention and resolution of failing institutions.</p> <p>CRD 6 has called for improving information sharing with tax authorities and makes it possible to disclose confidential supervisory information to tax authorities if it is in accordance with national law and has the agreement of the competent authority in the Member State where the information originates.</p>
3 EC6	Processes are in place for the supervisor to support resolution authorities (eg central banks and finance ministries as appropriate) undertaking recovery and resolution planning and actions.
Description and findings re EC6	<p>The SRB is the primary partner of the ECB for cooperation in crisis management. In turn, it can then involve relevant NRAs according to the SRB-NRA cooperation framework, if necessary. The interaction between the SSM and SRM is structured around three main pillars: the complementary institutional roles of the ECB and the SRB, mutual cooperation, and strong coordination.</p> <p>The MoU between the ECB and SRB covers the cooperation and the exchange of information between the two authorities with respect to all institutions directly supervised by the ECB, as well as all other cross-border groups or entities that fall under the direct responsibility of the SRB. The MoU includes arrangements for cooperation and information exchange in the different phases of supervisory and crisis management activities and also contains provisions regarding communication, knowledge exchange, confidentiality, data protection, and cooperation with regard to non-participating member states and third-country authorities.</p> <p>The SRB has access to relevant supervisory reporting data and recovery plans, which contain useful information for the purpose of resolution planning. In addition, the ECB has granted the SRB shared access to parts of its supervisory information platform. Information sharing</p>

	<p>with the SRB is now automatic once an SI is assigned a certain SREP rating. Information-sharing agreement between the SSM and SRM also include information from the central banking side of the ECB (e.g., Anacredit data).</p> <p>An ECB representative participates, as a permanent observer, in the meetings of executive sessions and plenary sessions of the SRB and is entitled to participate in the debates and has access to all documents. The Chair of the SRB participates as an observer in the meetings of the Supervisory Board for items relating to the tasks and responsibilities of the SRB. ECB banking supervision is responsible for requesting recovery plans from SIs and for their assessment, and it cooperates closely with the SRB in this assessment. The SRB is consulted on the SIs' recovery plans, focusing in particular on assessing whether the recovery plans would be operational in a crisis. The SRB is responsible for resolution planning, the determination of Minimum Requirements for Own Funds and Eligible Liabilities and the assessment of resolvability and cooperates closely with ECB banking supervision in these areas for SIs, including an annual formal consultation.</p> <p>The legislative package on CMDI includes amendments that better clarify the roles of the ECB and SRB in the various stages of recovery and resolution, and the ECB has offered its opinion laying out proposals in keeping with prudential responsibilities that deserve consideration.</p> <p>In the cross-border space, whenever ECB banking supervision acts either as a home or host supervisor of a bank subject to its direct supervision, it participates in resolution colleges. The WCCAs in place for supervisory colleges also include provisions on crisis management. In addition, there are 10 institution-specific cross-border cooperation agreements in place for the Crisis Management Groups (CMGs) of G-SIBs and the ECB has joined/is in the process of joining the Written Arrangements for resolution colleges led by the SRB. MoUs between the ECB, SRB, and the 6 EU non-participating NCAs/NRAs have been concluded in 2024 in accordance with the SRM Regulation.</p>
Assessment of Principle 3	Compliant
Comments	<p>The ECB has an extensive network of cooperation, information sharing and collaboration arrangements with domestic and foreign supervisory authorities that are working well. As on date, the ECB has signed 37 MoUs with third-country authorities within and outside the EEA. In addition, there are now 33 WCCAs in place for supervisory colleges including provisions on for crisis management. It has also joined 17 Written Arrangements for resolution colleges led by the SRB. Opportunities exist for undertaking joint inspections with foreign supervisors as envisaged in the MoUs, entering into a more substantive cooperation agreement with EIOPA and investigating the impediments to information flow from some peer supervisors.</p> <p>The ECB also has dedicated MoUs in place with the SRB to facilitate cooperation and the exchange of information, including the exchange of certain confidential statistical data. In addition, the SRB and the ECB have MoUs in place with the respective national supervisory and resolution authorities of the non-participating member states.</p>

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	
4 EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	<p>The term “bank” is not defined in laws or regulations. Instead, both the CRR and the CRD use 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”.</p> <p>Following the recommendations made in the previous FSAP, this definition has been extended to include investment firms carrying out certain activities as defined in the Annex I to the Markets in Financial Instruments Directive (MIFID) (dealing on their own account and underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis), and which fulfil certain thresholds defined in the CRR.</p>
4 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>Credit institutions (and investment firms that meet the conditions referenced in EC 1) are to be licensed and subject to supervision as banks. Union law defines a “credit institution” 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. Case-law clarified that a credit institution is an entity that take deposit to grant credits – there needs to be a functional link between the deposit business and the credit business. The types of activities that a credit institution can carry out are not exhaustively determined at the EU level, although a credit institution license can only be granted – and is required – if the proposed activities in which the applicant will be engaged fulfil the essential elements of the definition of the credit institution in the CRR.</p> <p>Annex I to the CRD 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 (‘List of activities subject to mutual recognition’). This does not restrict a Member State from allowing credit institutions to perform fewer or other in the same Member State, but in such a case, the additional activities would not be subject to mutual recognition and therefore the credit institution could only carry them out in its home Member State.</p> <p>Different regimes are in place at the national level, but where ‘universal authorization’ regimes are in place, the authorization covers all the activities listed in the CRD Annex I and in accordance with national law. Conversely, where no such ‘universal authorization’ is in place, the authorization is issued on an activity-by-activity basis and only covers the specific activities for which the authorization is granted.</p> <p>The CRD requires 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. National law defines whether a credit institution is allowed to undertake</p>

	<p>activities other than the taking of deposits or other repayable funds from the public and the granting of credits for its own account, including activities 3 to 15 of CRD Annex I.</p> <p>The procedure for authorization to take up the business of a credit institution as entrusted to the ECB and national competent authorities applies to all activities permitted to credit institutions, including activities subject to mutual recognition within the meaning of CRD Annex 1 as well as other regulated activities which under national law require authorization to undertake the business of a credit institution. This also applies if a credit institution, which already has a banking license, plans to undertake a new regulated activity listed in CRD Annex 1 or one that requires an authorization only under national law.</p> <p>This construction is made clear by SSMFR (Article 78(5)), which states 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> <p>Furthermore, the ECB (and competent authorities in general) have the power 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.</p>
4 EC3	<p>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.</p>
Description and findings re EC3	<p>The ECB does not have powers in relation to the restrictive and designated use of the word “bank” that are designed to ensure that the public is not misled. Such restrictions are placed at the national level and the list of prohibited terms varies across member states. As pointed out by the 2018 BCP assessment, in some euro area member states the use of the term “bank” and any derivations by other enterprises may be permitted on a grandfathered basis or if the activities of these enterprises preclude the impression that they conduct banking business. At the same time, there have been cases where the use of the term “bank” or similar by unlicensed institutions was investigated and sanctioned by the NCA, including for a domain name.</p> <p>Further, CRD (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.”</p>
4 EC4	<p>The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.¹⁹</p>

¹⁹ The Committee recognizes the existence of non-bank 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.

Description and findings re EC4	<p>The authority in this regard rests at the level of member states.</p> <p>CRD (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”. These restrictions do not apply to “the taking of deposits or other funds repayable by a Member State, or by a Member State's regional or local authorities, by public international bodies of which one or more member states are members, or to cases expressly covered by national or Union law, provided that those activities are subject to regulations and controls intended to protect depositors and investors.”</p> <p>Also, member states are required to notify the Commission and EBA of any national laws that expressly allow undertakings other than credit institutions to carry out the business of taking deposits and other repayable funds from the public. They may also not exempt credit institutions from the application of the CRD and the CRR. Correspondingly, the ECB is not involved in authorization procedures provided by national law, whereby specific regulated activities are carried out by non-CRR credit institutions since the latter do not fall under the definition of credit institution.</p>
4 EC5	<p>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.</p>
Description and findings re EC5	<p>The CRD tasks the EBA with publishing on its website and updating regularly a list of names of all credit institutions that have been granted authorizations. For this purpose, competent authorities notify every authorization that they make. This information is then made available under the credit institution register, which contains names of all institutions set up in member states, (b) branches of institutions established in EEA countries, and (c) branches of foreign banks. The ECB, on its part, publishes on its website a list of supervised institutions and supervised groups directly supervised by it, as well as a list of entities supervised by the NCAs. The ECB lists are updated based on the decisions taken on authorizations; the withdrawal or lapsing of authorizations; and the decisions amending the significance of institutions regarding the LSIs and SIs.</p>
Assessment of Principle 4	Compliant
Comments	<p>There are classes of credit institutions not authorized or supervised by the ECB (non-CRR credit institutions such as specialized banks and third-country branches). These gaps have partly been addressed by CRD 6. It requires that undertakings established in a third country which seek to provide such core banking services in the Union should at least establish a branch in a Member State and that such branch should be authorized in accordance with Union law unless the undertaking wishes to provide banking services in the Union through a subsidiary. In addition to authorization, it also provides for a more harmonized approach to the regulation of these branches by the member states. Further, in certain conditions, the Member State competent authorities will be able to require these branches to apply for authorization as a subsidiary, which in turn could make them potentially open to the supervision by ECB if they meet the significance threshold.</p> <p>It is also possible that electronic money or payment institutions or e-commerce entities gradually expand their activities in such a way that the line between their activities and those</p>

	of credit institutions gets blurred, and they also fall into the scope of taking deposits or other repayable funds from the public and perform banking activities. While the ECB is keeping a close eye on these developments, it would help if key terms relating to core functions of credit institutions (e.g. 'deposits', 'other repayable funds', 'grant credits' or 'the public') are defined in Union legislation as they are currently not always either defined or harmonized in national laws.
Principle 5	Licensing criteria. ²⁰ The licensing authority has the power to set criteria for licensing banks and to reject applications where the criteria are not met. 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) of the bank and its wider group, its strategic and operating plan, internal controls, risk management and projected financial condition (including capital base). Where the proposed owner or parent organisation is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
5 EC1	The law identifies the authority responsible for granting and withdrawing a banking licence. 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 supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	<p>The SSMR and SSMFR clearly identify the ECB as the ultimate competent authority for the licensing of all credit institutions.</p> <p>In the licensing process NCAs are the entry point for licensing. Although the ECB acts as the ultimate decision maker, this decision is based on the NCA's proposal; in this way, the NCAs' right to be heard is secured. In line with the SSMFR, the NCA assesses compliance with the requirements under national law, while the ECB assesses compliance with relevant Union law. Withdrawals also have a similar decision-making process with a difference of which party initiates the process. In case a withdrawal is initiated by the ECB for an LSI, the ECB has to consult with the NCA concerned. The SSMR requires the ECB and NCAs to be subject to the duty of cooperation in good faith and exchange of information. The assessors observed this strong cooperation between the ECB and the NCAs in their review and their discussions.</p> <p>In the last 5 years, 146 license applications have been received; 23 of them have been withdrawn or cancelled. During the same period, 40 SIs and 48 LSIs' licenses were revoked, withdrawn or surrendered.</p> <p>Regarding third-country branches, NCAs are the competent authority, and the ECB does not have any supervisory power for the licensing and supervision of third-country branches.</p>

²⁰ Reference documents: BCBS, Corporate governance principles for banks, July 2015; BCBS, Shell banks and booking offices, January 2003

	<p>ECB also has an approval procedure for financial holding companies. In the last 5 years, 49 FHCs were notified to the ECB, of which 21 were requests for approval and 28 were requests for exemptions.</p> <p>By default, there are no special supervisory requirements in CRD/CRR for de novo banks and the same regulatory framework applies to all banks. However, the ECB as licensing authority can impose additional conditions on newly licensed banks. The assessors saw licensing files where the ECB imposed specific conditions for licensing and then followed up on these conditions. Licensed banks are monitored by ongoing supervision. Please refer to BCP 5, EC 10 and 11 for further details.</p> <p>The assessors noted the lack any consistent approach across the SSM to supervise newly licensed banks, which are typically riskier than other banks during their first years of operations. The EBA Guidelines on the Authorization of Credit Institutions emphasize the importance of assessing business plans and attention is placed on realistic and plausible growth rate, return and costs, with some specific references to innovative business models are included. However, after a firm has been licensed, there is no specific supervisory approach to new banks (e.g., to ensure that banks invest significantly in developing governance, controls and capabilities in their early years of operation).</p>
5 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 licence was based on false information, the licence can be revoked.</p>
Description and findings re EC2	<p>The CRD defines the minimum criteria for licensing. National authorities transpose these criteria into national laws. Mainly, the criteria are related to the program of operations, structural organization and governance arrangements, initial capital, fit and proper requirements for management and shareholders, absence of close links that may prevent effective supervision and the co-location of the head office and registered office or jurisdiction where business is actually carried out. National laws can set additional criteria as long as they are not assessing the economic need for the bank to exist, which is prohibited under the CRD. Any additional national criteria are verified by the NCAs naturally since licensing is based on the proposal of NCAs' draft proposal.</p> <p>The CRD lays out the information requirements for license applications and stipulates that NCAs can propose to the ECB to grant license only if these criteria are complied with. Both the NCA and the ECB may reject an application for licensing. The ECB may object to the NCA draft proposal to grant an authorization—and thus reject the authorization—where the conditions for authorization set out in relevant EU law are not met. According to SSMFR, both the NCA and the ECB have the right to ask the applicant to provide all relevant information to assess whether the applicant meets the requirements for being licensed as a bank.</p> <p>An RTS pursuant to the CRD details the information to be provided in the application for authorization as a credit institution and the obstacles to effective supervision. An implementing technical standard provides the templates to be used for the provision of such information.</p>

	<p>The power granted to the ECB to revoke an authorization found to have been granted based on false information or other irregular means is set out in the CRD. The same applies to the NCA, in accordance with the relevant national law.</p> <p>Although the ECB needs to apply different national laws for licensing, the effectiveness of the SSM is strengthened by the application of common set of standards. The ECB has published a consolidated version of the Guide to Assessments of License Applications. The harmonization of the supervisory practices across the SSM has been further enhanced following the adoption of the EBA Guideline on a common assessment methodology for granting authorization as a credit institution. In addition to EBA guidelines the ECB has also published a guide to assessments of fintech credit institution license applications where the ECB identifies 'Fintech' as an umbrella term encompassing a wide variety of business models. The purpose of the Guide is to enhance transparency for potential fintech bank applicants and increase their understanding of the procedure and criteria applied by the ECB in its assessment of license applications.</p> <p>Furthermore, to prevent regulatory arbitrage in Recital 16 of the CRD it is noted that "The principles of mutual recognition and home Member State supervision require that member states' competent authorities should refuse or withdraw authorization where factors such as the content of the activities program, the geographical distribution of activities or the activities actually carried out indicate clearly that a credit institution has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within whose territory it carries out or intends to carry out the greater part of its activities."</p>
5 EC3	<p>The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective:</p> <p>(a) supervision on both a solo and a consolidated basis; and</p> <p>(b) implementation of corrective measures in the future.</p> <p>Shell banks must not be licensed.</p>
Description and findings re EC3	<p>Conditions for granting authorization include the CRD Article 13 requirements regarding the fitness and propriety of the management of the institution and the existence of a direct link between the member states where the institution is incorporated and where it is supervised.</p> <p>Authorization to commence the activity of a credit institution should be refused:</p> <ul style="list-style-type: none"> • if, taking into account the need to ensure the sound and prudent management of a credit institution, the licensor is not satisfied with the suitability of the shareholders or members; • where close links exist between the credit institution and other natural or legal persons, authorization should only be granted if those links do not prevent the effective exercise of the supervisory functions; • where the laws, regulations or administrative provisions of a third country governing one or more natural or legal persons with which the credit institution has close links or difficulties involved in the enforcement of those laws, regulations or administrative provisions, prevent the effective exercise of the supervisory functions.

	<p>These conditions have been broadly transposed to national laws implementing CRD. The ECB has been working with the NCAs to overcome assessment gaps and to ensure the suitability of board members through supervisory dialogue with relevant banks.</p> <p>The EBA RTS on the information to be provided for the authorization of credit institutions lists obstacles which may prevent the effective exercise of the supervisory functions of the competent authority, including the nature of close links between the credit institution and other natural or legal persons, such as politically exposed persons, and the nature of interactions with third country authorities, if any, supervising these persons.</p> <p>Developing a complete understanding of the proposed legal, managerial, operational, and ownership structures of the bank, both on a solo and consolidated basis, is an essential component of the licensing process at the ECB and generally also at the NCAs. If impediments exist or arise, the supervisor may take appropriate remedial measures, including withdrawal of the license.</p> <p>Assessors observed that licensing files cover the assessment of shareholders and controllers and the assessment of the structure. The licensing files also included assessments about potential conflicts of interest due to certain intragroup relations.</p> <p>The issue of licensing of shell banks is discussed in CP 13. While there are no legal prohibitions on establishing shell banks, the ECB has laid out its supervisory expectations on this topic, and, as a matter of practice, does not license such banks.</p>
5 EC4	<p>The licensing authority identifies and determines the suitability of the bank's major shareholders²¹ (including the 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.</p>
Description and findings re EC4	<p>CRD Article 14 covers the requirement of the suitability of a bank's major shareholders, including those that can exercise significant influence. The suitability requirements include reputation, knowledge, skills and experience, and financial soundness. Major shareholders include qualifying holdings or, when there are no shareholders with qualifying amounts, the top 20 largest shareholders.</p> <p>The licensing assessment process utilized by the NCAs and ECB requires applicants to identify direct and indirect shareholders. This applies to legal or natural persons who have a qualifying holding amount, which represents 10 percent or more of the capital or voting rights, or allows the holder to exercise significant influence over the management of that undertaking (see CP 6 EC 1). In case of no presence of shareholders with qualifying amounts the 20 largest shareholders must be identified. A background check is conducted, in line with the criteria set out in CRD, both on the suitability and the financial soundness of the shareholders, including a check on the existence of reasonable grounds to suspect that there is a risk for money laundering or terrorist financing, and therefore identifying the sources of initial capital and ensuring transparency of ownership.</p>

²¹ This includes corporate owners of banks, for those countries which allow corporate ownership of banks.

	<p>Commission Delegated Regulation 2022/2580 Article 6 stipulates that license applicants are required to provide an explanation of the available funding sources for own funds and, where available, evidence of the availability of those funding sources, including a summary of the use of private financial resources, including their availability and source.</p> <p>As a matter of supervisory practice, the NCAs and the ECB assess whether the financial soundness of shareholders is sufficient to ensure the sound and prudent operation of the credit institution for the first three years of business, taking into account the capital expected to be readily available once the credit institution commences its activities and the private financial resources of shareholders.</p> <p>Assessors reviewed licensing files where shareholders, ultimate controllers/beneficiary owners were identified and shareholders' suitability, funding sources and financial projects were reviewed.</p>
5 EC5	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC5	The CRD sets a minimum initial capital amount of EUR 5 million, which needs to be held as CET1. For banks licensed before 1979 this amount is 1 million EUR, while any increase in capital which took it above EUR 1 million must be retained as eligible CET1 until EUR 5 million is reached. However, CRD Article 12 (4) allows member states to grant authorization to specific categories of credit institutions the initial capital of which is less than EUR 5 million, but not less than 1 million. On top of the regulatory requirement, NCAs may set additional initial capital amount requirements based on the projected business plan of the applicant. Also, based on the transposition of the CRD, the initial capital amount may be different in member states.
5 EC6	At authorization, the licensing authority evaluates the bank's proposed board members and senior management in terms of their expertise and integrity, availability and time commitment to assume the responsibility, and any potential for conflicts of interest (fit and proper test). The fit and proper criteria include: skills and experience in relevant financial operations commensurate with the intended activities of the bank; and no record of criminal activities or adverse regulatory judgments that make a person unfit to hold important positions in a bank. ²² 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. The supervisor reassesses the suitability of board members in case of significant events (e.g. change of control or major acquisition) or upon receipt of information that impacts their fitness and propriety.
Description and findings re EC6	<p>The CRD lists the expected criteria for members of the management body. The Management body is empowered to set the institution's strategy, objectives, and overall direction, and oversees and monitors management decision-making. These criteria include good repute, sufficient knowledge, skills and experience. Failure to meet these criteria results in the refusal of licensing.</p> <p>The EBA and ESMA have issued Joint Guidelines on the assessment of the suitability of members of the management body and key function holders. The Guidelines specify the</p>

²² Refer to Principle 14 [BCP40.33].

	<p>notion of sufficient time commitment, the notion of adequate individual and collective knowledge, skills and experience; the notions of honesty, integrity and independence of mind with which the members of the management body should comply; the notion of adequate human and financial resources for induction and training; and the notion of diversity which is to be taken into account when recruiting members of the management body. Also, the Guidelines aim to establish harmonized criteria for the assessment of the suitability of the members of the management body and key function holders to ensure sound assessment processes as part of the institution's governance arrangements.</p> <p>The CRD also calls upon the member states to ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interest.</p> <p>Fit and proper assessments are covered in more detail in CP 14.</p> <p>As part of the licensing process, both the NCAs and the ECB carefully evaluate proposed directors with respect to fitness and propriety. The applicant must demonstrate that each prospective member of the management board has sufficient competence, experience and ability to direct the policies of the bank in a safe and sound manner, taking into account the circumstances and the plans of the organization.</p> <p>The ECB has adopted a set of policy stances on fit and proper, which serve as a guide for the suitability assessment conducted by the NCAs and the ECB. They aim to ensure the quality of, and consistency between, the assessments and cover all criteria laid out in the EC. In 2018, these were consolidated in one document and then published as the ECB 'Guide to Fit and Proper Assessments'. Further policy stances have been developed to cover interviews with candidates and the criteria for conditional approvals. With respect to interviews, additionally, a practical manual for conducting fit and proper interviews has been issued by the ECB.</p> <p>The CRD includes situations in which the suitability of board members has to be reassessed, for example, because of a proposed acquisition or when the competent authority has reasonable grounds to suspect that money laundering or terrorist financing is being or has been committed or attempted, or there is increased risk thereof in connection with that institution.</p> <p>Assessors observed in the licensing files they reviewed that board and executive management (reviewed files included key function holders – assessment is not required in all member states) are assessed in terms of their reputation, experience, education, potential conflict of interest, criminal background, or adverse judgements about them.</p> <p>The ECB relies on the national authorities for the collection of criminal background and AML related information. National laws may have different deadlines for providing such information and this may create certain challenges for the ECB. In this case, the ECB to increase the efficiency of its process benefits from the early information profiling phase.</p>
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5 EC7	<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 activities²³ 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.</p>
Description and findings re EC7	<p>The CRD provides that member states should 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. The Commission Delegated Regulation (EU) 2022/2580 sets out the content of the program, which should contain detailed information on the proposed business plan and include, at a minimum, information on structural organization, financial plans and forecasts, arrangements for governance, risk management, internal control, outsourcing and audit, IT structure and business continuity as well as remuneration, ICT and AML/CFT policies.</p> <p>The Regulation further states that the licensing application should include in its business plan a program of operations for at least the first three years, which should include, on a base case and stress scenario basis, information on planned business and the structural organization of the applicant credit institution. The program of operations should include an overview of the geographical distribution of activities, an explanation of viability, an overview of target markets, segments, products, services, delivery channels, an overview of all likely business and regulatory risks and the monitoring and control approach, an implementation plan for the period until fully operational, and an overview of overall strategy.</p> <p>Assessors observed in the licensing application files where applicants provide structural organization, internal governance policies, program of operations, projections and plans.</p>

²³ Refer to Principle 29 [BCP40.66].

5 EC8	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 EC8	<p>Applications for authorization must be accompanied by a range of information on the financial situation of the institution. Commission Delegated Regulation 2022/2580 details the financial information to be provided by the applicant. This includes forecast information on the applicant credit institution with a base case and stress scenario basis, including forecast accounting plans for the first three years (forecasted balance sheets, P&L accounts, cash flow), planning assumptions for the forecasts, forecasts of own fund and liquidity requirements funding profile and diversification; internal liquidity adequacy assessment; and an outline of any indebtedness incurred or expected to be incurred prior to commencement of its activities as a credit institution.</p> <p>According to the CRD, competent authorities should refuse authorization to commence the activity of a credit institution if the suitability of the shareholders fails to comply with conditions laid out in the directive which includes their financial soundness.</p>
5 EC9	In the case of foreign banks establishing a branch or subsidiary, before issuing a licence, 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 practises global consolidated supervision and uses this information to inform its approach to licensing and supervision.
Description and findings re EC9	<p>Branches of credit institutions already established in the EU/EEA member states, do not require authorization as they have access to “passporting” throughout the Single Market. However, the credit institution must notify the home supervisor, who has a right to oppose if they have a reason to doubt the adequacy of the administrative structure or the financial situation of the credit institution, taking into account the activities envisaged. If the home supervisor has no objection, it should communicate this information to the host supervisor and inform the credit institution.</p> <p>Regarding the opening of branches of credit institutions established in third-countries (outside of EU/EEA member states), the NCAs, and not the ECB, are the competent authority for supervision and licensing.</p> <p>Regarding the statement of non-objection:</p> <p>When it is implemented, CRD 6 will require that competent authorities should endeavor to conclude administrative agreements or other arrangements with relevant third-country competent authorities before a third-country branch commences its activities in the relevant Member State. However, it is worth noting that this requirement will not apply where third-country branches are subject to stricter national requirements. This is questionable as an effective supervisory relationship should always be initiated regardless of the national requirements that apply to the third-country branch. The CRD further provides that the supervisory authority of the ultimate parent undertaking in the third country should have been notified of and provided with the application to establish a branch in the Member State before activity commences. In addition, the competent authority should be able to</p>

	<p>access all the necessary information on the head undertaking from the supervisory authorities of that parent undertaking and to effectively coordinate its supervisory activities with those of the third country's supervisory authorities, in particular in periods of crisis or financial distress affecting the parent undertaking, its group or the third country's financial system.</p> <p>For the licensing of subsidiaries of credit institutions authorized in the EU/EEA Member State, the CRD requires the host authority to consult the home supervisor before granting any license. The "non-objection rule" is not, however, explicitly stated in the CRD.</p> <p>For the licensing of a subsidiary or a branch of third-country credit institutions, CRD calls for cooperation with the third-country authorities. However, despite recent amendments, it still does not mention an explicit "non-objection" requirement for licensing. Instead, it expects that the cooperation agreements will provide the information exchange both ways necessary for the supervision of parent undertakings in the third countries or necessary for supervision on the basis of consolidated financial situations in the member states. The Commission delegated regulation 2022/2580 requires the applicant to provide a certificate of good standing or equivalent from the third country authority in which its head office is located, but this in itself is not a "No Objection". Assessors saw examples in the licensing application packages of such certificates.</p> <p>Regarding global consolidation:</p> <p>To comply with this EC, the ECB, as host supervisor of the applicant should assess whether the home supervisor practices global consolidated supervision. The CRD requires that in the case of an institution which is not subject to consolidated supervision under the Intermediate EU Parent Undertaking (IPU) regime, the competent authority should assess whether the institution is subject to an EU equivalent consolidated supervision by the third-country supervisory authority. This approach raises two issues. First, ECB staff indicated to the assessors that the ECB is facing difficulties in assessing the consolidation supervision regime of the third countries, and no detailed assessments of third countries' regime with CRD consolidated regulatory regime have been conducted by the EBA and EU Commission. Second, the establishment of an IPU in the EU does not exonerate the ECB under this EC to verify that an institution is subject to global consolidated supervision by the home authority. Indeed, in the case of an international bank with operations in multiple jurisdictions, including but not only in the EU, an IPU would only ensure sub-consolidation from a group-wide perspective while global consolidated supervision is required under this EC.</p> <p>Regarding the licensing of third-country branches:</p> <p>The last FSAP recommended that branches exceeding a certain size should be licensed and supervised by the ECB. While CRD 6 brings important changes for the licensing of branches of third-country banks and banking groups providing banking services, supervision of major third-country branches by the SSM is not included.</p>
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	<p>According to CRD 6 third-country branches are to be subject to authorization based on a minimum criterion depending on their categorization as Class 1 and Class 2. Class 1 branches are either larger than 5 billion EUR asset size, collect deposits more than 5 percent of their total liabilities in a member state, or are not defined as qualifying branches. Class 2 branches are all other branches which includes qualifying branches. Qualifying branches are the ones of which the head undertaking is in a country where prudential standards and supervisory oversight equivalent to EU are applied, and the regulatory authority is subject to equivalent confidentiality requirements laid down in CRD and the country is not listed as a high-risk third country for AML/CFT.</p> <p>The authorization criteria are differentiated for Class 1 and Class 2 branches. Although these criteria bring strong controls, they are not as stringent as the licensing criteria for banks unless they meet certain conditions and thresholds.</p> <p>CRD 6 harmonizes the regulation of third-country branches in several key areas (authorization requirement, capital endowment requirement, liquidity requirements, internal governance and risk management, reporting obligations). In addition, the authorization will limit the third country branch's activities to the Member State where it is established and expressly prohibit cross-border services into other member states.</p> <p>CRD 6 also opens the possibility for the NCA to require that, where a branch is reaching certain threshold based on asset size in the EU (EUR 40 billion) or in the member state (EUR 10 billion) or is being assessed as systemic, the competent authority may, but is not obliged to, require the establishment of a subsidiary. Even if this option is exercised, the newly authorized subsidiary will not automatically fall under direct ECB supervision unless the relevant criteria for being a significant institution are fulfilled.</p> <p>Further, if in a member state, there is a branch of a third country bank and all branches of that bank in the EU have EUR 40 billion or more in assets, the competent authority supervising this branch can assess the systemic importance while consulting the EBA and informing other competent authorities where the same third country group has branches and subsidiaries. Although the competent authorities are expected to reach a consensus on the assessment, there is no certainty that this will be the case. In the absence of consensus, each competent authority could make use of the powers under the CRD (i.e., if the total assets of the branch they supervise are equal to or greater than EUR 10 billion). It is therefore possible that the competent authorities could reach different conclusions for different branches belonging to the same third-country group even though the objective of the consultation procedure is to avoid such an outcome. The process of converting large branches into subsidiaries is rather complicated and led by NCAs, without any possibility for the ECB to influence the outcome. There is a likelihood that there may be large branches in a member state which are comparable to licensed banks of the same country. These large branches would not be supervised by the ECB and not subject to the same requirements. After the implementation of CRD 6, the recommendation of the previous FSAP may not be fully met even with the CRD 6 provisions.</p>
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	<p>Currently, there is also limited information available at the EU or EA level on the type and importance of activities of third country branches, as well as on the risks taken and their booking models. CRD 6 will significantly improve the exchange of information between the competent authority responsible for the supervision of a subsidiary (i.e., the ECB in the case of an SI) and the supervisor of a third-country branch (i.e., an NCA). Under CRD 6 Article 48, Class 1 third-country branches will indeed be subject to the supervision of a college of supervisors that will be established where a third-country group has Class 1 third-country branches in more than one Member State but no subsidiary institutions in the EU, and where the third-country group has class 1 third-country branches in more than one Member State or at least one Class 1 third-country branch, and one or more subsidiary institutions in the EU. In addition, where a college of supervisors has already been established in relation to the subsidiary institutions of a third-country group, the class 1 third-country branches of the same group will be included within the scope of that college. The college of supervisors will “prepare a report on the structure and activities of the third-country group in the Union and update that report on an annual basis; and exchange information on the results of the supervisory review and evaluation process. Moreover, competent authorities will notify EBA with (a) all authorizations granted to third-country branches and any subsequent changes to such authorizations, (b) the total assets and liabilities booked by the authorized third-country branches, as periodically reported; and (c) the name of the third-country group to which an authorized third-country branch belongs. However, the ECB will not have access to relevant information if a third country group only has branches in the euro area and/or no college of supervisors has been established.</p>
5 EC10	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 the supervisory requirements outlined in the licence approval are being met.
Description and findings re EC10	<p>Once a new credit institution is authorized, its ongoing supervision if it is an SI is conducted by the relevant JST (see CP 9). The supervisory evaluation program (SEP) determines the minimum set of activities that JSTs are required to perform, as well as any additional activities needed to address the particular characteristics of the institution. In principle, these characteristics would be expected to include the newness of the institution, but there are no specific requirements in the SSM Supervisory Manual on this point.</p> <p>If there are conditions attached to the authorization of the credit institution, monitoring in the case of SIs is entrusted to the relevant JST and is carried out as part of ongoing supervision; if the conditions are based on national law, monitoring is entrusted to the relevant NCA in coordination with the JST. There are also specific conditions attached to the authorization of the credit institution that until they are implemented, the authorization decision is not effective. These conditions refer to the licensing criteria and are assessed and decided by the licensing authority (the Authorization Division of the ECB) and not by the ongoing supervision.</p>
5 EC11	The criteria for issuing licences are consistent with those applied in ongoing supervision. The supervisor determines that banks continue to comply with the applicable criteria once they are licensed.
Description and findings re EC11	The CRD requires withdrawal of authorization if the credit institution no longer fulfills the conditions under which authorization was granted. Thus, authorization conditions then become naturally part of the conditions to be monitored during on-going supervision. To

	this end, the ECB focuses on applicant banks' capital levels, their program of operations, structural organization and the suitability of their managers and relevant shareholders, as well as AML/CFT considerations as part of ongoing supervision.
Assessment of Principle 5	Largely Compliant
Comments	<p>EU legal provisions set out clear criteria for licensing and empower the ECB for licensing and withdrawal of licenses of new credit institutions and state clear criteria for licensing. Licensing applications are made to the national authorities of the member states first, and their assessments are sent to the ECB for approval. Licensing criteria based on the national legislations are also applicable in the licensing process of the SSM. The application of different national legislations in the licensing process adds an extra layer of complexity for the ECB. Guidance has been published on various aspects of the authorization process to support consistency in the assessment during the licensing phase. This includes EBA and ESMA joint guidelines on the assessment of the suitability of members of the management body and key function holders; ECB guide on assessments of license applications of credit institutions as well as for fintech credit institutions; and a guide to fit and proper assessments. In the last 5 years the ECB assessed 146 license applications.</p> <p>The ECB is not the licensing authority for third-country branches. The 2018 FSAP had recommended that euro area branches of third-country banking groups exceeding a certain threshold should be authorized and supervised by the ECB. Although CRD 6 brings important changes for the licensing of branches of third-country banks and banking groups providing banking services and harmonizes the regulation of third-country branches in several key areas (capital endowment requirement, liquidity requirements, internal governance and risk management), third-country branches will remain licensed and supervised by NCAs outside the SSM unless they are converted into subsidiaries and considered to be SIs. However, the process requiring the establishment of subsidiaries is rather complicated and led by NCAs, without any possibility for the ECB to influence the outcome. There is a likelihood that there may be large branches in a member state comparable to licensed banks in the same country, as explained under EC 9. Thus, even after the implementation of CRD 6, the recommendation of the previous FSAP may not be fully met. There is also limited information available at the EU or EA level on the type and importance of activities of these branches, as well as on the risks taken and their booking models. CRD 6 will significantly improve the exchange of information between the competent authority responsible for the supervision of a subsidiary (i.e., the ECB in the case of an SI) and the supervisor of a third-country branch (i.e., an NCA), but the ECB will not have access to relevant information if a third country group only has one branch in the euro area and/or no college of supervisors has been established.</p> <p>In the case of foreign banks establishing a branch or subsidiary, before issuing a license, there is no requirement that the host supervisor obtains a non-objection (or a statement of non-objection) from the home supervisor before issuing a license. EU regulatory framework requires a consultation with the foreign authority, but it is not a precondition to license the bank. Assessors were informed that an ITS is being drafted where a no objection statement will be made mandatory.</p>

	Regarding licensing applications of subsidiaries of third-country banks, the ECB face challenges in assessing whether third-country authority applies global consolidated supervision where no supervisory equivalence assessment of that third country's supervisory and regulatory framework has been conducted by the EBA and the EU Commission.
Principle 6	Transfer of significant ownership. ²⁴ The supervisor ²⁵ 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	
6 EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest".
Description and findings re EC1	<p>Under the CRR, 'qualifying holding' is defined as a direct or indirect holding in an undertaking which i) represents 10 percent or more of the capital or of the votes or ii) makes it possible to exercise a "significant influence" over the management of that undertaking. A qualifying holding includes a controlling interest. "Control" is defined in the CRR as the relationship between a parent undertaking and a subsidiary, as defined in the Accounting Directive, or the accounting standards to which an institution is subject, or a similar relationship between any natural or legal person and an undertaking. Under the Accounting Directive Article 22, control over another undertaking (subsidiary) arises, inter alia, where the parent undertaking holds the majority of voting rights, has right to appoint or remove the majority of board members, has the right to exercise dominant influence, is a shareholder of an undertaking and has appointed the majority of the board members during the financial year and the preceding one or controls a majority of voting rights jointly with other shareholders via an agreement. Control may also arise indirectly as well.</p> <p>Although the qualifying holding definition is made with reference to "significant influence", significant influence is not defined in CRR. However, EBA/ESMA/EIOPA joint guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector (JC/GL/2016/01) provide clarifications. To assess whether significant influence may be exercised, the target supervisor should take several factors into account, including the ownership structure of the target undertaking and the actual level of involvement of the proposed acquirer in the management of the target undertaking.</p> <p>The assessors reviewed files where the ownership changed due to significant influence, including an example of transfer of significant ownership and suspension of voting rights related to acting in concert, which is also a concept defined in the Joint Guidelines.</p> <p>The Joint Guidelines also clarify the identification of indirect acquisition of a qualifying holding and size of such indirectly acquired holding by a methodology based on the "control criterion" and "multiplication criterion." When a change occurs, the competent authority first tests the control criterion by which the indirect acquirer of qualifying holding is identified, which includes the ultimate natural person or persons at the top of the</p>

²⁴ Reference documents: BCBS, Parallel-owned banking structures, January 2003; BCBS, Shell banks and booking offices, January 2003.

²⁵ 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.

	<p>corporate control chain. If, from the application of such criterion, it is ascertained that the relevant person (or legal entity) does not exert or acquire, directly or indirectly, control over an existing holder or an acquirer of a qualifying holding in a target undertaking, the multiplication criterion should be subsequently applied in respect of that person. Such criterion entails the multiplication of the percentages of the holdings across the corporate chain, starting from the participation held directly in the target undertaking, which has to be multiplied by the participation held at the level immediately above (the result of such multiplication being the size of the indirect holding of the latter person) and continuing up the corporate chain for so long as the result of the multiplication continues to be 10 percent or more.</p> <p>The ECB has published its Guide on qualifying holding procedures, which aims at clarifying the supervisory approach taken by NCAs and the ECB in the assessment of qualifying holding procedures. The Guide also describes the definitions and concepts stated above. In addition, the Guide covers (i) the scope of the persons required to undergo an assessment (ii) how the assessment criteria are applied and (iii) further guidance on some of the key documentation required in the assessment of qualifying holding procedures.</p>
6 EC2	There are requirements to obtain supervisory approval or provide immediate notification with respect to proposed changes that would result in a change in ownership (including beneficial ownership), to the exercise of voting rights over a particular threshold or to a change in controlling interest.
Description and findings re EC2	<p>The CRD devotes a chapter to describing notification and assessment of proposed acquisitions, assessment criteria, cooperation between competent authorities, notification in the case of a divestiture, information obligations and penalties and criteria for qualifying holdings. The proposed acquirer/s has to indicate the size of the intended holdings and the relevant information, as specified in the CRD. In determining whether the criteria for a qualifying holding are fulfilled, the voting rights referred to in Directive 2004/109/EC and the conditions regarding aggregation set out in the same Directive should be considered.</p> <p>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 10 percent, 20 percent, 30 percent or one-third or 50 percent or so that the credit institution would become its subsidiary or the holdings enables the exercise of significant influence, need to be notified to the national competent authority. If the competent authorities decide to oppose the proposed acquisition, they should, within two working days of completion of the assessment, and not exceeding the assessment period, inform the proposed acquirer in writing, providing the reasons. If a holding is acquired despite opposition by the competent authorities, national legislation should provide either for the exercise of the corresponding voting rights to be suspended, or for the nullity of votes cast or for the possibility of their annulment regardless of any other penalty to be adopted. Under CRD Article 22(8), member states shall not impose requirements for notification to, or approval by, the competent authorities of direct or indirect acquisitions of voting rights or capital that are more stringent than those set out in this Directive.</p>

	<p>Conditional acquisitions bear the risk of being assessed after the acquisition has occurred, as the conversion might occur automatically without offering the proposed acquirer sufficient time to submit notification of the acquisition beforehand. In such cases, a notification should be submitted as soon as it can be expected that the acquisition will take place or, if not possible, immediately after the acquisition has taken place.</p> <p>According to the SSMR, the ECB is the exclusive competent agency to assess acquisitions and increases of qualifying holdings in credit institutions in the member states participating in the SSM, so this competence is applicable to both SIs and LSIs. The competence is exercised in close alignment with the NCAs, where NCAs serve as the entry points for notifications. SSMR Article 15 and SSMFR Articles 85-87 clarify the procedure that NCAs and ECB have to follow for the assessment of proposed acquisitions.</p> <p>When assessing acquisitions and increases of qualifying holdings in the member states participating in the SSM, the ECB must apply the SSMR and relevant national legislations transposing the CRD. The EU Level 1 legislation does not define certain key concepts, such as indirect holding, acting in concert and significant influence. Such concepts are clarified in Joint Guidelines. Most EA member states comply or intend to comply with the Joint Guidelines.</p>
6 EC3	<p>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 with 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.</p>
Description and findings re EC3	<p>CRD Article 23 sets the criteria to assess the likely effect of a proposed acquisition on the prudent management of a credit institution and the financial soundness of the proposed acquirer. The criteria consist of (1) the reputation of the proposed acquirer, (2) the fitness and propriety of any new managers to be appointed to the target, (3) the financial capacity, soundness and sustainability of the proposed acquirer, (4) the ability of the target to comply with the applicable prudential requirements and (5) suspicion/commitment of money laundering or terrorist financing activities related to the proposed acquisition. The economic needs of the market cannot be used to reject an application by the authorities. The Joint Guidelines further detail the supervisory practices on how to assess these five criteria. The competent authorities may oppose the proposed acquisition only if there are reasonable grounds for doing so on the basis of these criteria. If a holding is acquired despite opposition by the competent authorities, national legislation should provide either for the exercise of the corresponding voting rights to be suspended, for the nullity of votes cast, or for the possibility of their annulment regardless of any other penalty to be adopted.</p> <p>In the articles of the CRD related to qualifying holdings there is no explicit statement regarding measures to be taken in case the applications are approved based on false information provided by the acquirer. The response in such a case will depend on national legislation and may require the suspension of voting rights, adopting sanctions and subsequent disposal of the qualifying holding on the basis of the lack of integrity of the shareholder. In case of acquisition through false statements and if a shareholder is</p>

<p>unsuitable, the ECB can as last resort and if proportionate withdraw the authorization of the bank in line with Article 18 CRD.</p> <p>The Joint Guidelines also provide a list of supervisory practices on how to assess in detail the applicant(s) following the five criteria. For specific types of acquirers, some stringent approaches for the assessment are applied. For example, for acquirers such as private equity funds, hedge funds, sovereign funds, large non-banking groups, and acquirers from third countries, emphasis is given to the assessment of the impact of the intended acquisition of the credit institution. This is to ensure that the credit institution is not put under stress because (part of) the acquisition was financed by debt, which needs to be repaid by the credit institution. Where applicable, the ECB strives to prevent the proposed acquirer from financing the acquisition through any immediate asset or capital outflow from the targeted credit institution. Depending on the circumstances, it may also require commitments by the proposed acquirer as to the minimum holding period of the participation and the absence of dividend distribution during a reasonable period following the acquisition and/or the provision of additional funding on demand. Furthermore, a dedicated analysis of the specific acquirers' corporate governance is required. Where relevant, the acquirer could be required for supervisory purposes (subject to the principle of proportionality) to simplify the holding chain by limiting the number of intermediary levels, their localization, and the sharing of economic and legal rights. Where applicable, a sufficient number of members of the supervisory board of the target credit institution (ideally 50 percent) should be independent of the specific acquirer.</p> <p>The ECB also provides guidance on its supervisory approach with its guide on qualifying holding procedures.</p> <p>In addition to approving every qualifying holding (where the acquisition of a participation in a bank that represents 10 percent or more of the shares and or voting rights in that bank, or allows the holder to exercise significant influence over the management of that undertaking), the ECB exercises specific powers in the case of mergers of SIs supervised by the ECB in accordance with national law. The role of the ECB in reviewing mergers and acquisitions is dependent on the type of transaction the banks themselves choose. The ECB has a formal role if the transaction between banks implies an acquisition of a qualifying holding, as required under this EC, or the creation of a new bank, or if the merger involves significant banks and the law in their country gives the power to approve mergers to the supervisor.</p> <p>There have been few examples of cross-border mergers and acquisitions in the euro area. While noting that there may be obstacles to cross-border integration embedded in the European regulatory system (for example, the lack of a common deposit guarantee scheme, and the imposition of capital and liquidity requirements at a solo level), the SSM has developed a clear policy line on banking consolidation. Its prudential mandate is neither to assess whether consolidation efforts are beneficial nor to push for particular types of transactions but to make sure that the resulting business combination complies with prudential requirements and ensures effective and prudent risk management — an approach in line with the BCP. The ECB published a guide on the supervisory approach to</p>

	<p>banking consolidation, clarifying that cross-border mergers within the euro area would not be treated differently from domestic mergers. National concerns may still play a role given the composition of the SSM's Supervisory Board, which has the final say with regard to these matters.</p> <p>Until CRD 6, the ECB's involvement in a merger is dependent on the law of the country or countries where the merging banks are headquartered. In several member states, the national supervisor has the power to approve mergers or is involved in the approval process when the final decision rests with another authority which may follow other legitimate objectives (competition, consumer protection, etc.). CRD 6 introduces a harmonized EU regime for bank mergers. Under CRD 6, banking mergers will be subject to approval by the competent authority responsible for the entity resulting from such an operation (i.e., the ECB in the case of an SI). It remains to be seen if and how national legislations will coexist with the EU regime for bank mergers. When the final decision rests with several authorities, it is not clear how the various views would be reconciled in cases where the analysis of the ECB may diverge from the assessments submitted by other authorities.</p> <p>There would be a benefit in clarifying how the existing national provisions will coexist with the newly introduced harmonized EU-wide framework for banking mergers to ensure that prudential considerations are not subordinated to other factors in decisions on mergers and acquisitions. In any case, the ECB as the competent prudential authority independently assesses mergers based on its mandate and the applicable legal requirements.</p>
6 EC4	<p>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.</p>
Description and findings re EC4	<p>According to the AML Directive (Directive (EU) 2015/849), there is an obligation for all companies in the EU to "obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held".</p> <p>According to CRD, credit institutions trading on a regulated market should, at least annually, inform the competent authorities of the names of shareholders and members possessing qualifying holdings and the sizes of such holdings as shown, for example, by the information received at the annual general meetings of shareholders and members or as a result of compliance with the regulations relating to companies admitted to trading on a regulated market. In general, credit institutions are required to inform the authority upon becoming aware of acquisitions or disposals of holdings in their capital which cause the holdings to exceed or fall below a relevant threshold. Not all details will necessarily be covered, however. For instance, depending on the applicable national law, there is not always a requirement for the identification of the ultimate beneficial owners. However, in case of a qualifying holding acquisition the Joint Guidelines provide that "the identity of all persons who may be considered to be beneficial owners of the legal person" should be provided.</p> <p>Although CRD Article 26(1) has a requirement for annually informing the competent authority about shareholders and qualifying holdings for banks traded on a regulated market, it does not fully satisfy this EC as it does not cover all banks. The ECB can still</p>

	request this type of information from all banks – listed and non-listed- based on Article 10 SSMR. However, the assessors did not find evidence that ECB collects the information required by the EC (e.g., through periodic reporting or on-site examinations).
6 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	<p>The CRD requires member states to either apply administrative sanctions or suspension of voting rights as measures depending on the case but stays silent about reversing or modification of a change of control.</p> <p>The CRD envisages that in the case of acquisitions undertaken despite opposition by the competent authorities, national legislation should provide, regardless of any other penalty to be adopted, either for the exercise of the corresponding voting rights to be suspended, for the nullity of votes cast, or for the possibility of their annulment.</p> <p>Where the influence exercised by the acquirer of the qualifying holding is likely to operate to the detriment of the prudent and sound management of the institution, the competent authorities should take appropriate measures to put an end to that situation. These measures may consist of injunctions, penalties against members of the management body and managers, or the suspension of the exercise of the voting rights attached to the shares held by the shareholders or members of the credit institution in question.</p> <p>Further, the CRD stipulates that member states should ensure that their laws, regulations and administrative provisions provide for administrative penalties and other administrative measures at least in respect of, amongst other matters, 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 EC 2 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 CRD Article 22(1).</p> <p>Depending on the national laws and the reasoning for the transfer of qualifying holding, the use of the supervisory measures is considered on a case-by-case basis. For example, where an acquisition occurs as a result of a testament (inheritance) an ex-ante notification is not possible, and the ECB, together with the NCA, takes circumstances such as this into account when deciding on follow-up action.</p> <p>All SSM member states' national legal frameworks make provisions for the suspension of voting rights, and many also include prohibitions/limitations on the use of capital rights. According to the ECB, an unauthorized acquisition in itself is enough for a suspension of voting rights to take place in 19 member states while 8 member states have a legal framework that foresees an automatic suspension of voting rights. The ECB also noted that suspension of voting rights of non-supervised entities is somewhat limited in some jurisdictions, some legal frameworks do not foresee the possibility to suspend the voting</p>

	<p>rights of indirect shareholders (only 17 of 21 SSM participating member states) and that very few NCAs have experience with the suspension of voting rights of indirect shareholders.</p> <p>A number of national legal frameworks (20 out of 21) provide for administrative sanctions and/or pecuniary measures against acquirers who do not notify an acquisition or acquire without the necessary approval.</p> <p>However, the EU framework does not require the transfer of ownership to be void or reversed if this transfer is done without notifying the authority or receiving the authorization. This power is available in some member states through national legislations. In only half of the member states, national frameworks provide provisions allowing for an unwinding of the transaction, where possible, or a forced divestment in cases where an acquirer has not fulfilled notification requirements and/or has acquired without prior approval. The ECB is of the view that unwinding a transaction may sometimes prove difficult in cases where the seller no longer exists or cannot reasonably be required to have the shares returned.</p> <p>The assessors reviewed files of the ECB related to cases where qualifying ownership was transferred without notification of the authority, and the voting rights were then suspended by the authority. The assessors consider that the suspension of voting rights is a powerful tool, but it also has intrinsic limitations as a bank may still be vulnerable due to the presence of an unauthorized shareholder (i.e., substantial reputational risk, the shareholder may gain financial benefit from its unapproved ownership through dividend distributions, it may be able to influence nomination on executive management). In addition, in instances in which a new shareholder following a change in control is not suitable – and would not have been considered suitable had it been assessed at the licensing stage, there is an inconsistency in terms of the supervisors' powers, as compared with powers at point of licensing.</p>
6 EC6	Laws, 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	There are no specific requirements in the CRR or CRD for credit institutions to notify the supervisor as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder or a party that has a controlling interest. Some national frameworks like Latvia, Netherlands require such notification, but there is no EU-level requirement.
Assessment of Principle 6	Largely Compliant
Comments	The SSMR empowers the ECB as the exclusive competent authority to assess acquisitions and increases of qualifying holdings in credit institutions in the euro area. The ECB executes its competence in cooperation with the NCAs, who are the entry points for notifications received through the IMAS portal. The SSMR clearly defines the allocation of duties and processes. Between 2019 and 2023, 479 qualifying holding procedures were completed. In this process, the ECB applies all relevant EU laws and national transpositions of directives if needed. The approval process is supported with Joint EBA and ESMA Guidelines. The ECB has also published a guide to clarify the supervisory approach taken by NCAs and the ECB in the assessment of qualifying holding procedures.

	<p>In some cases, the ECB needs to rely on the national legislations for its supervision, but national laws do not always meet the BCP criteria. For example, not all member states have reporting requirements for the notification of supervisors as soon as they become aware of any material information that may negatively affect the suitability of a major shareholder or a party that has a controlling interest. The last FSAP recommended that the ECB confirm its supervisory expectation that credit institutions notify their JST as soon as they become aware of any such material information, but this has not been implemented.</p> <p>The assessors observed that there are cases where the transfer of ownership has been realized without notification or the authorization of the ECB. EU legislation does not require reversal or modification of transfers when it takes place without necessary notification to, or approval from, the supervisor, or where the approval of the change in ownership was based on false information. In such instances, the ECB may apply administrative sanctions or the suspension of voting rights in accordance with EU laws. The assessors are of the view that suspending voting rights has intrinsic limitations as a bank may still be vulnerable due to the presence of an unauthorized shareholder, including substantial reputational risk.</p> <p>Although the CRD has a requirement for annually informing the competent authority about shareholders and qualifying holdings for banks traded on a regulated market, this requirement does not, by definition, cover all banks. Besides, the assessors were not shown documents that reflected that such information was being systematically collected by the JSTs.</p>
Principle 7	Major acquisitions. The supervisor has the power to: (i) 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 (including the establishment of cross-border operations), against prescribed criteria; and (ii) determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
7 EC1	<p>Laws or regulations clearly define:</p> <ul style="list-style-type: none"> (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	<p>Until the transposition and implementation of CRD 6 is completed across EU member states, a patchwork of legal provisions governs acquisitions of different types of targets by an EU credit institution.</p> <ul style="list-style-type: none"> a. EU Banks: The acquisition (or increase) of qualifying holdings in a credit institution is governed by the CRD*. These provisions set out approval and notification requirements established by reference to the proportion of capital of the target undertaking that would be acquired (or increased). The acquirer must notify the competent authority of the target institution in writing, indicating the size of the holding and other relevant information.

- b. EU investment firms and EU insurance undertakings: Under Directive 2014/65/EU (MiFID II) and Directive 2009/138/EC (Solvency II), the acquirers of a qualifying holding in an investment firm or in an insurance undertaking need to notify their intention to the authority responsible for the supervision of investment firms or insurance undertakings.

Subsequently the authorities responsible for the supervision of the target entities (credit institution, investment insurance firm, or insurance firm) need to consult the competent banking supervisor, if the acquirer is a credit institution or the parent undertaking of a credit institution. Thus, the ECB is consulted if the acquirer is a significant institution.

*The acquisition or increase of qualifying holdings (Article 22 of CRD 5) in a credit institution by another credit institution, or by any natural or legal person is distinct from the acquisition of a material holding which now has been introduced by CRD 6 (Article 27a). Qualifying holdings assess the impact on the target institution, whereas the material acquisitions assess the impact on the acquirer. Acquisition of a material holding is not regulated in the currently applicable CRD (CRD 5) and is introduced by CRD 6.

- c. Non-banks (in the EU or outside) or non-EU banks: The acquisition by a bank of holdings in a non-bank (other than an EU investment firm and an EU insurance company listed under item b. above) or a bank outside the EU is not covered by the currently applicable version of the CRR or CRD (and EU legislative framework in general). However, where supervisory powers have been granted under national legislation in the home jurisdiction of an SI, the ECB can exercise supervisory powers.

Such powers in most of SSM jurisdictions consist of either an explicit prior approval requirement of the proposed transaction by the supervisor or the possibility for the supervisor to object to the proposed transaction within a specific period of time from the notification of that transaction by the significant supervised entity to the ECB. In these cases, the relevant SI cannot go ahead with the transaction without the ECB's approval. In other cases (Germany and Portugal) the national law only stipulates a simple notification requirement to the supervisor. This means that SIs established in these countries must only notify the ECB, however, the ECB cannot object to the proposed transaction ex ante based on national law, as no such approval power exists under national law. Even in such a case – and also in cases where there is not even a notification requirement under national law – the ECB may impose supervisory measures under the provisions of the SSMR in the context of its ongoing supervision should the transaction raise supervisory concerns. An absence of a notification requirement under national law could, however, affect the feasibility and efficacy of such a response.

While approval powers are included in most SSM jurisdictions, the range of acquisitions subject to supervisory approval under national laws is far from covering

	<p>all acquisitions in non-banks and in the non-EU banking sector. For example, in France, the competent authority can only object to the acquisition of holdings in insurance firms outside the EEA. In Spain, the authorities can only object to the acquisition of holdings in non-EU banks.</p> <p>It is worth noting that acquisitions by a bank in an undertaking outside the financial sector (i.e., not a financial sector entity) or an undertaking that does not carry on activities which are considered as a direct extension of banking, ancillary to banking or leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, are subject to a specific prudential treatment in accordance with the CRR and ECB Regulation 2016/445. If the significant ownership in the nominal capital exceeds 15 percent of the eligible capital of the acquiring institution or if the total amount of such significant ownerships held by the institution exceeds 60 percent of the eligible capital (Tier 1 plus Tier 2 limited to 1/3 of Tier 1) of the institution, any acquisition above the 15 percent threshold or the sum of such acquisitions that exceed 60 percent of eligible capital will be subject to a risk weight of 1,250 percent. As an alternative to applying a 1,250 percent risk weight to the amounts in excess of these limits, institutions may deduct those amounts from Common Equity Tier 1 items.</p> <p>CRD 6 introduces major changes and grants to competent authorities the power to assess the acquisition or divestiture of material holdings in financial or non-financial sector entities. Institutions, financial holding companies and mixed financial holding companies (the "acquirer") will be required to notify their competent authority in advance where they intend to acquire, directly or indirectly, a material holding (the "proposed acquisition"). A holding shall be deemed material where it is equal to or more than 15 percent of the eligible capital of the proposed acquirer.</p>
7 EC2	Laws or regulations provide criteria by which to judge individual bank proposals for acquisitions and investments.
Description and findings re EC2	<p>Prior to CRD 6, procedures and criteria to assess acquisitions and investments rest at the national level.</p> <p>If the bank acquires another bank or supervised institution established in the EU, a qualifying holding procedure (as described in CP 6) will be conducted by the competent authority of the target bank. The authorization of such an acquisition or increase of a qualifying holding in a bank is set out in the CRD, as are the criteria for assessing this acquisition or increase of a qualifying holding. The assessment is to be made by the competent authority of the target entity and should consider the suitability of the acquirer and the financial soundness of the proposed acquisition. These criteria are further clarified in the EBA/ESMA/EIOPA Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector, though these are mainly from the perspective of the target institution.</p> <p>For acquisitions of holdings in non-banks or banks outside the EU, national law prevails and , and the ECB exercises such powers insofar as they are provided under national law.</p> <p>Under CRD 6, all acquisitions exceeding a certain threshold (as per the definition of a material holding prescribed therein) will be subject to a notification and assessment</p>

	<p>procedure (as noted in EC 1). In particular, institutions, financial holding companies and mixed financial holding companies (the "acquirer") will be required to notify their competent authority in advance where they intend to acquire, directly or indirectly, a material holding. A holding should be deemed material where it is equal to or more than 15 percent of the eligible capital of the proposed acquirer. If the proposed acquisition concerns a qualifying holding in a credit institution as referred to in Article 22(1), the acquirer should also be subject to the notification requirement and the assessment under those rules of the CRD (acquisition of qualifying holdings in credit institutions). This will align provisions related to the acquisition of a qualifying holding in a credit institution with provisions on the acquisition of a material holding by an institution in case both assessments must be undertaken for the same operation.</p> <p>In dealing with the notification of the proposed acquisition, the competent authorities should assess the prospect for sound and prudent management of the proposed acquirer after the acquisition and, in particular, of the risks to which the acquirer is or might be exposed after the proposed acquisition, in accordance with the following criteria: (i) whether the acquirer will be able to comply and continue to comply with the prudential requirements set out in the CRD and CRR, and where applicable, other Union legal acts and (ii) whether there are reasonable grounds to suspect that, in connection with the proposed acquisition, money laundering or terrorist financing within the meaning of AML Directive (AMLD) is being or has been committed or attempted, or that the proposed acquisition could increase the risk thereof. Notably, the competent authorities may oppose the proposed acquisition only if there are reasonable grounds for doing so based on these criteria or if the information provided by the acquirer remains incomplete. A negative opinion by the authorities responsible for supervising the proposed acquirer in accordance with AMLD received by the competent authorities within 30 working days of the initial request, shall be duly taken into consideration by the competent authorities when assessing the proposed acquisition and may constitute a reasonable ground for opposition.</p> <p>In the past, some differences in implementation of EU directives have been observed across member states (see CP 1, EC 1). At the end of the FSAP mission, an assessment as to whether the full set of supervisory powers and assessment criteria under CRD 6 have been transposed in all jurisdictions was not available. The status will be known only closer to the application date of the revised CRD. Member states will have to transpose at least the common set of legal requirements for assessing acquisitions of material holdings.</p> <p>A point to note is that this EC references both acquisitions and investments, whereas the CRD text refers to acquisitions of holdings. The EBA has a mandate to develop a common methodology to assess acquisitions of material holding. The EBA indicated the assessors that the RTS currently under preparation will cover all acquisitions, whether for financial or for strategic purposes, but the assessors have not reviewed the draft RTS (consultation on the draft is expected around mid-2025).</p>
7 EC3	The supervisor determines that any new acquisitions and investments will not expose the bank to undue risks or hinder effective supervision, and (where appropriate) that they will

	not hinder effective implementation of corrective measures in the future. ²⁶ 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. In making this assessment, the supervisor considers the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	<p>The ECB determines that new acquisitions and investments made by a supervised entity do not expose it to undue risks as part of its ongoing supervision.</p> <p>The ECB's ability to object to or prohibit acquisitions by a bank of holdings in non-banks or a non-EU bank before the transaction takes place depends on the extent to which such powers are available to it under national law of the SSM jurisdictions. If such power exists for the supervisor (i.e. to approve or raise objection to the transaction ex ante) under national law, these national laws may also provide explicit assessment criteria for the supervisor, which reflect the letter or spirit of the requirements in this EC. The ECB then has to apply these assessment criteria for SIs. If however no specific assessment criteria are provided by the law, the ECB assesses the proposed transaction from the perspective of whether that transaction jeopardizes the sound and prudent management of the entity (as a generic 'fallback' criterion).</p> <p>Even in cases where national law does not grant power to the supervisory to prohibit or object to the transaction in advance, the ECB could impose a supervisory measure in the context of its ongoing supervision based on Article 16 of the SSMR.</p> <p>As mentioned in EC 2, under CRD 6, competent authorities will have the ability to oppose acquisitions of material holdings if they jeopardize effective supervision at consolidated level.</p>
7 EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organisational resources to manage the acquisition/investment.
Description and findings re EC4	<p>Currently, there is no specific requirement for the assessment of the adequacy of the financial, managerial or organizational resources of the acquiring bank prior to it making an acquisition outside the financial sector. The risks are managed through the 15 percent limit of investment in a non-financial sector entity as set out in CRR.</p> <p>As regards acquisitions by a bank of holdings in non-banks or a non-EU bank, as explained in EC 1, there is no uniform requirement or limit as the ECB applies different legal frameworks as national powers. In the SSM jurisdictions where such national power exists, the criteria that the competent supervisor needs to assess in respect of the acquisition are stipulated by national law. Spanish law, for example, requires that certain major acquisitions are assessed by the competent authority, taking into consideration financial position, management capacity and effective supervision. If the national law does not provide for specific criteria, the generic criterion that the transaction should not jeopardize the sound and prudent management of the bank would be considered.</p>

²⁶ The supervisor may consider whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

	<p>In addition, the ECB has also communicated to SIs that it needs to be aware of transactions that materially affect the risk profile of an institution in order to assess them prior to completion of the transaction. In this assessment, the ECB seeks to obtain a comprehensive view of the impact of the transaction on the overall risk profile of the institution, including but not limited to capital, liquidity, governance and organizational aspects. The impact of acquisitions will also figure in the SREPs following such transactions and may lead to setting new requirements in the SREP decision.</p> <p>Further, where the ECB is of the view that a transaction would negatively affect the institution, it can take measures under the SSMR, including capital and liquidity add-ons, governance and organizational reinforcements and even require divestment of activities that pose excessive risk provided if certain preconditions are fulfilled. The ECB expects that the possibility of imposing such measures would be a clear incentive for institutions to work with the ECB in advance of the conclusion of a transaction to avoid having to unwind the transaction.</p> <p>Under CRD 6, acquisitions by banks exceeding a certain threshold (as per the definition of a material holding) will be subject to a uniform notification and assessment procedure. As mentioned in EC 2, the competent authorities should assess the prospect for sound and prudent management of the proposed acquirer after the acquisition and, in particular, of the risks to which the acquirer is or might be exposed after the proposed acquisition</p>
7 EC5	The supervisor is aware of the risks that non-banking activities can pose to a bank and can act to mitigate those risks. The supervisor considers the bank's ability to manage these risks before permitting investment in non-banking activities.
Description and findings re EC5	<p>The ECB is aware of the risks posed by non-banking activities to a supervised entity group, and this is covered in the ongoing supervision. It has the means to take actions to mitigate these risks, including the power under the SSMR 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 and to require the reduction of the risk inherent in the activities, products and systems of institutions. However, it may be limited in its ability to take timely action in the case of the acquisition of non-banks by a supervised entity, depending on whether the national laws require pre-notification and assessment of the acquisition and detail the criteria to do so.</p> <p>Under CRD 6, all acquisitions by banks exceeding a certain threshold that meets the definition of a material holding will be subject to a uniform notification and assessment procedure. This will facilitate the ECB in making an assessment of the proposed transaction in a uniform manner while also considering the ability of the bank to manage non-banking risks in accordance with the applicable regulatory provisions.</p>
7 EC6	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. Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.

Description and findings re EC6	<p>Although there is no explicit stipulation in this regard, the ECB expects to review major acquisitions by other entities in the banking group to determine that they do not expose the bank to undue risks or hinder effective supervision as part of its ongoing supervision. It also expects to take available supervisory measures, qualitative and quantitative, to address its findings in this regard. Where the ECB is aware of a transaction in advance of its closing in line with the supervisory expectation described in EC4, it will also consider whether the bank can ensure effective implementation of corrective measures in the future.</p> <p>The ECB is aware of the risks that such transactions can pose to a banking group. Any undue risks are assessed as part of the SREP, and the qualitative and quantitative supervisory measures available to it under the SSMR may be taken to mitigate such risks. Where the ECB is aware of a transaction in advance of its closing in line with the supervisory expectation described in EC4, it will also consider whether the bank can ensure effective implementation of corrective measures in the future. As stated in EC 1, for acquisitions of holdings in non-banks or a non-EU bank, the ECB may exercise such powers in respect of significant institutions to the extent those are available to it under national law.</p>
Assessment of Principle 7	Materially Non-Compliant
Comments	<p>The intent of the principle is that all supervised entities should notify the supervisor of the intent to undertake a material acquisition or investment in another entity, domestic or cross-border, and the supervisor should have the ability to review, approve or reject a proposal for a material acquisition or investment that could pose an undue risk or hinder effective supervision. As was pointed out in the 2018 assessment, the regulatory requirements and supervisory powers vary depending on the nature of the target institution and its location and apply more for the target institution than the acquiring one. At the Union level, they cover only holdings in EU banks and holdings in the non-bank financial sector in general. In the case of EU banks, the current regime aims primarily at the supervisor of the target entity. For non-banks in general and for banks outside the EU, the ECB can intervene ex ante of the transactions only when such powers exist in national laws of the SSM country where the bank is established. Until CRD 6 is implemented, national approaches differ and at present range from simple prior notification to prior approval requirement before the transaction takes place. Importantly, where specific approval powers are available under national legislations, the range of acquisitions subject to supervisory approval is far from covering all material acquisitions in non-banks and in the non-EU banking sector as required under CP 7. Despite these challenges, the ECB has on occasion used its general supervisory powers to address risks arising from acquisitions, and the assessors reviewed cases where the execution and integration risks arising from material acquisitions were address ex-post through enhanced P2R add-ons.</p> <p>CRD 6 will bring about significant changes and grant competent authorities (thus the ECB, for SIs) the power to assess the acquisition or divestiture of material holdings in both financial or non-financial sector entities in keeping with the requirements of this principle. It aligns definition of materiality for banks as acquiring entities with those for banks as target entities and introduces notification, assessment and approval requirements. Full compliance with CP 7 will depend on how the directive is ultimately transposed into national laws that allow for supervisory powers to be used in a consistent manner across member states; till then</p>

	existing national laws will prevail. While the ECB can encourage banks to follow the new requirements in the transition period, this cannot be enforced. This is the main driver of the grade given to this CP. Still, this is a significant step towards compliance with the BCP. As the RTS are drawn up, it will be important to see that all open issues, including definitions, thresholds, approval and reporting requirements, are spelt out. A point to note is that Basel references both acquisitions and investments, whereas the CRD text refers to acquisitions of holdings – the RTS should align this with the Basel text to ensure that it does not fall short.
Principle 8	Supervisory approach. ²⁷ An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks, 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 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	
8 EC1	<p>The supervisor uses a well-defined methodology and processes to determine and assess on an ongoing basis the nature, impact and scope of the risks which banks:</p> <ul style="list-style-type: none"> (a) are exposed to; and (b) present to the safety and soundness of the banking system (including implications for and interlinkages with financial system stability). <p>The methodology and processes address (among other things): banks' group structure (including risks posed by entities in the wider group); risks around banks' business models, including business model sustainability;²⁸ banks' risk profile with a forward-looking view;²⁹ their internal control environment; and their resolvability. The methodology permits relevant comparisons between banks, and the nature, frequency and intensity of supervision reflect the outcome of this analysis.</p>
Description and findings re EC1	<p>The EBA Guidelines set out a standard methodology (The Supervisory Review and Evaluation Process) to provide a comprehensive, forward-looking view of banks' risk profile and overall viability. The SREP has four elements:</p> <ul style="list-style-type: none"> a) Element 1: Business Model Analysis and profitability assessment; b) Element 2: Internal Governance and risk management assessment; c) Element 3: an assessment of risks to capital by risk type; and d) Element 4: an assessment of risks to liquidity by risk type. <p>Within the SSM, the SREP Process consists of:</p> <ul style="list-style-type: none"> a) an assessment by supervisors;

²⁷ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Principles for the effective management and supervision of climate-related financial risks, June 2022; BCBS, Frameworks for early supervisory intervention, March 2018; BCBS, Sound Practices: implications of fintech developments for banks and bank supervisors, February 2018; BCBS, Guidelines for identifying and dealing with weak banks, July 2015; [SRP10], [SRP20], [SCO50].

²⁸ The ultimate responsibility for designing and implementing sustainable business strategies lies with a bank's board.

²⁹ The time horizon for establishing a forward-looking view should appropriately reflect climate-related financial risks and emerging risks as needed.

	<p>b) a benchmarking against suitable comparator banks; and</p> <p>c) a decision-making step and communication of a preliminary assessment—"the supervisory dialogue"—will first be undertaken before being finalized by the Supervisory Board.</p> <p>The assessment of each element of the four elements is performed in three phases: supervisors gather data from the bank (Phase 1); production of an automated preliminary anchoring score for the risk level and a formal compliance check for risk control (Phase 2); and supervisors carry out a more thorough risk assessment, taking into account supervisory judgements regarding the specificities of the bank (Phase 3).</p> <p>The framework is fully articulated. Internal SREP guidance is very comprehensive, and a version has been published. The goal of the SREP for the SSM has been to establish a level playing field, which explains the significant effort put into the benchmarking exercise.</p> <p>However, the comprehensiveness comes at a cost in terms of the resource burden on the SSM and the length of time the process takes—it is virtually continuous.</p> <p>The SSM acknowledges that the SREP needs to adapt to reduce the administrative burden, a view corroborated by a Wise Persons report in 2023. The change will be gradual. The first significant change is introducing some optionality for supervisors to determine the periodicity with which they review components of the four elements. This means that some areas of a bank's risk profile will move from an annual assessment to, say, a tri-annual one. Benchmarking and data-supported risk assessment will continue. This Multi-Year Approach will initially release resources as areas move from an annual frequency to something longer before settling down when the full roll-out is complete. The hope is to reduce the length of time the SREP process takes to nine months. The consequence of this timeline would be that the supervisory dialogue can take place in June/July rather than September.</p> <p>The Multi-Year Approach marks a significant break for the SSM towards a more risk-based approach. It remains to be seen how much further the SSM will need to go to deliver the efficiency savings it seeks.</p> <p>The SREP process and its benchmarking phase primarily compare banks. The SSM uses various approaches to compare, such as business model clustering, and it goes to great lengths to ensure that comparators are valid.</p> <p>The assessors reviewed several documents related to the SREP process and its outputs. The assessors noted that the standard deviation of SREP scores was reducing and that the mean of that distribution was increasing. Furthermore, the assessors noted a distinct asymmetrical pattern in the movement of SREP scores. One hypothesis for this asymmetry was the propensity to quickly reflect perceptions of an increase in a bank's risk profile but a greater level of caution (perhaps to give time to gather evidence) to reduce the risk.</p>
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	Finally, the assessors noted that the SREP's typical timeline for risk management is one to three years, which is incompatible with some climate—or nature-related risks. The assessors understand that the EBA is reflecting on this point.
8 EC2	The supervisor, in conjunction with relevant authorities where appropriate, uses a process to assess and identify which banks are systemically important in a domestic context. Supervisors publicly disclose information that provides an outline of the process employed to assess and determine systemic importance. The supervisor conducts these assessments sufficiently regularly to ensure they reflect the current state of the domestic financial system.
Description and findings re EC2	<p>The SSMFR sets out the legal framework.</p> <p>The ECB Banking Supervision is responsible for supervising SIs in the euro area. A significance assessment determines which institutions will be subject to ECB Banking Supervision each year.</p> <p>There is some complexity surrounding with whose initiative an assessment rests (i.e. between the ECB and an NCA).</p> <p>There are three main criteria for the determination of significance outlined in the chart below.</p> <pre> graph TD Q1{Is Bank one of the three largest in Member State?} -- Yes --> S1[SIGNIFICANT] Q1 -- No --> Q2{Are Total Assets >€5bn} Q2 -- Yes --> Q3{Are Total Assets/GDP >20%} Q2 -- No --> Q4{Are Total Assets >€30bn} Q3 -- Yes --> S1 Q3 -- No --> Q4 Q4 -- Yes --> S1 Q4 -- No --> Q5{Is cross-border activity significant?} Q5 -- Yes --> S1 Q5 -- No --> S2[NOT SIGNIFICANT] </pre> <p>Additionally, the NCA can request a review if, in their view, the bank meets a national economic importance test or if the ECB believes a bank is significant for the economy of the European Union.</p>

	<p>Currently, 113 institutions are designated as significant and supervised by the ECB. The NCAs supervise over 2,000 LSIs. The important institutions comprise over 80 percent of the banking assets in the Eurozone.</p> <p>The assessors noted that changes to the number of institutions designated as significant do not change much each year. Still, given that the criteria for significance are mostly in nominal terms, there will be a gradual increase in the proportion of firms classified as significant. In addition, this is also likely to increase the heterogeneity of business models supervised by the ECB, which in turn makes benchmarking difficult.</p> <p>Five Financial Market Infrastructures (FMIs) which include CCP and CSD have a banking license in the euro area. These FMIs are all considered LSI and supervised by NCAs. One FMI has met the size criterion to be considered a SI but has continued to be classified as LSI owing to particular circumstances, as provided for under Article 6(4) of the SSM Regulation. These firms are globally systemic FMIs. Any disruption in their activities would have large spillovers for global financial markets and carry reputational risks for national and European regulatory authorities. An important safeguard is the consistency of supervisory approach to avoid regulatory arbitrage opportunities within the euro area, that could have consequences for the euro area and beyond. One option would be for a single regulator, such as the ECB, like many other central banks, to take over the direct supervision of these FMIs. Exercising direct supervision would, however, have some drawbacks given the existing synergies at national level between FMIs oversight and prudential supervision of FMIs with a banking license (which, in some NCAs, may be conducted in the same department). Alternatively, the ECB's oversight of the supervision of FMI classified as LSI could be strengthened, including through benchmarking and harmonizing the approach to calibrating Pillar 2 requirements. This would also help achieve more consistency and ensure a level playing field.</p>
8 EC3	The supervisor assesses banks' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	The assessment of the banks' and banking groups' compliance with prudential regulations and other legal requirements is made regularly in the context of the SREP. In particular, for each relevant risk category, there is an assessment of the compliance with the applicable laws and regulations covering own funds requirements, securitization, large exposure limits, liquidity, leverage, reporting and public disclosure of information on those matters, 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 (ICAAPs), including Internal Ratings Based models.
8 EC4	The supervisor considers the macroeconomic environment, climate-related financial risks and emerging risks in its risk assessment of banks. The supervisor also considers cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	The macroeconomic, regulatory, and operating environment of supervised institutions are considered in prudential supervision through the strategic planning exercise and the SREP (See CP 9 EC 2). The ECB, has, in particular, been at the forefront of the supervisory issues relating to climate change and biodiversity loss.

	<p>The assessors were shown some good examples of broader issues being included in the assessment of individual banks. The assessors also saw an internal audit report outlining challenges in incorporating the macroeconomic perspective into the SREP.</p> <p>Of course, a wider range of issues being brought to individual supervisors does present a prioritization challenge, particularly where resources are limited. On the whole, the assessors saw evidence that this was well managed, but there were some examples of crowding out.</p>
8 EC5	<p>The supervisor, in conjunction with other relevant authorities, identifies, monitors and assesses:</p> <ul style="list-style-type: none"> (a) the build-up and transmission of risks, trends and concentrations within and across the banking system as a whole; (b) any emerging or system-wide risks which could impact banks and the banking system as a whole; and (c) common behaviours by banks (e.g. procyclical actions), interlinkages and interconnections that may adversely affect the stability of the banking system, including implications for financial system stability. <p>The supervisor incorporates this analysis into its assessment of banks and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks to other relevant authorities with responsibilities for financial system stability.</p>
Description and findings re EC5	<p>The SSM carries out detailed risk identification, seeking a holistic picture of risks. This builds upon analysis from NCAs, other EU authorities, and international bodies.</p> <p>Assessors reviewed several of this process's outputs, which we considered to be of high quality.</p>
8 EC6	<p>Drawing on information provided by the bank and other domestic authorities, 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, banks to adopt appropriate measures, where necessary, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures consider their effect on the soundness and stability of the bank's ongoing business.</p>
Description and findings re EC6	<p>The CRD, BRRD, SSMR, and SRMR form the Level 1 framework.</p> <p>The crisis management framework of ECB Banking Supervision covers several phases depending on the specific situation of the bank. It ranges from day-to-day risk management in business-as-usual times (ongoing supervision) to bank-specific risk identification (through the Emergency Action Plan (EAP), failing or likely to fail preparations and involvement in resolution decisions. However, during the resolution process, the main decision-makers are the resolution authorities (i.e. the SRB and the NRAs). Within this context, the ECB Banking Supervision plays an advisory role and cooperates with NRAs/SRB on any necessary follow-up actions.</p>

	<p>Cooperation between the ECB and SRB is underpinned by an appropriate legal framework, which is complemented by specific procedures for consultation, information sharing, notification, and cooperation between the SRB and ECB for early intervention measures, recovery and resolution plans, resolvability assessment and addressing resolvability impediments, setting of own funds and eligible liabilities (MREL) requirements, and resolution initiation. EU requirements for resolution plans and the assessment of resolvability are described in EBA technical standards. In 2020, the SRB published further guidance on how it assesses resolvability in its "Expectations for Banks", setting out the specific principles on which it assesses seven dimensions of resolvability. The SRB has since continued to publish guidance on specific topics, such as operational continuity and liquidity in resolution. SRB publishes an annual resolvability report including information on its assessment of banks' progress in aggregate towards meeting the SRB's expectations, and its priorities for future work, but there is little disclosure from the SRB or banks themselves on bank-specific issues, in part due to confidentiality restrictions. The SRB has powers to require banks to remove substantive impediments to resolvability, but has rarely used these, as during the initial implementation phase of these expectations most impediments were common across a large number of banks and were addressed through sector-wide guidance and communication. In the steady-state phase, more impediments are likely to be bank-specific, requiring greater use of these powers.</p>
8 EC7	<p>The supervisor has a clear framework or process (e.g. identification of risk and early intervention) for handling banks in the build-up to and during 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>Supervision assesses recovery plans annually and also monitors a bank's current risks. If a bank's financial position deteriorates, supervisors determine the appropriate strategy. This could include Early Intervention measures (if BRRD conditions are fulfilled) (see CP 11 for further details). If the SREP scores meet specific criteria or if supervisors judge that such an assessment is necessary, they conduct it in conjunction with the annual SREP assessment.</p> <p>An EAP includes the operational steps and escalation framework for crisis management and crisis mitigation for SIs. It is part of a broader crisis management framework set out by the SSM Supervisory Manual.</p> <p>The ECB will also make use of the supervisory college framework.</p> <p>Cooperation with the SRB escalates as the situation moves through the stages.</p> <p>Supervisors follow a specific decision-making procedure. This procedure respects the EU Treaty rules governing decision-making within the ECB, which assigns decision-making powers exclusively to the Governing Council and the Executive Board. Under this procedure, one of the ECB's Supervisory Board tasks is to propose 'complete draft decisions' to the Governing Council. Note that the Supervisory Board cannot make legally binding ECB decisions on its own initiative, nor can decision-making powers be delegated to it. In case of emergencies, the Chair of the Supervisory Board convenes a meeting in time to make the necessary decisions, as appropriate, also via teleconferencing/videoconferencing as a derogation from the general rules.</p>

	<p>The Supervisory Board meeting is convened in person, via video/conference call, or through written procedure for swift decision-making. The Supervisory Board is responsible for assessing all proposals for complete draft decisions submitted for approval through the Directorates-General and deciding on the final proposal to be transmitted to the Governing Council. Then, the decision is adopted by the Governing Council in a physical meeting, via conference call, or through written procedure. The Governing Council is the relevant ECB decision-making body with a limited role for the Executive Board. The Governing Council cannot amend draft decisions; they only approve or object to them. Approval can also occur tacitly in that complete draft decisions proposed to the Governing Council are adopted where it does not object within a defined period (“non-objection procedure”).</p> <p>The assessors welcomed the focus on timely decision-making. Assessors were able to view some of the good-quality outputs of the SSM’s Early Warning System.</p> <p>The assessors noted that crisis procedures are largely framed in the context of a single firm’s idiosyncratic failure and may not be suitable in situations where several firms are impacted simultaneously—for example, in an operational resilience or cyber situation.</p>
8 EC8	Where the supervisor becomes aware of banks restructuring their activities to avoid regulatory perimeter, the supervisor takes appropriate steps to address this. 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 to address regulatory arbitrage.
Description and findings re EC8	<p>The SSMR sets the Level 1 Framework.</p> <p>Where supervisors become aware of bank-like activities being performed wholly or partially outside the regulatory perimeter or of banks restructuring their activities to avoid the regulatory perimeter, they are expected to take appropriate steps to draw the matter to the attention of the responsible authority.</p> <p>The assessors did not see any examples of this taking place in practice nor any internal guidance on this matter.</p>
Assessment of Principle 8	Largely Compliant
Comments	<p>In their own words, the SSM applies a highly intensive supervisory approach. They substantially achieve this. In addition, in its ten years of existence, the SSM has not strayed far from delivering against the mandate it was given at its creation to raise the quality of supervision across the euro area and to level the playing field. It has achieved that mandate. It has a highly codified and transparent supervisory approach with extensive input from the SSM and broader on the risks to individual banks and the system as a whole. This is done through regular communications on the supervisory approach and the main supervisory expectations. It carries out extensive benchmarking to ensure consistency.</p> <p>The cost of this approach is that it is resource-intensive and can be burdensome and challenging to be agile.</p>

	<p>The SSM acknowledges that the SREP needs to adapt to reduce the administrative burden, a view corroborated by a Wise Persons report in 2023. The change will be gradual. The first significant change introduced some optionality for supervisors to determine the periodicity with which they review components of the four elements. This means that some areas of a bank's risk profile will move from an annual assessment to, say, a tri-annual one. Benchmarking and data-supported risk assessment will continue as of now. This Multi-Year Approach will initially release resources as areas move from an annual frequency to something longer before settling down when the full roll-out is complete. The hope is to reduce the length of time the SREP process takes to 9 months. The consequence of this timeline would be that the supervisory dialogue can take place in June/July rather than September.</p> <p>The Multi-Year Approach marks a significant break for the SSM towards a more risk-based approach. It remains to be seen how much further the SSM will need to go to deliver the efficiency savings it seeks. Changes to the Fit and Proper assessments and internal model approval could be further streamlined and made even more risk-focused, perhaps by making a distinction between plain vanilla cases and more complex cases. The SREP process and its benchmarking phase primarily compare banks. The SSM uses various approaches to compare, such as business model clustering, and it goes to great lengths to ensure that comparators are valid. It remains to be seen whether the benchmarking process itself will have to be reduced in order to strike the right balance between assessment/analysis on the one hand and internal benchmarking/controls on the other.</p> <p>Notwithstanding the heavy workload of the SSM, it was notable that they have managed to innovate and, in some cases, provide thought leadership on important issues for supervision. They have committed substantial resources to move the dial on the supervisory risks related to climate change and biodiversity loss.</p> <p>Assessors reviewed several documents related to the SREP process and its outputs. The assessors noted that the standard deviation of SREP scores was reducing and that the mean of that distribution was increasing. Furthermore, the assessors noted a distinct asymmetrical pattern in the movement of SREP scores. One hypothesis for this asymmetry was the propensity to quickly reflect perceptions of an increase in a bank's risk profile but a greater level of caution (perhaps to give time to gather evidence) to reduce the risk.</p>
Principle 9	Supervisory techniques and tools. ³⁰ The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, considering the risk profile and systemic importance of banks.
Essential criteria	
9 EC1	The supervisor employs an appropriate mix of on-site and off-site supervision to evaluate the condition of banks, their risk profile, their 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

³⁰ Reference document: BCBS, High-level considerations on proportionality, July 2022.

	<p>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.</p>
Description and findings re EC1	<p>The CRD, SSMR and EBA Guidelines on the SREP set the framework.</p> <p>The SSM employs a variety of supervisory tools, including on-site and off-site work. Compared with peers, the SSM probably uses on-site inspection more. The SREP process (see CP 8 EC 1) determines supervisory priorities. It contributes to the Supervisory Examination Programme (SEP) conducted for each bank, with the aim of setting a proportionate response to the bank's risks. In addition, the SSM will carry out thematic inspections as part of campaigns.</p> <p>The SSM also has a dedicated horizontal supervision function that performs benchmarking and industry-wide assessments.</p> <p>Both offsite and onsite work are comprehensively laid out in the SSM Manual.</p> <p>Assessors reviewed several outputs from the on-site inspections, horizontal work, and other off-site work. These were high-quality and very detailed. In most cases, key messages were highlighted, and the assessors saw some excellent examples of extending the lessons learned into training material for wider SSM staff.</p> <p>The assessors noted challenges in staffing some inspections and reviews, a point also raised in a report by the EU Court of Auditors.</p> <p>The assessors also saw some instances of overlap between horizontal and inspection resources in terms of areas covered.</p>
9 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 there is effective coordination and information-sharing between the on-site and off-site functions.</p>
Description and findings re EC2	<p>The strategic planning process follows the principles laid down in the SSM Risk Management Framework. According to this framework, supervisory priorities are defined annually and cover a three-year time horizon. They consist of a set of prioritized vulnerabilities, associated strategic objectives, and a High-Level Work Program, which together reflect the strategy the SSM intends to follow to address the main risks to the banks.</p> <p>Planning is lengthy and complex to reflect a variety of inputs and interests.</p> <p>The assessors noted that the planning process was intense on the demand side, i.e., deriving priorities and considering a bottom-up and top-down assessment of risks. However, this demand view sometimes becomes disconnected from the supply side of the plan, i.e., resourcing. This is not easy, but if successful, it should lead to fewer inspection cancellations and less resource overstretch.</p>
9 EC3	<p>The supervisor uses a range of information to regularly review and assess the safety and soundness of banks and the stability of the banking system, the evaluation of material risks,</p>

	and the identification of necessary corrective and supervisory actions. This includes information such as prudential reports, statistical returns, information on a bank's related entities and publicly available information. The information received on banks is used by supervisors to form a holistic view and understanding of their risk profile. The supervisor determines that information provided by banks is reliable ³¹ and obtains, as necessary, additional information on banks and their related entities.
Description and findings re EC3	<p>Supervisory assessments are performed based on a wide range of information sources, from a quantitative and qualitative nature. Quantitative data are of particular importance to the SSM as they assist with consistency and comparability. Key sources of quantitative information include:</p> <ul style="list-style-type: none"> a) risk indicators based on financial reporting (FINREP) and common reporting (COREP) data (available on a consolidated level since mid-2014); b) risk indicators from sources other than FINREP/COREP (e.g. from the ECB Short term – STE – data collection exercise); c) indicators on economic and market conditions (GDP, sector NPL, market volatility, etc.); d) other regulatory data, not harmonized (central credit register, etc.); e) a bank's internal estimates (ICAAP, Internal Liquidity Adequacy Assessment Process (ILAAP), stress tests, internal reports); f) financial statements, Pillar 3; g) peer group indicators; h) supervisory stress test results; and i) market views (external ratings, investors' quantitative analyses, etc.). <p>Qualitative information is also necessary for identifying weaknesses and includes:</p> <ul style="list-style-type: none"> a) supervisory findings (on-site inspection reports, meeting reports, etc.); b) institutions' internal documents (ICAAPs/ILAAPs, financial statements, board memos, organizational charts, internal audit reports, whistle-blower reports etc.); and c) business and risk management reports (dashboards, limit reports, etc.) <p>reports on the environment in which they operate (risk trends, new areas of focus, analysts' reports, rating agencies' reports, equity analyst recommendations, news, etc.)</p>
9 EC4	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the stability of the banking system, including:</p> <ul style="list-style-type: none"> (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) analysis of corporate governance, including risk management and internal control systems; (e) reviews of the outcome of stress tests undertaken by the banks; and

³¹ Refer to Principle 10 [BCP40.23].

	<p>(f) assessments of the adequacy of banks' capital and liquidity levels under adverse economic scenarios, which may include conducting supervisory stress tests on individual banks or on a system-wide basis.</p> <p>The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p>The CRD and CRR provide the Level 1 Framework.</p> <p>The SREP process (see CP 8 EC 1) provides the backbone of the supervisory process and covers the elements of this EC.</p>
9 EC5	<p>Based on the information provided by banks and its own analysis, the supervisor communicates its findings to banks as appropriate and requires them to take action to mitigate any particular vulnerabilities that have the potential to affect their safety and soundness or the stability of the banking system (including implications for and interlinkages with financial system stability).</p>
Description and findings re EC5	<p>Supervisory activities detect weaknesses, which leads to the application of supervisory measures directed at banks to remediate those weaknesses. Measures are typically recommendations, adopted through so-called operational letters and requirements, legal decisions taken by the ECB Supervisory Board and formally adopted by the ECB Governing Council. Supervisory measures are typically preceded by an informal dialogue with banks and followed by several routine steps, including a formal notification to the bank, the bank's right of reply, the monitoring of compliance and, if necessary, when the bank does not properly implement the supervisory measures, escalation including up to enforcement and sanctioning.</p> <p>The SSM aims that all measures, whether quantitative or qualitative, are achievable and provide a clear sense of direction and prioritization for supervisors and supervised entities alike. Supervisors are expected to clearly communicate their measures to the supervised entities from the onset, and measures should use simple, precise language directly linked to the spirit of the finding. Such communication should also include what the bank can expect as a supervisory response (e.g. follow-up actions or enforcement and sanctions, when applicable) if it fails to comply with supervisory expectations.</p> <p>The assessors reviewed several letters from supervisors to banks. In terms of communication, the assessors saw a mixed picture. Letters were often lengthy and very legalistic, making it difficult for supervisors to set the agenda for banks on compliance issues. There was also room for improvement in terms of individual measures and findings. The SSM recognizes this and has begun some initiatives, such as Executive letters, which provide more context and prioritization for banks, and Help Desks to assist supervisors in preparing communication with banks.</p>
9 EC6	<p>The supervisor evaluates the work of the bank's internal audit function (including those that are outsourced or co-sourced) and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.</p>
Description and findings re EC6	<p>The CRD and EBA Guidelines on internal governance provide the legal framework for supervisors to evaluate the work of the IA function within the supervisory assessment.</p> <p>The work of the internal audit function is evaluated within the SREP.</p>

	<p>Further assurance can be obtained through onsite inspection.</p> <p>On the basis of the assessment of the internal audit function carried out during the SREP and onsite inspection, supervisors determine whether and to what extent it may rely on the internal auditors' work to identify areas of potential risk. In some cases, supervisors can use the auditor's assessment as an additional layer of assurance to the supervisor's own assessment of the bank's evidence to determine whether the bank has appropriately remediated a supervisory measure.</p>
9 EC7	<p>The supervisor engages sufficiently frequently 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.</p>
Description and findings re EC7	<p>The CRD establishes the legal framework.</p> <p>JSTs are responsible for all external written and oral communication with banks. Usually, JSTs interact extensively with the banks through requests for information or meetings with bank representatives. Meetings are used to get to know the management, gather information on the bank's strategies and activities, and complement and cross-check the data used in the supervisory process. Meeting with the bank is a critical component of the off-site process to discuss strategic planning.</p> <p>A top-level meeting is held with heads of the supervisory and/or management and/or risk managers to discuss the bank's condition, its strategic and operational perspectives, governance issues and the business policies (also regarding 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 attend banks' board meetings as observers to complement their assessment without interfering in the meeting itself.</p> <p>Mid-level management also attends technical and operational meetings, which focus on areas such as risk management methodologies, self-assessment of capital adequacy, and control systems.</p>
9 EC8	<p>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 appropriate. The supervisor also meets separately with the bank's independent board members and external auditor, as necessary.</p>
Description and findings re EC8	<p>See also CP 9 EC 5.</p> <p><u>Onsite</u></p>

To ensure full transparency, findings from on-site inspections and internal model investigations are shared with the banks at various stages throughout the inspection lifecycle, both in meetings and in writing. This allows the bank to review the facts and react to the findings with possible clarifications and comments. It also supports effective follow-up and remediation of the shortcomings identified by the inspection team. First of all, during the investigation phase, the inspection team can hold status meetings with the inspected bank at the working level to discuss preliminary facts and findings. Before being shared with the bank, the draft report undergoes an independent consistency review.

The draft report is typically sent 3-5 days in advance to allow the inspected legal entity to prepare for the meeting adequately.

The inspected legal entity is granted two weeks to submit written comments on the facts and findings included in the draft report. The final report is produced after the exit meeting and receiving the bank's written feedback.

The report is expected to be clear, concise, and to the point. It should contain an executive summary, findings, and an overall assessment of the mission's topics. The length of the document should be commensurate with the scope and magnitude of the inspection. A finding contains the following elements: Criteria (What should be); Condition (What is); Root Cause(s) (Why did it happen); Effect (What are the consequences and the potential risks).

As an on-site inspection is a point-in-time exercise, findings are based on the actual situation at a given time. As a result, deficiencies for which the institution has taken corrective measures during the inspection must be documented accordingly in the report but flagged as findings. By contrast, no conclusions should be reported regarding deficiencies that had already been corrected before the reference date of the inspection. Where appropriate, this could be mentioned in the report.

The inspection findings are categorized according to their impact on the financial situation of the inspected legal entity. Where appropriate, the findings should refer to the applicable European legislation and, if necessary, other legal texts.

Based on the final inspection report, the JST is responsible for drafting a follow-up letter including recommendations or a draft decision including supervisory measures and related deadlines.

The ongoing supervision unit should assess the action plan and deadlines proposed by the LSI. If the action plan is not implemented satisfactorily, the NCA should consider applying its supervisory measures. The recommendations and remedial actions are closed when the NCA has reasonable assurance that the remedial measures have been appropriately implemented.

Off-site

	<p>A SREP decision includes a Pillar 2 requirement expressed as a percentage of a bank's RWAs (P2R-RWA), a Pillar 2 guidance expressed as a percentage of a bank's RWAs (P2G-RWA), a leverage ratio Pillar 2 requirement (P2R-LR) and a leverage ratio Pillar 2 guidance (P2G-LR). The intention is to help the bank understand how it has been assessed and where it needs to improve.</p> <p>The assessors reviewed several letters and found a mixed picture. The descriptions of findings were generally strong, but the measures sometimes did not meet the Specific, Measurable, Achievable, Relevant and Time-bound (SMART) objectives that the SSM aims for. The assessors also noted an ECB internal audit finding that deadlines were missed in the communication timetable for on-site inspections.</p> <p>The assessors also received feedback that the P2 requirements and what banks needed to do to reduce them were not always clear.</p>
9 EC9	<p>The supervisor undertakes appropriate and timely follow-up activities 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>The intensive supervisory approach with a higher mix of on-site assessments inevitably generates a large number of findings and, consequently, a challenge to follow up. The assessors noted in management information produced by the SSM that the number of outstanding issues has remained high; indeed, in 2023, the number of issues opened was greater than those closed. It is also recognized that with such a volume of findings, supervisors often identify symptoms and miss the root cause. The assessors agree with this analysis, but we would note that determining root causes must be balanced. Go too far to the root cause; everything potentially has a single rather fundamental source. (i.e., governance-related issues).</p> <p>The SSM has made recent public statements on escalation. However, this is still in its early stages and is currently structured more thematically—e.g., it is looking to escalate the absence of foundational aspects of the management of climate-related and environmental risks for which monitoring efforts were conducted for all banks in the same time frame. The monitoring of existing shortcomings was conducted by supervisory teams, supported by a central Help Desk function led by a PMO. This is in contrast to an individual supervisor going through the escalation ladder on an idiosyncratic risk basis.</p>
9 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 breaches of legal or prudential requirements.</p>
Description and findings re EC10	<p>The CRD and BRRD provide the framework.</p> <p>Level 1 text requires banks to notify supervisors of any acquisitions or disposals of holdings in their capital that cause holdings to exceed or fall below one of several set-out thresholds. A bank must immediately notify the supervisor of any decision to take action or refrain from it if recovery plan indicators are met. There are also reporting requirements on cyber incidents. There is also a requirement to notify breaches of legal or prudential requirements.</p>

	The assessors noted that there is no requirement for substantive changes in activities or internal structure.
9 EC11	<p>The supervisor may use independent third parties, including external experts, but it cannot outsource its prudential responsibilities to third parties. Where third parties are used, the supervisor:</p> <ul style="list-style-type: none"> (a) clearly defines and documents their roles and responsibilities, including the scope of work where they are appointed to conduct supervisory tasks; (b) assesses their suitability for the designated task(s), the quality of their work and whether their output can be relied upon to the degree intended; (c) ensures that they are subject to appropriate confidentiality restrictions; (d) considers the biases that may influence them; and (e) requires that they promptly bring to its attention any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	<p>The SSM prefers to staff on-site inspections and internal model investigations with staff from NCAs and/or ECB. Nevertheless, the ECB can decide to make recourse to external experts when this is considered appropriate. External experts will be appointed as team members and will carry out the tasks assigned under the lead of a member of the SSM. The ECB has concluded a framework agreement with twelve firms to appoint external professionals to on-site inspection or internal model investigation missions. External professionals may support on-site inspection and internal model investigation missions in case the inspection team lacks appropriate resources. External consultants can only participate as team members to ensure that the responsibility is not outsourced.</p> <p>To ensure the independence of the external provider, the firm should not have worked on the same subject matter for the entity to be inspected. It must provide the ECB with some background information about its relationship with the entity. This information and the firm's self-assessment about the potential existence of a conflict of interest will be assessed before accepting any offer and issuing an Order. Depending on the amount of fees, the Order is then signed by the relevant stakeholders according to the generic provision of delegation of power; after the end of the Order, the firm and the professionals appointed by the contractor to support the on-site mission should both respect the cooling-off period.</p> <p>Their presence is transparently communicated to the inspected institution.</p>
9 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	The SSM has an impressive array of information systems to support supervision, from compliance, issue tracking, data analysis, benchmarking, network analysis and various machine learning and artificial intelligence solutions.
Additional criterion	
9 AC1	The supervisor has a framework for periodic independent reviews, for example by an internal audit function, internal risk function or third-party assessor, of the adequacy and

	effectiveness of the range of its available supervisory tools and the effectiveness of their use, and makes changes as appropriate. The supervisory approach should be reviewed at periodic intervals and improved as necessary to ensure it remains effective and fit for purpose.
Description and findings re AC1	<p>The SSM has both a risk management and audit function.</p> <p>The risk management function is responsible for:</p> <ul style="list-style-type: none"> a) Strategic risk <ul style="list-style-type: none"> a. Assessment of the principal risks and vulnerabilities of the banking sector. b. Conduct market intelligence activities and targeted analyses to support the risk assessment. c. Horizon-scanning to support long-term strategic thinking in the SSM. d. Advise the Supervisory Board on the SSM supervisory strategic priorities for the next three years and in the longer term. b) Consistency and effectiveness risk <ul style="list-style-type: none"> a. SREP Benchmarking and horizontal analyses, supported by state-of-the-art data analytics open to the whole SSM. b. Thematic reviews, leading to recommendations to improve supervision. c. SSM-wide reporting on supervisory findings and measures c) Implementation risk <ul style="list-style-type: none"> a. Definition of the SSM mission statement and bringing the SSM supervisory culture to life b. Monitor and challenge the 1LoD's operational planning and high-level work programs. c. Establish and maintain a risk tolerance framework (RTF) to support risk-based supervision and (de)prioritization. d. Monitor the supervisory strategic planning (SSP) of JSTs and their consistency with the risk tolerance levels. e. Monitor the implementation of supervisory priorities. f. Pilot the measurement of supervisory effectiveness, also making more extensive use of analytical and research tools. g. Assess organizational readiness and advise the Chair on the SSM Pool allocation. d) Operational Risk <ul style="list-style-type: none"> a. Operational risk management & business continuity policy in the SSM b. Representing ECB Banking Supervision in the ECB Operational Risk Committee c. Coordination of SSM audit activities. <p>The internal audit function is responsible for:</p> <ul style="list-style-type: none"> a) Providing independent and objective assurance and consulting services designed to add value and improve the ECB's operations; and b) Bringing a systematic, disciplined approach to evaluate and improve the effectiveness and efficiency of risk management, control and governance processes.

Assessment of Principle 9	Compliant
Comments	<p>The SSM is a highly sophisticated regulator with a comprehensive and fully articulated supervisory approach. It is supported by excellent risk analysis, support from technology, and a strong skill set in all aspects of supervision. As noted in BCP 08, SSM aims and delivers an intensive supervisory approach. Delivering at this level given a highly complex context (probably the most complicated of any comparable supervisor) - coordinating NCAs and operating under a fragmented policy base is a substantial challenge.</p> <p>In such a system, improvement can always be made, and the assessors noted areas that would merit attention. The structure is still in its infancy and needs to settle down. The assessors noted some areas of overlap between horizontal and inspection, for example, that should be avoided. The assessors found a detailed and inclusive planning process on the demand side, but challenges in setting those demands against a realistic resource base given it needs to balance budgetary discipline, some skill shortages and NCAs that have their own budget constraints and resource demands. Given the broad remit of the SSM, prioritization is a significant challenge and is increasing as the supervisory approach to new and emerging risks is developed. In such conditions there is a risk that the new can crowd out the old. The supervisory priorities setting exercise has been recently improved and combines risk based a system-wide perspective (via top-down guidance) and combines a bank-specific JST/bottom-up perspective (supported by the Risk Tolerance Framework and supervisory planning) in order to achieve for every supervised institution a balanced mix of horizontal and bank-specific priorities and corresponding supervisory activities. As more experience is gained with this new approach, it will be important to ensure that the prioritization process is adequately applied from the bottom up and top-down perspectives so that both emerging and traditional risks are adequately addressed at the individual and system level.</p> <p>The SSM is prioritizing improving communication with banks, and the assessors would support that. At the moment, there are too many examples of overly long and legalistic letters that fail to convey clearly and prioritize what the supervisor wants from banks. The assessors encourage the SSM to continue improving communication to banks to set the agenda for the banks' governing body and ensure that recommendations and measures are always focused, specific, measurable, achievable and realistic and with a timeframe.</p> <p>Poor communication was frequently mentioned in relation to Pillar 2 assessments, but not exclusively so. The assessors would encourage the SSM to increase transparency around the main drivers of the decision to determine Pillar 2 requirements. The revised Pillar 2 methodology is expected to simplify the link between capital requirements and the underlying SREP risk assessment. This should facilitate a better understanding by SIs of the Pillar 2 outcomes. The assessors have not reviewed the revised P2R methodology which was not implemented at the time of the assessment.</p> <p>The assessors also noted many outstanding findings; some of the most severe have been outstanding for a considerable, perhaps excessive, period of time. Whilst there is an escalation ladder for such issues, this was in its early stages of roll-out and was currently</p>

	<p>dominated by more thematic exercises such as the centrally organized monitoring of banks' remediation of shortcomings related to climate-related financial risk management, rather than being used idiosyncratically.</p> <p>The assessors also noted audit findings on the timeliness of on-site inspection and the framework for breach reporting. There were also some gaps in the reporting of material changes.</p> <p>Regarding the ECB oversight of LSI supervision, the use of moral suasion vis-a-vis NCAs and benchmarking to identify outliers (rather than direct intervention and the use of formal instruction) has been effective in being more proportionate (through the high-risk/ high-impact approach) and disseminating best supervisory practices in the LSI sphere. Since the last BCP Assessment, the SSM has made considerable progress. Further work may be warranted in some areas. A few NCAs are not using the SREP module in IMAS, priorities defined by some NCAs may slightly differ from those agreed for the SSM, and the in-depth assessment conducted by the ECB of the SREP scores and P2R and P2G for LSI suggest that further work is needed to further improve supervisory convergence.</p> <p>Assessors also noted the lack any consistent approach across the SSM to supervise newly licensed banks, which are typically riskier than other banks during their first years of operations (as noted in CP 5).</p>
Principle 10	Supervisory reporting. ³² The supervisor collects, reviews and analyses prudential reports and statistical returns ³³ 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	
10 EC1	The supervisor has the power to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance and risk exposures, 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 (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, market risk and information that allows for the assessment of the materiality of climate-related financial risks and emerging risks to banks.
Description and findings re EC1	All EU banks are obliged to prepare and submit information on their financial position and risk level. The major reports are financial reports (FINREP) and prudential reports (COREP) under the CRR and the Commission Implementing Regulation (EU) 2021/451 (ITS on Supervisory Reporting). The EU-wide harmonized reporting framework is further

³² Reference documents: BCBS, Principles for the effective management and supervision of climate-related financial risks, June 2022; BCBS, Sound Practices: implications of fintech developments for banks and bank supervisors, February 2018; BCBS, Principles for effective risk data aggregation and risk reporting, January 2013; BCBS, Principles for the supervision of financial conglomerates, September 2012.

³³ 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 [BCP40.61].

	<p>complemented by other technical regulations and by various (legally non-binding) EBA Guidelines.</p> <p>FINREP and COREP provide detailed information on such matters as capital adequacy, liquidity, Pillar 1 risks, balance sheet and profit and loss (P&L), off-balance sheet items, large exposures, asset quality, and related party transactions. However, it is worth noting that the definition of related parties used for FINREP reporting purposes is based on IAS 24, which is narrower than that provided in CP 20. Also, the reporting on transactions with related parties is not sufficiently granular as data are provided at counterparty level and are grouped by type of counterparties (i.e., parent and entities with joint control or significant influence, subsidiaries and other entities of the same group, associates and joint ventures, key management of the institution or its parent, other related parties).</p> <p>FINREP and COREP form the EU level common reporting framework which cannot be modified by the competent authorities to ensure full harmonization of the reporting framework. FINREP is required by the EBA only for banks using IFRS for accounting, with the exception specified below (EC 2). Importantly, some but not all elements of Pillar 2 reporting are included in the harmonized EU framework via COREP. CRR Art 430 (1)(f) mandates the EBA also to cover CRD requirements. This provision has been used to include IRRBB in COREP (harmonized reporting started in 09/2024). ESG risks will be covered during 2025.</p> <p>Under the current EU framework competent supervisory authorities such as the SSM retain the flexibility to collect additional data if not available under the EBA reporting framework, as needed for supervisory purposes.</p> <p>The EU harmonized reporting framework applies to all EU banks, including SIs under the supervision of the ECB. In addition to legal obligations brought by CRR and ITS on Supervisory reporting, the ECB has the power to require information from institutions under its supervision according to Article 10 of SSMR and Article 141 of SSMFR. One of the areas the ECB uses its power to collect information from banks is Short Term Exercises (STE), as discussed below.</p> <p>The data are reported on both a solo and/or consolidated basis as required by the ITS. However, the ECB may waive institutions from reporting on individual level (Articles 7 (derogation from prudential standards applying on solo basis), 8 (derogation from liquidity requirements on solo basis), and 10 (waiver for solo solvency and liquidity requirements for credit institutions permanently affiliated to a central body)³⁴ of the CRR).</p>
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³⁴ Credit institutions permanently affiliated to a central body are institutions with a mutual/cooperative structure.

Derogation from the application of prudential requirements on an individual basis ^{1/}			
Type of CRR Waiver	Number of waivers ^{2/}	Number of significant supervised groups benefiting from a waiver	Number of SIs' subsidiaries for which a derogation has been given
Article 7	126	32	126
Article 8	124	29	124
Article 9	9	8	9
Article 10	133	3	133
Total ^{3/}	392	50	309

^{1/} Data as of 2023Q4

^{2/} One waiver is granted to one single entity in accordance with one of the CRR Articles mentioned. For example, if a liquidity waiver is granted to an SI composed of 5 entities, this would amount to 5 waivers granted to 5 entities.

^{3/} The totals count groups or (solo) entities that have any of the possible waivers

While FINREP was originally mandatory only for International Financial Reporting Standards (IFRS) institutions on consolidated level, ECB Regulation (EU) 2015/534 gradually extends the financial supervisory reporting to institutions under other accounting standards (nGAAP) and on solo level. The amount of information reported takes into account the proportionality principle (i.e., institutions with a low level of complexity not surpassing certain thresholds are allowed to submit fewer data points).

EU wide harmonized supervisory reporting requirements are set by the EBA and adopted by the Commission and are directly applicable to institutions. Article 430(10) CRR allows competent authorities to notify EBA if they believe additional information that should be included in the ITS on supervisory reporting. The SSM is represented in the relevant bodies responsible for the establishment of reporting requirements in the EU and cooperates with the EBA but has no voting powers in its Board of Supervisors.

Areas not addressed by the EBA EU-wide harmonized supervisory reporting framework are covered via additional data collections, most notably by the ECB-specific reporting requirements defined in the Short-Term Exercises (STE). For example, there is a data collection related to the SREP. The ECB is also collecting data on climate risk, where the ECB SREP Climate Risk methodology relies on the EBA template on ESG risk disclosure, complementing it with additional data requests on: profitability information related to all exposures towards sectors that significantly contribute to climate change; additional geographic breakdowns (for both EU and non-EU areas); breakdown of greenhouse gas (GHG) financed emissions; and alignment to a decarbonization pathway for counterparties owning production assets in six key transition sectors (oil and gas, steel, cement, coal, automotive, and power). Other examples include the data request for (i) the horizontal benchmarking of Corporate and Investment Banking activities (CIB analysis), (ii) the Targeted Review of Asset Liability Management (ALM) Governance & Strategy, (iii) the data request for the EBA EU-wide stress test in 2023 and (iv) the monitoring of Basel supervisory standards to 84 selected SIs. Lastly, in crisis situations (such as the COVID-19 pandemic) the ECB was able to collect on an ad-hoc basis relevant data to assess the impact of the crisis on the SSM banks. In addition, the ECB collects data required for the work of supervisors and

	<p>for thematic reviews. Specific individual reporting requirements may be imposed on institutions on a case-by-case basis.</p> <p>The needs for STE data collections are reviewed every year; as soon as certain information collected through the STE become available as ITS reporting, the respective STE templates will be discontinued (e.g., on interest rate risk in the banking book). Over the medium to long term, the ECB aims to propose to the EBA appropriate amendments to the ITS reporting framework. The process to revise and enhance the standardized suite of regulatory returns at the EU level is lengthy as it requires amending the ITS on supervisory reporting. The process for revising and enhancing the standardized suite of regulatory returns at the EU level is structured into distinct phases, including preparation, consultation, finalization, and implementation. This comprehensive process typically necessitates a timeline of approximately nine months prior to implementation, followed by an additional six to twelve months for the actual implementation phase, which entails amendments to the Implementing Technical Standards (ITS) on supervisory reporting. However, this timeline can be accelerated through the application of a fast-track procedure in critical situations, as demonstrated during the COVID-19 crisis</p> <p>Assessors noted that the ECB has improved its operational processes for collecting and processing STE data. ECB staff expressed that STE data quality improves over time after a new data collection is introduced. That said, the STE are less standardized compared to ITS reporting which may lead to a generally lower data quality due to its more dynamic nature.</p> <p>In addition to the EBA ITS and ECB data collection, the SSM benefits from AnaCredit (analytical credit datasets) statistical returns. AnaCredit is a dataset containing detailed information on individual bank loans in the euro area, harmonized across all member states.</p> <p>Going forward, if completed, the work on an integrated reporting system may radically change the landscape of supervisory data reporting if certain conditions are met (see EC 9).</p>
10 EC2	<p>The supervisor provides reporting instructions that clearly describe the 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>Detailed instructions for supervisory reporting based on IFRS and local GAAPs are included in the ITS on Supervisory Reporting. Annexes of the ITS include detailed templates and instructions for prudential reporting. The Assessors observed that ECB specific additional reporting instructions for STEs are disclosed on the SSM website.</p> <p>Not all SIs use IFRS for reporting purposes. According to the CRR, institutions that prepare their consolidated accounts in conformity with IFRS are required to provide FINREP reporting templates for supervisory purposes. To complement the CRR requirements, ECB Regulation (EU) 2015/534 requires supervisory financial information for non-IFRS reporters and at solo level. It extends FINREP by requiring standardized reporting for all SSM-supervised entities that are subject to capital requirements (i.e., non-waiver institutions). The regulation requires the reported financial information to be based on valuation rules existing under the relevant accounting standards (IFRS or nGAAP), as detailed in CP 27.</p>

	<p>The ECB Regulation on reporting supervisory financial information uses templates designed by the EBA that form part of Commission Implementing Regulation (EU) 2021/451. There are dedicated nGAAP reporting templates that harmonize the reporting of entities under these accounting standards while respecting their differences vis-à-vis IFRS.</p> <p>ECB provides instructions to banks in case ad-hoc data collections are carried out.</p>
10 EC3	<p>The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximises the use of relevant and reliable inputs which are 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 adjust its reporting for capital adequacy or regulatory reporting purposes.</p>
Description and findings re EC3	<p>The CRD requires that the management body devotes 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.</p> <p>To the extent that the applicable accounting framework is IFRS, the measurement of fair values and valuation rules are determined on the grounds of IFRS requirements.</p> <p>In relation to internal approaches, CRD requires that, at least annually, competent authorities assess the consistency and comparability in risk-weighted assets (RWA) produced by institutions' internal modelling approaches for which competent authorities have granted permission to be used for capital purposes.</p> <p>The EBA RTS for prudential valuation, establishes approaches for prudential valuation adjustments as mandated by the CRR for traded instruments ('simplified' and 'core' approaches). The CRR requires that verification of market prices and model inputs should be performed by a person or unit independent from persons or units that benefit from the trading book, at least monthly, or more frequently depending on the nature of the market or trading activity. Where independent pricing sources are not available, or pricing sources are more subjective, prudent measures such as valuation adjustments may be appropriate.</p> <p>The ECB is not formally empowered to require a bank to adjust its regulatory reporting if valuations are deemed not sufficiently prudent. However, the SSMR provides a wide range of powers to the ECB. In the Report from the Commission to the European Parliament and the Council on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013, it is clarified that the power to require specific provisioning policy does not amount to accounting powers that would allow the ECB to impose a specific provision, but they allow the ECB to influence the provisioning policy of a bank within the limits of accounting standards, for instance where such framework allows for flexibility in selecting policies or requires subjective estimations, and the specific implementation chosen by the institution is not adequate or sufficiently prudent from a supervisory point of view.</p>

	Furthermore, the ECB is empowered to require credit institutions to apply specific adjustments (deductions, filters or similar measures) to own funds calculations where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective.
10 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>The EU harmonized supervisory reporting framework is subject to the following minimum frequencies:</p> <ul style="list-style-type: none"> - Capital requirements/COREP (quarterly) - IRRBB/COREP (quarterly) - FRTB (preparatory reporting) (quarterly) - Benchmarking internal models (annually) - Financial information/FINREP (quarterly with some templates semi-annually or annually) - Large exposures (quarterly) - Losses from immovable property (annually) - Leverage ratio (quarterly) - Liquidity (LCR and additional liquidity metrics monthly, NSFR quarterly, asset encumbrance (quarterly), funding plans (annually) - Remuneration policies (annually) - G-SII reporting (quarterly) <p>Certain reporting obligations are adjusted depending on the complexity of the institution, as specified in the ITS on supervisory reporting. This follows a proportional approach, leveraging in many cases the definitions of ‘small and non-complex institution’ and ‘large institution’ under the CRR. The frequency of reporting can also be adjusted depending upon the risk profile and systemic importance of the bank as per the CRD. The ECB has the power to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions according to CRD Article 104(1) paragraph j. This article has been referred by the JSTs in the last 4 years’ SREP cycles 85 times for 55 banking groups for additional reporting and frequency. For example: weekly liquidity reporting, NPE coverage reporting, reporting on action plan related to IT governance, reporting on addressing of high level of NPEs have been imposed based on this power. STE data collections provide more flexibility, and the frequency can be adjusted as necessary. The internal process for horizontal reporting requests assesses the commensurateness of the data request with the nature of the information requested.</p>
10 EC5	To make meaningful comparisons between banks, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and for the same dates (stock data) and periods (flow data).
Description and findings re EC5	The ECB has direct supervisory competence in respect of credit institutions, financial holding companies, mixed financial holding companies established in participating member states, and branches in participating member states of credit institutions established in non-participating member states that are significant. The EBA supervisory reporting framework provides harmonized reporting requirements for all EU institutions (financial reporting is only required by the CRR from IFRS institutions at the consolidated level, with the possibility for competent authorities to extend reporting to other institutions). Some institutions are

	<p>waived from regulatory reporting and the associated prudential standards. The perimeter of the entities included in the prudential scope of consolidation is defined in the CRR and is applied to all institutions supervised by SSM (See EC 1).</p> <p>Where institutions are permitted by national laws to report their financial information based on their accounting year-end which deviates from the calendar year, reporting reference dates may be adjusted accordingly in accordance with Commission Implementing Regulation (EU) 2021/451, so that reporting of financial information is done every three, six or 12 months from their accounting year-end, respectively. This helps ensure comparability between institutions with different year-ends.</p>
10 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:</p> <ul style="list-style-type: none"> (a) material to the condition of the bank; (b) material to the assessment of the risks of the bank; or (c) needed to support resolution planning. <p>This includes, but is not limited to, internal management information, corporate governance information, transactions with the wider group (e.g. any non-bank entities) and related party transactions.</p>
Description and findings re EC6	<p>The SSMR empowers the ECB to collect information in recurring intervals and in specified formats from credit institutions established in the participating member states, from mixed-financial holding company (MFHC), financial holding company (FHC), mixed activity holding companies and persons belonging to them and from third parties providing outsourcing to these firms.</p> <p>Ad hoc reporting based on supervisory decisions complements the regular reporting under the ITS. The SSM routinely collects management information from institutions to fulfill its supervisory tasks.</p> <p>In the case of bank-led financial conglomerates for which the ECB is the coordinator, JSTs receives specific information on the 4 items defined in the supplementary supervision (capital adequacy, on intra-group transactions, risk concentration and internal governance). The harmonization of the templates is done at European level through the work of the Joint Committee on Financial Conglomerates (JCFC) where the ECB is an active member.</p> <p>Collection of information on intra-group transactions and risk concentration by financial conglomerates has been effective since the Commission Implementing Regulation (EU) 2022/2454 came into force on Dec 31, 2023. Regarding the collection of information on capital adequacy, the discussion at JCFC level is still ongoing. There is no reporting on the liquidity situation of FCs.</p> <p>Assessors observed evidence of the capacity of JSTs to obtain information needed for their assessment of the bank or banking groups' conditions from banks and entities in the wider</p>

	group. However as mentioned in EC 1, the definition of related parties used for reporting purposes is narrower than the BCP definition.
10 EC7	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 appropriate level of the bank's senior management that is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC7	<p>The SSMR gives the general power to the ECB to apply administrative penalties. If an SI fails to comply with statutory reporting requirements or reporting requirements adopted in an ECB decision the ECB can, depending on the infringement, impose enforcement measures and/or efficient, proportionate and dissuasive sanctions. Enforcement measures (first and foremost periodic penalty payments) are aimed at compelling supervised banks to comply with the prudential requirements laid down in supervisory decisions or regulations. These measures can only be imposed in the case of ongoing breaches. In several instances, the SSM has applied sanctions for reporting including inaccurate reporting.</p> <p>Since 2023, the ECB requires the management body of directly supervised institutions to underwrite a Management Report on Data Governance and Data Quality, which includes information on punctuality, accuracy, and completeness of the institution's supervisory reporting, as well as a qualitative self-assessment on reporting capabilities. This exercise is aimed at ensuring adequate accountability of the management bodies regarding supervisory, financial, and internal risk reporting.</p>
10 EC8	The supervisor utilises policies and procedures to determine the validity and integrity of supervisory information. This includes a programme for the periodic verification of supervisory returns either by the supervisor's own staff or by external experts.
Description and findings re EC8	<p>The ITS reporting framework developed by the EBA defines data items and binding validation rules that ensure consistent application of the requirements. The EBA has developed additional quality checks for use by NCAs when reviewing the reported information. In addition, the ECB in cooperation with NCAs is using a set of additional data quality checks that complement those already included in the EBA supervisory reporting framework.</p> <p>In accordance with the SSMFR, the ECB organizes the processes relating to collection and quality review of data reported by supervised entities. The Banking Supervision Data Division (BSDD) in the Directorate General Statistics of the ECB is responsible for carrying out these tasks, as established in the SSM Supervisory Manual.</p> <p>The main objective of BSDD is to ensure that the ECB has reliable and accurate supervisory data. Therefore, the function maintains close cooperation with NCAs' reporting units, which are the first recipients of prudential reporting by credit institutions and perform the first data quality checks on this data.</p> <p>The BSDD also ensures that reporters follow reporting deadlines established in the EBA ITS and assesses whether the data are submitted in a timely fashion. It forwards the received reports—overnight—to end-users, such as JSTs and horizontal functions within the ECB. Upon receipt, selected data is also forwarded to the EBA. The data is made available to end-</p>

	<p>users according to the SSM Information Security Policies and IT-system entitlements. The BSSD checks the completeness and accuracy of each report received as well as the presentation of products and indicators derived from the reports in order to ensure a common format among the different reporting agents (allowing for data consistency and facilitating historical or sector-wide analysis). These different processes are largely be automatized to ensure a sound and efficient follow-up of the reports as their number is significant.</p> <p>A dedicated database stores information related to failing data quality checks (including cross-module checks, results from outlier analysis) and allows BSSD to keep track of their status.</p> <p>A Quality Findings Report (QFR) is addressed to NCAs across the SSM which targets the SIs subject to the SREP and provides a point-in-time picture of the pending failing data quality checks by those entities (not explained and not corrected) in the data reported for the past 5 quarters. The aim of the QFR is to engage the NCAs and the banks on potential data quality issues and to allow banks to assess, explain or correct them.</p> <p>The ECB carries out data quality checks and validations as part of its regular on-site and offsite activities and this was evidenced in one on-site report provided to the assessor which included data quality checks.</p>
10 EC9	<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 EC9	<p>As regards the EBA ITS data, Article 430(8) CRR mandated the EBA to prepare a report measuring the costs that institutions incur when complying with the reporting requirements set out in the EBA's ITS on supervisory reporting. While focusing on reducing the reporting burden, in particular for small and non-complex institutions, it also compared the costs against the benefits delivered by the reporting requirements for the purposes of prudential supervision. Article 99(7) of the CRR allows competent authorities to notify the EBA whenever they believe that additional information should be included in the ITS on supervisory reporting. Accordingly, the EBA ITS is periodically updated to follow regulatory developments and to close data gaps identified by supervisors.</p> <p>In accordance with the SSM Supervisory Manual states, the Short-Term Exercise related to the SREP is reviewed every year before the start of the annual SREP. Additionally, in 2021, an extensive assessment was conducted to evaluate the utilization of STE templates by SSM stakeholders across various platforms where STE data is disseminated. This analysis aimed to gauge template usage, identifying those most and least utilized, thereby informing decisions on template relevance and making sure that information that is no longer relevant or fit-for purpose for supervisory needs is excluded from the collection.</p> <p>If completed, the work on an integrated reporting system may change the landscape of supervisory data reporting. Article 430c of the CRR2 provided a mandate for the EBA to assess the feasibility of developing a consistent and integrated system for collecting statistical, resolution and prudential data. A feasibility study was published by the EBA in 2021. Since then, European authorities have been working on developing an integrated reporting system which can only be completed in the medium term as a number of</p>

	<p>preconditions need to be met. All authorities agree on the need to define a common data dictionary for prudential, statistical and resolution data as a key building block for an integrated reporting system. In the context of its Integrated Reporting Framework (IReF), the authorities are also investigating possibilities to increase the granularity of reported statistical data. Data would be collected at granular level, to allow their re-use for several purposes (e.g., once granular data are made available by banks, there would be several ways of combining such data to generate, but not necessarily replicate, supervisory reports, as desired by each competent authority). In turn, integrated reporting would reduce the need for ad hoc-data requests. A Joint Bank Reporting Committee (JBRC) involving all relevant EU bodies (including the EBA and ECB), as well as national authorities and banking industry representatives has been established to enhance cooperation in view of the development and implementation of the integrated reporting system. The implementation of an integrated reporting system is a medium-term project that has already been delayed.</p>
Assessment of Principle 10	Largely Compliant
Comments	<p>Institutions routinely furnish information that the ECB requires to carry out its supervisory functions. The requirements associated with supervisory reporting are now predominantly governed by a harmonized EU regime. All EU banks are obliged to prepare and submit information on their financial position and risk level. The standard suite of returns includes financial reports (FINREP) and capital adequacy reports (COREP) under the ITS on supervisory reporting. On a routine basis, banks submit a standardized suite of regulatory returns on a quarterly frequency and more often for certain types of information. Data submitted by banks are subject to various statistical validations for data accuracy and quality and then analyzed by supervisors to assess banks' financial soundness and compliance with relevant laws and regulations. Supervisors review these returns and other information.</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 supervisors. Nonetheless, the existence of different accounting treatments makes comparisons between banks and risk positions difficult and the identification of outliers more complex.</p> <p>Under the current EU framework, supervisory reporting requirements are specified by the EBA, while competent supervisory authorities such as the SSM retain the flexibility to collect additional data if not available under the EBA reporting framework, as needed for supervisory purposes. More detailed risk information may indeed be needed than FINREP and COREP to support the off-site supervision process and undertake in-depth analysis. However, the process to revise and enhance the standardized suite of regulatory returns at the EU level is lengthy as it requires amending the ITS on supervisory reporting. Relevant data that fit the SSM's needs may be lacking (e.g., there is no reporting on intraday liquidity and discussion at the EBA level is still ongoing).</p> <p>Where data needs of the SSM are not addressed by the EBA harmonized supervisory reporting framework, they may be covered via additional data collections undertaken by the ECB, such as the Short-Term Exercise (STE). This approach is, however, a second-best solution which faces two limitations. First, the ECB cannot collect additional data in areas</p>

	<p>already covered by the ITS on supervisory reporting, nor can it require the reporting of that data in a different format nor in a different breakdown (e.g., more data points, different segmentation, more time buckets, etc.). Second, the STEs are less standardized compared to ITS reporting, which may lead to a generally lower data quality. Collecting management information from banks is always possible but does not facilitate peer group analysis. Given these intrinsic limitations, it is critical to expedite the implementation of the integrated reporting system that will strike a better balance between the harmonization of reporting requirements and the flexibility in responding to evolving data needs. However, the implementation of an integrated reporting system is a medium-term project that has already been delayed.</p> <p>Banks' management's accountability for the accuracy of supervisory returns has improved. Since 2023, the ECB requires the management body of directly supervised institutions to underwrite a "Management Report on Data Governance and Data Quality", including information on punctuality, accuracy, and completeness of the institution's supervisory reporting, as well as a qualitative self-assessment on reporting capabilities.</p> <p>While the ECB is not formally empowered to require a bank to adjust its regulatory reporting if valuations are deemed not sufficiently prudent, the SSMR provides the ECB with the power to require a bank to apply a specific provisioning policy or treatment of assets in terms of own funds requirements. This allows the ECB to require credit institutions to apply specific adjustments (deductions, filters or similar measures) for determining the capital ratios for prudential purposes where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective.</p> <p>Data collection on transactions with related parties is not sufficiently granular and the scope is too restricted as the definition of related parties which is being used (i.e., the definition under IAS 24) is narrower than that of CP 20. See CPs 20 and 28 for further details.</p>
Principle 11	Corrective and sanctioning powers of supervisors. ³⁵ 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, that it can apply at its discretion, to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
11 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 it 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	The CRD and the SSMR empower the ECB to require its supervised entities to take necessary measures at an early stage to address problems with respect to compliance with prudential

³⁵ Reference document: BCBS, Parallel-owned banking structures, January 2003.

requirements (current or future), the soundness of management and sufficiency of the coverage of risks in order to ensure the viability of the credit institution.

The ECB conducts at least annually the SREP under the CRD and the related EBA Guidelines and consequently adopts the appropriate supervisory measures through supervisory decisions. ECB supervisory decisions are required to be adopted following the provisions set forth in the SSMR and SSMFR. As a rule, supervisory decisions are notified in writing. As prescribed in the SSMFR, supervisory decisions can be notified to the persons authorized to represent the SI, which includes its legal or statutory representatives or any other representative empowered by written mandate to take any and all actions relating to the ECB supervisory procedure.

In addition, the ECB may identify the need for other immediate measures to counteract negative developments at a significant credit institution during the exercise of its supervisory tasks through ongoing off or on-site supervisory activities or through meetings with the management or key staff members of the credit institution or by a letter of intervention in a timely manner. These methods, which comprise non-binding routine or ad hoc requests, letters, statements, etc., can be exercised whenever it is deemed sufficient to list in detail the goals to be achieved as well as the related time frame and the steps to be taken while leaving to the credit institution the duty of identifying the most appropriate actions.

The monitoring task of follow-up actions is performed by the JSTs. The follow-up of the decisions may be based on periodical or ad hoc reports only or may take place through specific meetings with the credit institution's management or follow-up inspections to monitor the implementation activities of the credit institution. This process of monitoring the implementation of supervisory measures (e.g. recommendations, requirements or other decisions) is carried out by the JSTs with the support of a dedicated IT tool ("IMAS"). The follow-up process, including the frequency and type of monitoring process, is defined by the JST and communicated to the banks from the time the initial measures are issued. Moreover, JSTs must include the follow-up of supervisory measures in the supervisory calendar for the relevant credit institution.

If a credit institution does not comply with a supervisory measure, the JSTs have to consider taking additional action against the credit institution and this is where the escalation framework comes in. The possible responses that can be initiated range from informal notifications to the credit institutions or the use of additional supervisory powers, enforcement measures or even sanctions, depending on the nature of the original supervisory measure and the extent of the non-compliance.

Based on the information provided, the JST assesses whether the progress on the implementation of the supervisory measure(s) is adequate. In this regard, the JST produces regular follow-up notes describing the progress in implementing the supervisory recommendations, requirements or decisions and forwards the information to the ECB's horizontal divisions and if relevant, to the Supervisory Board and/or the Governing Council, as deemed relevant.

	<p>In case there are reasons to suspect that a breach of a prudential requirement or of an ECB regulation or decision is being or has been committed, it has to be referred to the ECB's Enforcement and Sanctions Division. In addition, if the ECB considers that additional supervisory measures - different from enforcement measures or sanctions - are needed, it will evaluate which supervisory measures should be applied to the significant credit institution.</p> <p>The decisions on measures and sanctions are taken by the Supervisory Board and the Governing Council following general decision-making procedures. For LSIs, any material supervisory procedures or material draft supervisory decisions should, especially for riskier and larger LSIs, be notified by the NCA to the ECB as part of its oversight function.</p> <p>Internally, the ECB has codified these practices in an 'SSM Playbook on Supervisory Findings and Actions Effectiveness' available to all supervisors in ECB and NCAs' since December 2023. A series of horizontal support teams have been created to address topic-specific issues (Help Desks), which foster supervisory effectiveness for key SSM priorities (e.g., climate and environmental risks, risk data aggregation and reporting, management bodies). The playbook contains guidance on how to manage findings and measures, including practical examples. Principles 7 (timely remediation) and 8 (escalation) of this playbook relate to the need for timely action in remediating banks' issues once findings are detected, to the need to issue corrective measures for banks to implement and then follow up on those measures or to request others if needed.</p>
11 EC2	<p>The supervisor uses an appropriate range of supervisory tools³⁶ in a timely manner when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, 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>The ECB, as the competent authority for significant credit institutions, has a range of tools at its disposal to address insufficiencies and irregularities within credit institutions at an early stage, which mirrors the powers entrusted to competent authorities laid out in the CRD and the SSMR. In addition to these powers, the ECB may also:</p> <ul style="list-style-type: none"> - directly exercise all powers conferred on the NCAs by national law, transposing Union law directives; and - require NCAs, to the extent necessary to carry out tasks conferred on the ECB by the SSMR 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 <p>The supervisor acts in two different ways in order to address shortcomings of the credit institution or other threats to the depositors:</p>

³⁶ Refer to Principle 1, essential criterion 1 [BCP40.5].

	<p>a. Informal dialogue with the credit institution (or operational acts), which do not require a Supervisory Board and Governing Council decision and have no legal effect on the supervised credit institution (e.g., letters to describe specific insufficiencies within a credit institution and to indicate what is expected from the credit institution to correct these or meetings, the minutes of which are stored in the SSM database). These informal measures act as moral suasion and are an important part of ongoing supervision.</p> <p>b. Formal binding supervisory measures, which require decisions by the Supervisory Board and the Governing Council, and may be resorted to if the moral suasion does not work or if the breach is significant. 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.</p> <p>The use of tools may differ in accordance with the detected issue or infringement (e.g., rectifying the breach of prudential requirements or restitution of viability), or depending on the supervisory response envisaged (quantitative or qualitative).</p> <p>Finally, apart from supervisory measures, which aim to ensure that credit institutions take the necessary measures at an early stage to address shortcomings related to the prudential requirements set out by relevant Union Law, the ECB has at its disposal (1) enforcement measures in order to compel the credit institution to comply with regulations, national laws implementing a directive or ECB decisions and, thus, ensure compliance with regulatory or supervisory requirements and (2) sanctions, which mainly aim to punish infringements (see EC 3 and 4).</p>
11 EC3	<p>The supervisor uses its powers to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor intervenes at an early stage to require a bank to take action to prevent it from breaching its regulatory threshold requirements. Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions, without limiting the supervisor's discretion to act.</p>
Description and findings re EC3	<p>The CRD imposes upon competent authorities the responsibility to require an institution to take the necessary measures at an early stage if it does not meet the requirements of the CRD or the CRR or if it is likely to breach these requirements in the following 12 months. The SSMR requires the ECB to ensure compliance with the relevant Union law and national law provisions transposing Directives that impose prudential requirements on significant credit institutions in areas of own funds requirements, securitization, large exposure limits, liquidity and leverage.</p> <p>As mentioned in EC2, when a significant credit institution does not meet such prudential requirements or the ECB has evidence that the credit institution is likely to breach them, or it 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, the ECB may exercise the supervisory powers conferred on it by the SSMR. In addition, the ECB may, as appropriate, apply enforcement measures aimed at compelling the significant institution to comply with prudential</p>

	<p>requirements. As detailed in EC 4, the SSM can also use the early intervention powers available under the BRRD.</p> <p>The SREP process is utilized to document the Pillar 2 assessment of SIs in accordance with the CRD, including the decision on adequate levels of capital, liquidity and additional supervisory measures. The various steps involved in arriving at a reasoned decision and their timing are detailed in the SSM common timeline. An update of the SREP reports outside the annual procedure is considered in cases justified by a significant change in the group's situation (e.g., in the risk profile or operating environment or a significant acquisition).</p> <p>On top of the day-to-day supervision, the ECB has developed a quarterly dashboard that provides each supervisor with an overview of regulatory breaches, warnings and potential referrals to Enforcement and Sanctions. It includes information on the main regulatory metrics: capital ratios, liquidity ratios, Leverage ratio, and Large Exposures.</p> <p>The ECB's supervisory processes and powers are generally sufficient to resolve issues. In the event an institution remains non-compliant or when the severity of the finding so requires from the outset, the ECB may resort to enforcement measures and sanctions which pursue different objectives. While enforcement measures aim at compelling supervised entities to comply with prudential requirements, sanctions are intended to punish misconduct and deter future infringements. Before CRD 6, ECB's enforcement powers were limited as PPP were the only enforcement tool directly available to the ECB in every jurisdiction. Nevertheless, the ECB could also employ directly other types of enforcement measures to affirmatively compel supervised entities to comply with applicable supervisory or legal requirements, but only when provided for in the national transposition of CRD. In addition, other purely national measures could be imposed indirectly by the ECB by way of requests to NCAs.</p> <p>The ECB has not been provided express authority to adopt "cease and desist" orders directly as an additional supervisory tool. In some cases, if the measures stemming from CRD such as cease and desists orders are qualified as enforcement measures in the national legislations implementing the CRD, the ECB may apply these directly based on Article 9(1) 2nd paragraph of the SSMR. Otherwise, the ECB may impose such measures indirectly by way of requests address to the NCAs (under Articles 9(3) and 18(5) SSMR).</p> <p>As concerns sanctions, the SSM has the power to impose both pecuniary and non-pecuniary penalties. The former can be imposed directly by the ECB and the latter indirectly by way of requests to NCAs to open sanctioning proceedings.</p> <p>The ECB enforcement and sanctioning powers have been reinforced with the recent coming into force of CRD 6, which provides for an enlarged application of administrative penalties by broadening the list of sanctionable breaches, as well as ensures further harmonization of enforcement tools by introducing the distinction between 'administrative sanctions' and 'enforcement measures' and enlarging the scope of application of PPPs. These new powers had not yet been used at the time of the assessment as CRD 6 remained to be transposed into national legislations.</p>
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	<p>The ECB is accountable to the European Parliament and to the Council for the implementation of the SSMR and, for this purpose, must submit on an annual basis to the European Parliament, to the Council, to the Commission and to the Eurogroup a report on the execution of the tasks conferred on it. This follows from the provisions of the Treaty on the Functioning of the European Union (TFEU) which provides that the ECB should, in accordance with the general principles common to the laws of the member states, make good any damage caused by it or by its servants in the performance of their duties.</p> <p>While the ECB is responsible for the damages it may cause in the discharge of its duties (see recital 61). SSM regulation) and accountable to the Parliament and the Council in the discharge of its supervisory tasks, there are no laws or regulations that specifically guard against the supervisor unduly delaying corrective actions.</p> <p>Internally, the SREP process is meant to incorporate all findings and measures and is followed up through the internal monitoring processes in a timely manner. With the aim of expediting supervisory action, the ECB has developed an internal process for the referral of suspected breaches identified either in the context of the SREP or of any other supervisory activity to the ECB's independent investigating unit. This unit assesses the referred breaches and decides whether to open a sanctioning procedure, taking into consideration all the circumstances of the case, the severity of the alleged breach and the urgency of the matter.</p> <p>The response time to breaches by way of imposition of sanctions has improved over time with the adoption of this process and the method of setting administrative penalties as well as the experience gained. In the cases where the ECB has direct sanctioning powers, the SSMR and Regulation 2532/98 provide what is, in principle, a 'reasonable time' for the ECB to impose a sanction without contradicting the general principles of EU law (i.e., five years from the date when the breach was committed or, in case of on-going or repeated breaches, when the breach ceased to exist). Regarding the cases where the ECB has only indirect sanctioning powers by requesting the relevant NCA to open proceedings, the EU regulations do not contain any explicit rule on the limitation period to be applied. In these cases, the ECB is obliged to respect the general principles of Union law, in particular the aforementioned principle of reasonable time, acting in due consideration of the national time limits.</p>
11 EC4	<p>The supervisor uses a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above [BCP40.26(2)]. These measures include the ability to impose sanctions expeditiously or require a bank to take timely corrective action. 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 licence.</p>

Description and findings re EC4	<p>The ECB can require banks to take corrective actions through supervisory measures and also impose enforcement measures and sanctions.</p> <p><u>Supervisory measures</u></p> <p>The findings, the measures (the deficiencies and the response expected), and the rationale for the actions to be taken are laid out in the SREP letter and/or in such other ECB decision under Article 16 SSMR.</p> <p>The SSMR gives ECB broad powers to impose supervisory measures:</p> <ul style="list-style-type: none"> (a) to require institutions to hold own funds in excess of the capital requirements (b) to require the reinforcement of the arrangements, processes, mechanisms and strategies; (c) to require institutions to present a plan to restore compliance with supervisory requirements (d) to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements; (e) 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; (f) to require the reduction of the risk inherent in the activities, products and systems of institutions; (g) 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; (h) to require institutions to use net profits to strengthen own funds; (i) to restrict or prohibit distributions by the institution to shareholders, members or holders of Additional Tier 1 instruments; (j) to impose additional or more frequent reporting requirements (k) to impose specific liquidity requirements (l) to require additional disclosures; (m) to remove at any time members from the management body of credit institutions who do not fulfil the requirements set out in the acts <p>Thus, the SSMR provides the ECB with the authority to take action direct against the supervised entities as listed in the EC, while actions against individuals can only be undertaken through the NCAs in the situations mentioned in the CRD and subject to the conditions laid out in the National Laws.</p> <p>According to the SSMR, complementary to the aforementioned powers and for the purpose of carrying out its supervisory tasks, the ECB can directly exercise all powers conferred on the NCAs by national law transposing Union law directives. Thus, the ECB may directly adopt those measures that NCAs should have under the national law implementing relevant directives. Further, the ECB may make use, by way of instructions to the national competent authorities, of additional powers under national law (if any) that go beyond the scope of CRR and CRD ('purely national' powers) and whose exercise is necessary for the fulfilment of the tasks conferred on the ECB, where the SSMR does not confer such direct powers on the ECB. In such a case, the use of those powers will follow the procedures and the conditions set out in national law.</p>
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Overall, the SSM has a wide range of supervisory measures available, although there is scope for harmonizing the conditions for adopting supervisory and early intervention powers. The SSM may use either supervisory powers under the SSMR, which includes a number of early intervention tools, or the ‘early intervention’ powers in the BRRD. The latter includes powers to require a restructuring plan; limit lending, deposit growth, or other business activities; require implementation of recovery plan options; and to dismiss management (while having a broader scope, Article 16(2) of the SSMR includes most of these powers). Early intervention powers under the BRRD have rarely been used, in part due to higher triggers for their use and concerns that they may be more likely to face successful legal challenges. Supervisory measures can be introduced under SSMR when arrangements, strategies, processes and mechanisms implemented by the credit institution do not ensure a sound management and coverage of its risks, while the criteria for adopting early intervention measures under the BRRD are more restrictive (i.e., a bank has breached or, due to a rapidly deteriorating financial conditions, is likely to breach prudential requirements).

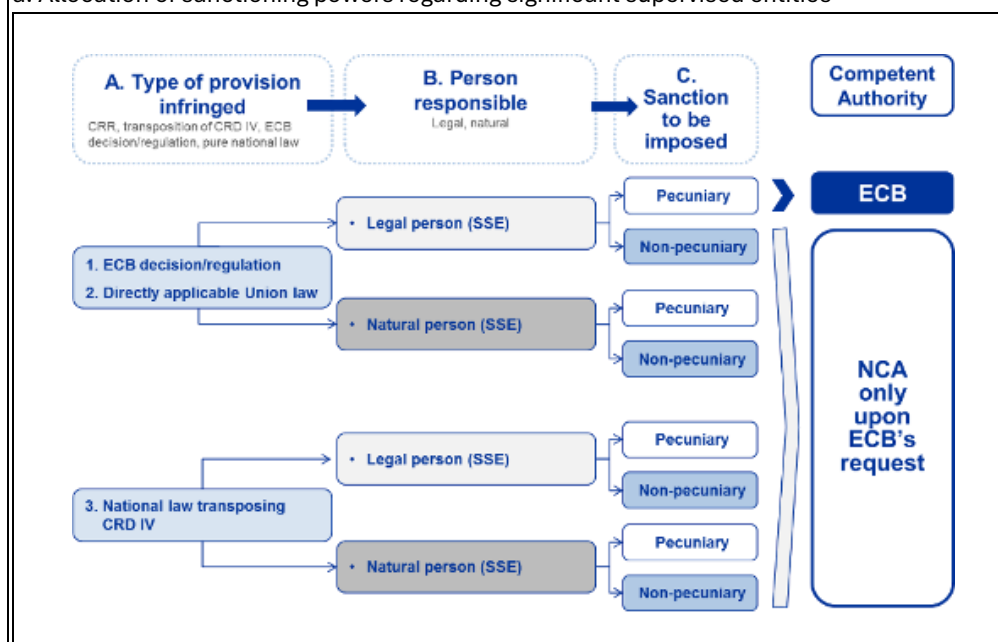
There would be merit in including all supervisory and early intervention powers currently included in the SSMR and BRRD under a single provision in a directly applicable EU legislation, as has been proposed by the EC in the context of the CMDI review. The use of these powers should be subject to the same conditions, with a view to ensuring that the ECB can always intervene promptly even if an infringement or likely infringement of prudential requirements has not yet materialized. This would remove some unnecessary conditions for the use of early intervention powers under the BRRD.

Sanctioning powers

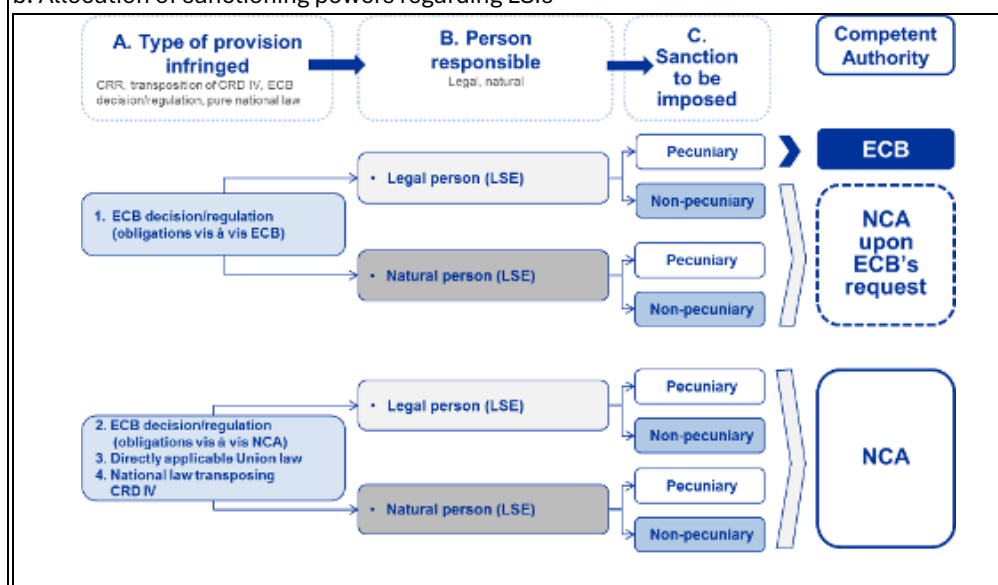
A summary of the distribution of sanctioning and enforcement powers relating to SIs as well as LSIs is presented in the tables below.

Sanctioning powers are distributed between the ECB and the NCAs. The allocation of these powers 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) type of person responsible (i.e. supervised entity or natural person,); (iii) sanction to be imposed (i.e. pecuniary or non-pecuniary).

a. Allocation of sanctioning powers regarding significant supervised entities



b. Allocation of sanctioning powers regarding LSIs



By way of exception, NCAs can impose sanctions relating to the common procedures (licensing or acquisitions of qualifying holdings) concerning LSIs for breaches of the related national provisions transposing CRD only upon a request of the ECB.

Where SIs intentionally or negligently breach a requirement under relevant directly applicable Union law in relation to which administrative penalties are made available to competent authorities, the ECB may impose administrative pecuniary penalties. These financial sanctions can be 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. This maximum amount applies to breaches of ECB regulations or decisions as well. A guide setting out the principles and method for determining the administrative pecuniary penalties is published on the ECB website. The list of breaches for which administrative penalties are made available to competent authorities will be extended with the entry into force of CRD6, thus increasing the scope of sanctionable breaches by the ECB.

Finally, the ECB can also require NCAs 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. NCAs are required to notify the ECB once a national procedure initiated at the request of the ECB has been completed. NCAs can only open sanctioning proceedings or take enforcement actions against SIs for breaches of prudential requirements at the request of the ECB.

Enforcement measures

The ECB also has the power to impose enforcement measures to compel a significant credit institution to comply with (i) an ECB supervisory decision or regulation or (ii) an obligation under relevant Union law. The ECB can also impose enforcement measures against LSIs for ongoing breaches of ECB decisions or regulations imposing an obligation vis-à-vis the ECB. The allocation of enforcement powers between the ECB and the NCA is as follows:

ECB ENFORCEMENT POWERS			
Enforcement measures	Measures directly available to ECB		Measures indirectly available to ECB
	Periodic Penalty Payments (Art. 18(7) SSMR, Reg. 2532/98, Art. 129 SSMFR)	Tools qualifying as enforcement measures under the national law transposing relevant Directives (Art 9(1) SSMR)	Pure national enforcement measures not related to transposition of relevant Directives (Art 9(1) SSMR)
Authority exercising the measure	ECB		NCA (under ECB instructions)
Subject person	Significant Supervised Entities (SSE), Less Significant Supervised Entities (LSE), Natural persons.		

As regards the types of enforcement measures available, the ECB may directly impose PPPs provided for in Council Regulation (EC) No 2532/98 in cases of ongoing breaches of ECB supervisory decisions or regulations. The upper limit of PPPs should be 5 percent of the average daily turnover per day of infringement for a maximum period of six months. Upon the entry into force of CRD 6 and its national transposition, the enforcement powers of competent authorities (including the ECB) are expected to be enhanced, particularly in view

	of (i) the recognition of PPPs as a measure for restoring compliance with prudential requirements, distinct from administrative penalties and from other administrative measures and (ii) their extended scope of application. This should also reduce the asymmetry of the legal framework in this area, a shortcoming that had been pointed out in the 2018 BCP assessment.
11 EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the board, or relevant individuals. The supervisor has the power to apply corrective measures and sanctioning measures simultaneously, including financial penalties.
Description and findings re EC5	<p>As brought out in the diagram in EC 4, the ECB may directly impose sanctions only on legal entities (significant institutions) but does not have the power to directly impose sanctions on natural persons. The SSMR provides that the ECB, as the competent authority for SIs, may require national competent authorities to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed for breaches of prudential requirements. Further, national competent authorities may impose sanctions on natural persons belonging to SIs only at the ECB's request and should inform the ECB of the outcome of the proceedings. National competent authorities may also ask the ECB to request them to open proceedings to impose a sanction on natural persons belonging to a significant institution.</p> <p>As also provided in the SSM Supervisory Manual, supervisory measures, enforcement measures and sanctions, which have different objectives, are not mutually exclusive and may be used in parallel or sequentially depending on the circumstances of the case.</p>
11 EC6	The supervisor exercises its power to take corrective actions, including ring-fencing 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	As listed in EC 4, the SSMR provides the ECB with the power to ringfence a bank from the actions of related companies ("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"). This authority has been used, including together with imposing specific liquidity requirements to ringfence banks from their network of institutions.
11 EC7	Laws, regulations or the supervisor establish a clear policy on whether imposed sanctions are made a matter of public knowledge and, in that case, what to disclose and when. The decision to publish sanctions or corrective measures applied to banks and individuals (e.g. senior managers, board members, directors, officers and other employees) may be subject to confidentiality considerations, and it must not jeopardise other supervisory objectives or prejudice another case pending before the supervisor. While transparency of enforcement measures is encouraged, the decision to disclose sanctions can be made on a case-by-case basis, depending on their seriousness and the frequency of their occurrence, among other considerations.
Description and findings re EC7	The ECB is required to publish on its website any penalties imposed on supervised entities pursuant to the provisions of the CRD and the SSMFR, unless such disclosure would jeopardize financial stability, affect ongoing criminal proceedings, or cause disproportionate damage to the supervised entity.

	<p>The publication covers the name of the supervised entity, the type and nature of the penalty, the period of time during which the breach occurred and the root cause. There is no publication in the Official Journal of the EU. The ECB also publishes on its website the list of sanctions imposed by NCAs in proceedings opened at the ECB's request.</p> <p>Moreover, on a yearly basis, the ECB publishes a report on the sanctioning activities conducted by the ECB and the NCAs while exercising their tasks in relation to the prudential supervision of credit institutions within the SSM. Data from the 2023 Report shows that a total of 168 administrative penalties were imposed by the end of the year, and</p> <ul style="list-style-type: none"> • Pecuniary penalties accounted for 53 percent of those, with fines totaling around EUR 25.1 million. The highest pecuniary penalty was EUR 6.8 million imposed on an SI. For other types of persons, the highest pecuniary penalties were as follows: EUR 1.5 million for a less significant institution (LSI); EUR 0.23 million for a legal person other than an SI or an LSI; and EUR 0.07 million for a natural person. The remaining 47 percent of penalties were non-pecuniary in nature. • Sanctioning activities mainly concerned LSIs, which accounted for 62 percent of all proceedings conducted and percent of all administrative penalties imposed. Sanctioning activities concerning natural persons accounted for 30 percent of all proceedings conducted and 14 percent of all administrative penalties imposed.
11 EC8	<p>The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank (which could include closure, assisting in restructuring, or merger with a stronger institution).</p>
Description and findings re EC8	<p>The legal framework for crisis management and bank resolution is established under BRRD and SRMR. The framework defines in detail the cooperation arrangements between the ECB and the SRB/NRAs during the resolution process for SIs and is detailed in CP 1. The ECB has also decided to comply with the relevant EBA Guidelines on 'failing or likely to fail' (EBA/GL/2015/07).</p> <p>With respect to the resolution process and, in particular, when determining whether an institution is failing or likely to fail, the ECB cooperates closely with the resolution authorities (SRB/NRA). A MoU has been signed (and subsequently updated) between the ECB and SRB, which aims to ensure early and effective coordination and information sharing between the competent authority and the resolution authorities.</p> <p>More specifically, before determining the failure or likely failure of an institution, the competent and resolution authorities have to consult each other. If ECB Banking Supervision determines that the institution is failing or likely to fail, or if the ECB/SSM receives such a determination from an institution itself, ECB Banking Supervision should 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 ECB Banking Supervision that it</p>

	<p>intends to make this determination and allow the ECB three calendar days to make an assessment.</p> <p>Decisions on mergers, restructuring, etc., in a resolution context fall within the remit of the SRB, with the ECB playing primarily a consultative role. Furthermore, at a resolution stage, the BRRD envisages certain tasks to be performed by the supervisor. The ECB performs these tasks in accordance with the national transposition of the BRRD, for example, where the sale of a business tool or bail-in instrument is to be used, the assessment of the acquisition and/or a resulting qualifying holding will be performed. In case a bridge institution is set up by the resolution authority, it may submit a request to the competent authority for a temporary exemption of the conditions for authorization. In these cases, the ECB Banking Supervision could grant authorization, and it could become the competent authority for the bridge bank. The resolution authority will also request that the ECB publishes on its website a copy of the resolution order or instrument or a summary note.</p> <p>Whenever ECB Banking Supervision acts either as a home or host supervisor of a bank subject to its direct supervision, it actively participates in resolution colleges and shares information with all participating authorities as appropriate.</p>
11 EC9	Where appropriate, when taking formal corrective action in relation to a bank, the supervisor informs the supervisor of related non-bank financial entities of its actions and coordinates its actions with them.
Description and findings re EC9	<p>The CRD envisages the exchange of information between competent authorities and the authorities entrusted with the public duty of supervising other financial sector entities and the authorities responsible for the supervision of financial markets in the discharge of their supervisory functions. The SSMR also envisages the ECB as entering into MOUs with competent authorities in the member states responsible for markets in financial instruments. Accordingly, the ECB has the ability to exchange information with the supervisors of related non-bank financial entities and is thus in a position to, although not obliged to, inform them before taking corrective action against a related bank.</p> <p>However, to do so with an entity outside the SSM, a MOU will be required, and it should meet the equivalence of confidentiality required by the CRD. A sampling of the published MoUs shows provisions for request-based information sharing, which also includes corrective action but not necessarily coordinated action.</p>
Assessment of Principle 11	Largely Compliant
Comments	<p>To carry out its tasks, the ECB may adopt supervisory measures, take enforcement actions, and impose sanctions against SIs.</p> <p>The 2018 IMF assessment pointed out the lack of harmonization in the scope and approach to enforcement and sanctions resulting in similar breaches being addressed asymmetrically and recommended to harmonize direct enforcement measures and sanctions on individuals and entities regarding all breaches of the CRR. It had also recommended that the EU should give the ECB express authority to enforce “cease and desist” orders as an additional supervisory tool.</p>

The SSM enjoys a broad range of supervisory measures to intervene at an early stage, although supervisory and early intervention powers are currently included in different pieces of legislation (SSMR and BRRD) and are not subject to the same conditions for their activation.

Concerning enforcement and sanctioning powers, important changes have been made to the legislative framework since 2018. CRD 6 enhances the powers of the competent authorities by introducing periodic penalty payments as an enforcement tool for restoring compliance with prudential requirements, which are distinct from administrative penalties to sanction banks. In the case of SIs, the ECB is the unique competent authority for imposing periodic penalty payments (unlike sanctioning which remains a shared responsibility between the ECB and NCAs). CRD 6 also enlarges extensively the list of breaches for which administrative penalties are available to competent authorities (e.g., capital requirements breaches, breaches of specific governance arrangements defined in CRR, breaches of remuneration requirements, lack of compliance with supervisory decisions). Although the ECB does not have express authority to adopt “cease and desist” orders directly as an additional supervisory tool, it may adopt such measures – directly or indirectly – if the NCAs have them in their toolkit.

However, there continue to be limitations in the sanctioning powers directly available to the ECB in Union law. Under the SSMR, the ECB can directly impose administrative pecuniary sanctions only on SIs that breach directly applicable acts of EU law, such as the CRR. In case of breaches of national law implementing EU directives, breaches committed by natural persons, or when a non-pecuniary penalty is considered, the ECB can only request the relevant NCA to open national sanctioning proceedings. Until now, there have also been material differences between the various national laws transposing the CRD that are applied by competent authorities when exercising their sanctioning powers. Several factors affect a competent authority’s decision to pursue a breach – e.g., the length of the limitation period or discretion to close a case solely for reasons of proportionality. In addition, in some member states, banks have the possibility to appeal sanctions taken by NCAs to other administrative bodies (e.g., Ministry of finance), which may result in delaying the enforceability of sanctions and negatively impact the effectiveness of the sanction policy.

In the assessors’ view, the current approach which relies on a mix of centralized and decentralized sanctioning responsibilities is not a substitute for a more integrated framework whereby all corrective and sanctioning powers rest with one supervisory authority following a unique set of procedural rules with a view to ensuring a consistent and timely sanctioning policy in all SSM member states.

Notwithstanding these shortcomings, the ECB has made a big effort to streamline the enforcement and sanctions processes for taking corrective and enforcement actions and imposing penalties. This has involved the early involvement of NCAs as soon as a referral is received and the use of an informal consultation with an expert group on Enforcement and Sanctions. The average length of proceedings has started to come down and will help in reducing the dependence on (or conversely increasing the effectiveness of) moral suasion for influencing bank behavior.

	<p>Overall, the ECB has shown to be more willing to escalate more rapidly than in the past, including to take enforcement actions to ensure that supervised entities comply with its requirements. An escalation framework has been introduced to expedite the internal processes and decision-making and to facilitate the full and timely use of its tools by supervisors, e.g. from moral suasion through the imposition of Periodic Penalty Payments (PPPs). The ECB now appears to be more willing to take on legal risk than in the past in taking enforcement actions. A case in point is the action it has taken in the case of climate-related and environmental financial risks in its creditable vision for the need to manage risks associated with a net-zero carbon and more sustainable future and the physical impact from climate change and environmental degradation. It has engaged in continuous dialogue with supervised entities, provided regular feedback to banks through operational letters as well as issued binding supervisory decisions and set final deadlines for banks to comply with the requirements imposed in those decisions. The ECB further clarified in 2022 that it would take enforcement action, if necessary. This willingness to take more enforcement actions than in the past could also help in influencing wider deterrence in the banking system. Apart from climate-related financial risks, enforcement tools have, however, rarely been used.</p> <p>The ECB has also recognized that more efforts need to be made to eliminate the backlog in the follow-up and remediation of the stock of pending measures. The supervisory priorities announced for 2025-27 include further strengthening banks' efforts to effectively address material shortcomings identified by supervisors in previous cycles and remedying them in a timely manner. These efforts will focus on areas which have been subject to close supervisory scrutiny in the past, including risk data aggregation and risk reporting (RDARR) – where, despite long-standing engagement with supervisors and acknowledged improvements, some banks have still not addressed major shortcomings. In addition, full compliance with supervisory expectations as regards banks' management of climate-related and environmental risks will remain a priority. The assessors are of the view that reducing the stock of pending measures will require specifying more clearly what is required or expected from banks in the SREP letters and resorting to stricter measures, notably in the case of banks struggling with the same issue for several years, whether it is in relation to climate risk management (as already initiated), risk data aggregation and risk reporting (as currently envisaged by the SSM) or any other significant issues that remain unaddressed (e.g., excessive risk taking, weak risk management or internal governance).</p>
Principle 12	Consolidated supervision. ³⁷ 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.
Essential criteria	
12 EC1	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, whether domestic or cross-border. The supervisor understands and assesses how

³⁷ Reference documents: BCBS, Principles for the supervision of financial conglomerates, September 2012; BCBS, Home-host information sharing for effective Basel II implementation, June 2006; BCBS, The supervision of cross-border banking, October 1996; BCBS, Principles for the supervision of banks' foreign establishments, May 1983; BCBS, Consolidated supervision of banks' international activities, March 1979; [SCO10].

	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 reputational risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>As the competent authority, the ECB conducts its supervision at consolidated, sub-consolidated, and single-entity levels within a banking group. The ECB has the discretion to waive prudential requirements on an individual basis if certain conditions are met subject to Articles 7 (derogation from prudential standards applying on solo basis), 8 (derogation from liquidity requirements on solo basis), and 10 (waiver for solo solvency and liquidity requirements for credit institutions permanently affiliated to a central body) of CRR. In the case of a financial conglomerate, the ECB also takes into account the outcome of the supplementary supervision as required by FICOD which governs the cooperation among sector supervisors.</p> <p><i>Consolidated supervision</i></p> <p>Consolidated supervision generally consists of the following elements:</p> <ul style="list-style-type: none"> • The day-to-day supervision of each supervised group is carried out by a JST, comprising staff from both the ECB and NCAs and coordinated by an ECB coordinator. • 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. <p>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.</p> <p>For solo/sub-consolidated supervision of subsidiaries and branches established in third countries (outside the EU), the model based on Memoranda of Understanding, and if possible on colleges as set out in CRD, applies.</p> <p>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.</p> <p>Risks arising from participation in consolidated entities that are not supervised as credit institutions by ECB banking supervision (i.e., supervised by other authorities such as insurance supervisors, financial market regulators, or not supervised at all) are also considered as part of the SREP.</p> <p>The assessors met with JST team members of consolidated banking groups with numerous subsidiaries and foreign subsidiaries or operations to get a practical understanding of the ECB's supervisory approach to consolidated entities.</p>

	<p>Findings of sub-consolidated or single entity (i.e. solo) supervision feeds the consolidated supervision of banking group.</p> <p>The JST Coordinator leads the ongoing supervision in supervisory teams and coordinates by referring to ECB delegated experts and NCA experts directly. JST coordinator mandates the sub-coordinator of the parent company with the management of specific tasks. The core JST plays a role in consolidated supervision with respect to information exchange and the 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 sub-coordinator is the NCA staff in the JST, who is assigned as the competent organizational manager for the parent company and participates in the discussions on strategic issues related to the supervisory program. The JST coordinator liaises with the JST sub-coordinators on important supervisory issues like SREP decisions. The experts involved in consolidated supervision include the ECB supervisors, those from the NCA previously responsible for the parent company before the SSM was established, and supervisors overseeing material subsidiaries. They are organized as one cross-border team to avoid unnecessary competition and potential overlap between the ECB and the NCA supervisors.</p> <p>Solo and sub-consolidation level supervision is under management of JST sub-coordinator - planning the supervisory activities with his/her team. The teams can get support from the ECB staff working at the national level for parent entity and material subsidiaries. The JST coordinator still has right to directly contact with the employees involved in the sub-consolidated or solo supervision.</p> <p><i>Financial conglomerates</i></p> <p>Financial conglomerates are identified where certain criteria are met in accordance with FICOD.³⁸ The assessment of financial conglomerates includes (i) an extension of the scope of four SREP elements to account for risks coming from non-banking entities and (ii) an additional layer of supervision (on top of the sector-specific supervision) in line with FICOD (i.e., supplementary supervision).</p> <p>In the case of bank-led financial conglomerates, the SREP assesses the potential impact of nonbanking activities on the risk profile, profitability, capital and liquidity position of the banking part of the financial conglomerates together with overall situation at the conglomerate level. During the assessment, JSTs would need to understand the risks from</p>
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³⁸ A financial conglomerate is a group or subgroup formed of companies that operate both in the banking or investment sector and in the insurance sector, and the consolidated and/or aggregated activities of the entities in the group within the insurance sector and the consolidated and/or aggregated activities of the entities within the banking and investment services sector are both significant. The thresholds for determining the significance and identifying financial conglomerates are based on fixed percentages of balance sheet. While FICOD provides supervisory discretion by allowing the coordinator to replace or complement the criterion based on balance sheet assets with other parameters, namely income structure, off-balance sheet activities or total assets under management, this provision that would make the identification criteria more risk-based has never been used by the JSTs due to a lack of methodology within the ECB.

	<p>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 banking part of the conglomerate. This assessment may lead to additional specific supervisory requirements in the context of the supplementary supervision required for financial conglomerates.</p> <p>Due to separate regulatory requirements for each sector, financial conglomerates may have separate databases for risk data of banking, insurance and other activities. Some form of consolidation of risks is, however, performed within financial conglomerates and is presented in financial conglomerates' internal risk dashboards. Where ECB is the coordinator for conglomerate supervision, it receives conglomerate's data from the supervised banking entity which heads the financial conglomerate. The ECB is currently the coordinator for 28 financial conglomerates, five of them containing a G-SIB. There are two financial conglomerates where the ECB supervises the banking element but is not the lead supervisor. If the supervised institution is managing the risks in a fully integrated manner, the information provided may be used in the assessment. The ECB may also receive information from the competent insurance supervisors. FICOD provides that the relevant competent authorities should exchange any information which is essential or relevant for the exercise of the other authorities' supervisory tasks under the sectoral rules and FICOD. While many exchanges between the ECB and the other relevant competent authorities exist (for instance through the financial conglomerate colleges), the assessors saw limited examples of joint supervisory work with insurance supervisors, such as for example, joint onsite inspections.</p> <p>The supplementary supervision of financial conglomerates under FICOD does not substitute sectoral supervision but addresses risks that stem from the activities of group in different financial sectors. Specifically, supplementary supervision addresses capital adequacy at group level (i.e. avoidance of "double gearing" across the sectors), contagion (i.e. supervising intra-group transactions), concentration (i.e. supervising risk concentration across business lines), conflict of interest (i.e. the issues with respect to corporate governance), and complexity. The supplementary supervision of financial conglomerates was not reviewed as part the BCP assessment.</p> <p><i>Intensity of supervision of banking groups</i></p> <p>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. The assessors were provided several examples of the ECB's analysis of a banking group's structure and its management of group-wide domestic and cross-border risks.</p> <p>The dimensions considered while mapping the group's perimeter includes, as a minimum, the following:</p> <p>a) Degree of relevance of the subsidiary/sub-consolidated group:</p>
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	<p>"Relevance" indicates the importance of a given subsidiary/sub-consolidated group 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.</p> <p>b) Degree of significance of the subsidiary/sub-consolidated group:</p> <p>"Significance" indicates the importance that a given subsidiary/sub-consolidated group holds in the local market, 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. There may, of course, be cases where the statuses of significance and relevance do not correspond to each other.</p> <p>c) Degree of centralization/decentralization of strategy, business, operations, risk governance and controls:</p> <p>Institutions' organizational 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, backup 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. Indeed, the higher the degree of centralization, the less significant the contribution to the analysis on a solo basis, at least potentially, and vice versa.</p> <p>d) Level of perceived risk:</p> <p>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>This mapping is an important input for the supervisory planning and allows for the identification of two subsets of subsidiaries/sub-consolidated groups. First subset involves significant and/or relevant and/or more autonomous and/or riskier (material subsidiaries) - warranting a level of supervisory intensity comparable to that applied at the consolidated level. The second subset is the remaining entities (non-material subsidiaries), for which the supervisory intensity may be lower. The mapping, to be performed along the</p>
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	<p>aforementioned dimensions, is the JST's responsibility, supported by the College Working Group and NCAs where needed.</p> <p>The JSTs assess the business model viability indicators on a consolidated level to assess viability by means of a quantitative analysis of several risk indicators at the consolidated level, and to compare to peers. These and other indicators give the analyst a full picture of the real and concrete strategy pursued by the bank and the key metrics regarding profitability at the consolidated level. They use 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). All available information from FINREP and COREP, data and indicators available in IMAS as well as data from external providers will form the starting point of the analysis.</p>
12 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, exposures to related parties, lending limits and group structure.</p>
Description and findings re EC2	<p>Prudential standards established by the CRR/CRD (Pillar 1 and Pillar 2 requirements) are imposed at consolidated, sub-consolidated and on institutions on an individual under Article 6 of the CRR (unless a waiver is granted under Articles 7, 8 and 10 of the CRR). According to the CRR, a "consolidated situation" is defined as "the situation that results from applying the requirements of CRR to an institution as if that institution formed, together with one or more other entities included in the scope of prudential consolidation, a single institution". See EC 5 for further details on the scope of entities included in scope of prudential consolidation.</p> <p>The CRR requires banks to comply with own funds, capital requirements, large exposures, liquidity, leverage, and disclosure standards on a consolidated basis. The CRR provides that that relevant information should be reported on both a solo and consolidated basis (and sub-consolidated basis where applicable) unless a waiver from reporting on a solo basis applies (See CP 10). The assessment of EC1 applies here in regard to the supervision of the different levels of institutions. The supervisor collects and analyses information on a consolidated basis for the banking group covering various business areas. Resources and the intensity of supervisory activity are based upon risk and systemic importance (See EC1).</p> <p>The assessors saw several examples of consolidated financial review and in-depth analysis of banking groups' capital, liquidity, concentrations, lending limits, and group structure conducted by the JSTs.</p>
12 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. The supervisor determines that parent banks have unimpeded access to all 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 considers the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>

Description and findings re EC3	<p>The ECB has implemented a group-wide supervisory approach when assessing legal entities. The supervisor gathers all information necessary, such as information concerning 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. The results from those assessments feed into the reliability assessment for capital and liquidity determinations.</p> <p>In the case of home/host relationships, appropriate coordination and cooperation, including the exchange of information, is organized through the colleges of supervisors, in line with the Commission Delegated Regulation and Commission Implementing Regulation (see CP 13 for further details on this process).</p> <p>The assessors were provided with sample supervisory reviews of the adequacy of SI groups' oversight of their foreign operations which reveal that the ECB thoroughly assesses SIs' oversight of foreign operations. The sample of onsite "operational act" letters assessed internal governance, risk management, compliance, internal audit, and financial activities at the entities' foreign operations.</p>
12 EC4	<p>The home supervisor visits the foreign offices of the bank periodically. The location and frequency of these visits are determined by the risk profile and systemic importance of the bank's foreign operations. 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 require additional reporting, and it has the power and resources to take those actions as and when appropriate.</p>
Description and findings re EC4	<p>Article 12 of SSMR empowers the ECB to conduct all necessary on-site inspections at the business premises of the legal persons referred to in Article 10(1) SSMR 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) SSMR.</p> <p>Colleges of supervisors are the main 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 and CRR. CRD 5 and CRR 2 incorporated new amendments, enlarging the application of the framework of supervisory colleges to mixed financial holding companies and financial holding companies that take management, operational or financial decisions brought under the direct scope of the CRD and CRR. The ECB has the role of home supervisor for significant banking groups where the ECB is the consolidating supervisor. Colleges include supervisors from non-participating member states (European colleges) or from countries outside the EU (international colleges).</p> <p>Regarding cross-border inspections conducted in countries outside the euro area in the last 5 years, the ECB performed 90 onsite inspections and 28 internal model inspections (IMIs).</p> <p>The assessors reviewed several agendas and minutes of supervisory college meetings during which banks with cross borders operations were discussed between home/host supervisors.</p>

	Discussions covered multiple topics including financial results, business model and organizational changes, supervisory findings, and substantive international policy issues.
12 EC5	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 takes appropriate supervisory action.
Description and findings re EC5	<p>A bank may have as its ultimate parent another bank, an FHC, an MFHC in the case of financial conglomerates, or a nonfinancial parent in the case of corporate ownership of banks.</p> <p>A financial holding company is defined in the CRR as a financial institution, the subsidiaries of which are exclusively or mainly institutions or financial institutions, at least one of such subsidiaries being an institution. Financial services must represent the predominant activity of the group parented by a financial holding company.</p> <p>A mixed financial holding company is a parent undertaking, other than a regulated entity, which together with its subsidiaries constitutes a financial conglomerate.</p> <p>A mixed activity holding company is a parent undertaking, other than a financial holding company or an institution or a mixed financial holding company, the subsidiaries of which include at least one institution.</p> <p>Under SSMR Article 10, the ECB may require all information necessary from credit institutions, FHCs, MFHCs, mixed-activity holding companies (in the participating member states), persons belonging to the above entities, and third parties to whom the above entities have outsourced functions or activities.</p> <p>Bank parent companies, FHCs and MFHCs are included in the prudential perimeter for prudential requirements. They are also subject to the prudential requirements unless these provisions are waived as described in EC 1 and EC 2. Supervisory and investigatory powers, as set out in SSMR, are also applicable to these holding companies. Subsidiary undertakings that are institutions, financial institutions or ancillary services undertakings are included in the scope of prudential consolidation, while the ECB can impose the prudential consolidation of undertakings which are not controlled or are not financial institutions when deemed necessary from a risk perspective. Parent FHCs and parent MFHCs are subject to a specific approval process under the CRD.</p> <p>Mixed activity holding companies are neither included in the scope of prudential consolidation nor subject to an approval process.</p> <p><i>Financial conglomerates</i></p> <p>Additional information on the supervision of non-banking activities within a financial conglomerate is found in EC 1 and EC 2. For financial conglomerates, the JSTs analyze contributions from insurance and other non-banking sectors to the financial conglomerates profitability in the short term and medium term with the analysis of scenario projections (typically over 3 years). In this sense, management information and audited accounting</p>

	<p>information help identifying the contribution of non-banking sectors to recurrent income at financial conglomerate level (e.g. percent fees from the insurance business); non recurrent income at financial conglomerate level (e.g. one-off results from sales of assets); and financial conglomerate cost structure (e.g. cost-to-income ratio), considering transfer pricing and shared services.</p> <p>The JST analyses in depth the information on the form of links that the top entity has with the entities exercising non-banking business. The analysis of this information aims at understanding the real reasons for the SIs having links with the insurance undertakings and other non-banking activities and, therefore, at understanding the sustainability of the financial conglomerates (i.e. cross-sectoral) business model, since the stricter the link in terms of capital, organization or governance, the higher could be the cross-sectoral synergies but also the cross-sectoral business model risks.</p> <p><i>Mixed-activity groups</i></p> <p>With the advent of large and complex mixed activity groups – distinct from financial conglomerates as defined in the EU legislation, it is essential for the supervisor to consider activities and entities in the wider group that could have an impact on the banking entity and the banking group. The ECB has observed that large non-bank groups, including those that provide financial technology ('FinTech') are increasing their financial activities in the EU. Those mixed activities groups can offer a range of different financial and non-financial services and may comprise regulated banks.</p> <p>Large and complex groups may deliberately structure their activities to avoid establishing a financial holding company with a view to escaping prudential consolidated supervision (as mentioned above, financial services must represent the predominant activity of the group parented by a financial holding company, which may not necessarily be the case in a mixed-activity group). Furthermore, FICOD does not provide an adequate framework for the supervision of such mixed activity groups. First, the criteria for identifying a financial conglomerate would not be met if the group of entities only includes banks. Second, the financial conglomerate itself may be included in a wider group, and supplementary supervision does not extend to group entities that lie outside the financial conglomerate. In a recent opinion, the ECB has made the point that competent authorities lack an appropriate mandate for group-wide and cross-border activities and that they should be adequately informed regarding all direct and indirect financial activities conducted by large and complex mixed-activity groups, and that the relevant information is properly shared between all competent authorities (including those in charge of supervising non-bank service providers). This is indeed a critical dimension from a BCP perspective as the banking supervisor needs such information to assess risks to banks posed by entities in their wider groups.</p> <p>The EBA and ECB have been working actively on these new developments. The EBA conducted in 2023 a stocktake of BigTech subsidiaries providing financial services in the EU and is about to launch another monitoring exercise in 2025. The ECB has also started exploring potential policy options to better regulate and supervise mixed-activity groups,</p>
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	including through strengthening prudential supervision of all financial services providers and introducing group-wide supervision. This would require legislative changes.
12 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 is compromised because the activities expose it to excessive risk and/or are not properly managed; (b) the supervision by other domestic authorities 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>The ECB is empowered, inter alia (please refer also to BCP 8, EC3), 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 and to require the reduction of the risk inherent in the activities, products and systems of institutions.</p> <p>As the competent authority for licensing (See CP 5), the ECB can also limit the range of activities at the licensing phase - if applicable according to national law. At the licensing stage, the ECB aims to ensure that applying entities meet relevant requirements, in particular on governance, conduct of business, prudential requirements and business model (program of operations), and fulfil the applicable national requirements. A license can be withdrawn by the ECB on its own initiative.</p> <p>Assessors saw examples where the authority used from moral suasion to incentivize banks to divest from cross-border activities.</p>
12 EC7	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 solo basis and understands its relationship with other members of the group. ³⁹
Description and findings re EC7	<p>In addition to supervising on a consolidated basis, supervision also takes place on individual level in the banking group in order to gain a better understanding of the group dimension. The application of prudential requirements at solo level may be waived by the ECB based on specific criteria.</p> <p>The ECB as the competent authority 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 Article 7, 8 and 10 of the CRR. Within the SREP, the various assessments are performed at different frequencies, which can be fine-tuned for each individual institution.</p> <p>Assessors saw SREP assessments where individual entities in the group are assessed.</p>

³⁹ Refer to Principle 16, additional criterion 2 [BCP40.38].

Additional criterion	
12 AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for senior management of parent companies.
Description and findings re AC1	Only general criteria exist under Article 23 of CRD to assess the suitability of a corporate acquirer. In the case of ownership in banks by corporates, no authority exists to conduct fit and proper reviews on an ongoing basis of senior management of banks' nonfinancial parent companies.
Assessment of Principle 12	Largely Compliant
Comments	<p>Banking prudential standards established by the CRR/CRD are imposed at consolidated, sub-consolidated and individual basis within banking groups. The ECB undertakes intensive supervision of banks on both a standalone and consolidated basis. This was displayed to the assessors during reviews and presentations of the supervisory process. The ECB can also be the coordinator for bank-led financial conglomerates. In addition, the ECB regularly engages with host supervisors responsible for the supervision of the foreign operations of SIs and has established bilateral supervisory relationships with many host supervisors that enable the mutual exchange of information. This, in turn, facilitates consolidated supervision.</p> <p>A bank may have as its ultimate parent another bank, an FHC, an MFHC in the case of financial conglomerates, or a nonfinancial parent in the case of corporate ownership of banks. Bank parent companies, FHCs and MFHCs are included in the prudential perimeter for prudential requirements. Supervisory and investigatory powers as set out in SSMR are also applicable to these holding companies. Subsidiary undertakings that are institutions, financial institutions or ancillary services undertakings are included in consolidation, while the ECB can impose the prudential consolidation of undertakings which are not controlled or are not financial institutions, when deemed necessary from a risk perspective. Parent FHCs and parent MFHCs are subject to a specific approval process under the CRD.</p> <p>In the case of bank-led financial conglomerates, the ECB assesses 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. The ECB also ensures that the supplementary supervision requirements are fulfilled. To carry out supplementary supervision, JSTs receive specific information on capital adequacy, intra-group transactions, risk concentration and internal governance. Harmonizing the reporting on solvency of financial conglomerates and introducing a reporting on liquidity would certainly facilitate and enhance the analysis of risks posed to financial conglomerates and their banking components. The assessors saw limited examples of joint supervisory work with insurance supervisors, such as for example, joint onsite inspections.</p> <p>With the advent of large and complex mixed activity groups – distinct from financial conglomerates as defined in the EU legislation, it is essential for the supervisor to consider activities and entities in the wider group that could have an impact on the banking entity and the banking group. In that respect, the ECB has observed that large non-bank groups, including those that provide financial technology ('FinTech') are increasing their financial</p>

	<p>activities in the EU. Those mixed activities groups can offer a range of different financial and non-financial services and may comprise regulated banks. Large and complex groups may deliberately structure their activities to avoid establishing a financial holding company with a view to escaping prudential consolidated supervision. Furthermore, FICOD which is focused on bancassurance groups does not provide an adequate framework for the supervision of mixed activity groups. In a recent opinion, the ECB has made the point that competent authorities lack an appropriate mandate for group-wide and cross-border activities in the case of mixed-activity groups, and that they should be adequately informed regarding all direct and indirect financial activities conducted by large and complex mixed-activity groups with relevant information being properly shared between the competent authorities. This is indeed a critical dimension as the banking supervisor needs such information to assess risks posed to banks by entities in the wider group.</p> <p>In the case of ownership in banks by corporates, no authority exists to do fit and proper reviews on an ongoing basis of senior management of banks' nonfinancial parent companies.</p>
Principle 13	Home-host relationships. ⁴⁰ 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	
13 EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, considering the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor which has a relevant subsidiary or a significant branch in its jurisdiction and a shared interest in the effective supervisory oversight of the banking group is included in the college. The structure of the college reflects: (i) the nature of the banking group, including its scale, structure and complexity, and its significance in host jurisdictions; and (ii) the opportunity to enhance mutual trust and meet the needs and responsibilities of both home and host supervisors.
Description and findings re EC1	<p>The JSTs are the mechanism used for information sharing, cooperation and coordination of activities for the operations of SIs in SSM member states. Each JST is composed of staff members from the ECB and from the NCAs including National Central Banks (NCBs) where the NCB is not designated as an NCA but cooperates with the NCA in the supervision based on national law</p> <p>For subsidiaries of SIs 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 prudential requirements as required by the CRD. The</p>

⁴⁰ Reference documents: Financial Stability Board (FSB), Key attributes of effective resolution regimes for financial institutions, October 2014; BCBS, Principles for effective supervisory colleges, June 2014; BCBS, Home-host information sharing for effective Basel II implementation, June 2006; BCBS, High-level principles for the cross-border implementation of the New Accord, August 2003; BCBS, Shell banks and booking offices, January 2003; BCBS, The supervision of cross-border banking, October 1996; BCBS, Information flows between banking supervisory authorities, April 1990; BCBS, Principles for the supervision of banks' foreign establishments, May 1983.

	<p>ECB chairs the college of supervisors as consolidating supervisor and NCAs participate in the colleges as observers. Supervisory college tasks are performed at least on an annual basis.</p> <p>The decision on college membership or observer status of supervisory authorities is based on a mapping exercise based on the basis of Article 2 Commission Delegated Regulation (EU) 2016/98 and Article 2 of Commission Implementing Regulation (EU) 2016/99, which identifies the entities (subsidiaries, branches, other financial sector entities) of a cross-border banking group and determines the significance of these entities for the local markets and the group. The EBA is invited as a college member by default. 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 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, participate in the colleges as members.</p> <p>Furthermore, other authorities are also invited to be observers of the supervisory college including the supervisory authorities of third countries where institutions or branches are established or authorized or have branches that are deemed important; the group-level resolution authority and the lead supervisor of the AML/CFT college. In addition, AML/CFT authorities, market supervisors and consumer protection authorities and other public sector entities with a role in prudential supervision may also be invited.</p> <p>The framework of observers' participation in colleges is recorded in the WCCAs. College structures can depend upon the size and activities of the banking group with all college members and observers attending a General College. In addition to the Supervisory College and its substructures (General College and Core College) such cooperation takes place through the CMGs, Resolution Colleges, Cross Border Stability Groups, and AML Colleges. All of them are governed by specific written arrangements. For financial conglomerates, the coordination of the supplementary supervision between the relevant (banking, insurance and market) authorities is also organized on the basis of dedicated coordination arrangements.</p> <p>Regarding LSIs, the SSM has defined a "Crisis Management Cooperation Framework" between the ECB and the NCAs. This framework serves to identify LSIs in crisis situations and to determine the cooperation, processes and information exchange at different stages between the ECB and the relevant NCA as well as with other relevant stakeholders on individual LSI crisis cases.</p> <p>In addition, the ECB has concluded and published on its website supervisory MoUs with the supervisors of G-SIBs excluding China, where negotiations are in process with the NFRA.</p>
13 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 on:</p>

	<p>(a) the material risks (including those arising from the respective macroeconomic environments) and risk management practices of the banking group; and</p> <p>(b) the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction.</p> <p>Informal or formal arrangements (such as memoranda of understanding and confidentiality agreements) are in place to enable the timely exchange of confidential information.</p>
Description and findings re EC2	<p>The ECB shares relevant information on a regular and on an ad-hoc basis with other supervisory authorities, both as a home and host supervisor, in either bi- or multilateral settings. Colleges of supervisors are an important forum for the exchange of information. The legal basis for sharing information is laid out in the CRD and the operational framework for the exchange of supervisory information in colleges is set forth in the related Commission Delegated Regulations. This empowers the sharing of group risk assessments, early warning signs and potential vulnerabilities. In an EU context, the ECB cooperates closely with other supervisory authorities and facilitates the sharing of relevant information for the exercise of supervisory tasks, as laid out in the CRD. In its capacity as consolidating supervisor for SIs the ECB establishes a framework for the exchange of information in going concern and in emergency situations through a college-specific WCCA. Under this framework, the ECB coordinates the gathering and dissemination of relevant information in going concern and emergency situations with other supervisory authorities, as well as oversight bodies, who participate in the college. Information sharing is particularly relevant with regard to liquidity, solvency, deposit guarantee, large exposures, administrative and accounting procedures, internal control mechanisms, and other factors that may influence the systemic risk posed by such institutions. The same arrangements are in place where the ECB acts as the host supervisor and relevant information is shared with the home supervisor accordingly.</p> <p>The colleges exchange among the members all information necessary to facilitate the exercise and coordination of supervisory activities and the joint decisions on institution-specific prudential requirements. Information sharing is subject to the confidentiality regime of the CRD and the competent authorities receiving confidential information can only use this information in the course of their duties. Competent authorities can also transmit to monetary authorities and authorities overseeing payment systems information related to their role and function. The information to be exchanged includes the outcomes of the SREP and a set of commonly agreed indicators.</p>
13 EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	In its capacity as consolidating supervisor for SIs, the ECB establishes a framework for the planning and coordination of supervisory activities both in going concern and in emergency situations through a college-specific WCCA. These agreements provide for the ECB and the members of the college to discuss and agree on the content of the college supervisory examination program that contains at least: (i) the areas of joint work identified as a result of the supervisory review and evaluation process or as a result of any other colleges activities undertaken, (ii) the areas of focus of the college's work and its planned supervisory activities, including on-going activities, on-site inspections and internal model investigations, (iii) the

	<p>respective supervisory examination programs of the consolidating supervisor and the members of the college, (iv) the members of the college responsible for undertaking the planned supervisory activities and (v) the expected timelines, both in terms of timing and duration.</p> <p>In its capacity as a host supervisor, the ECB shares and discusses its supervisory examination program (SEP) with the home supervisor as relevant. Planned activities and on-site missions are discussed on a college level and bilaterally. Where relevant, the home supervisor may participate as an observer or as an additional resource in scheduled missions. Furthermore, through the establishment of MoUs with third country authorities, the ECB also manages its relationship with the third country supervisors/regulators who participate in the colleges as observers.</p> <p>In addition to the WCCAs, the assessors viewed the agenda of the college meetings and other communications that reflected discussions on collaborative work. However, joint inspections and on-site visits are rarely undertaken, and this is attributed to the lack of resources or conflicting schedules.</p>
13 EC4	<p>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 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 the consistency of messages on group-wide issues.</p>
Description and findings re EC4	<p>In its capacity as consolidating supervisor for SIs, the ECB establishes a college communication policy with the college participants and sets this out in a college-specific WCCA.</p> <p>The communication policy includes the scope, frequency and channels of communication (in accordance with the CRD and the Commission Delegated Regulation (EU) 2016/98. Under this policy, the ECB, as the consolidating home supervisor, is responsible for communicating, including requesting information, with the EU parent undertaking. The other members of the college are responsible for communicating, including requesting information, with the EU institutions and EU branches within their supervisory remit. In particular, this applies to the outcomes of joint activities and college meetings, which are communicated to the parent undertaking by the consolidating supervisor, whereas host supervisors convey these messages to the entities under their respective supervision.</p> <p>As regards information sharing and communication among the involved authorities, the ECB establishes an on-going information sharing regime for SIs. For this purpose, the ECB maintains and shares with the competent authorities of a host Member State an up-to-date list for each institution containing the relevant contacts, including emergency contacts, for the exchange of information.</p> <p>Further, the Commission Implementing Regulation 201/99 also requires that the competent authorities of the home Member State and the members of the college responsible for the supervision of branches affected or likely to be affected by an emergency situation should</p>

	coordinate to the extent possible their external communications, and ex-ante agree on a range of issues including the allocation of responsibilities for coordinating external communication at the different stages of the emergency situation and the level of information to be disclosed.
13 EC5	Where appropriate, given the banking group'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, subject to rules on confidentiality, in a way that does not materially compromise the prospect of a successful resolution.
Description and findings re EC5	<p>The EU framework for cross-border crisis cooperation and coordination among home and host authorities for the management of a cross-border financial crisis has been formalized and significantly strengthened since the establishment of the SSM and the SRM, as well as the adoption of the BRRD. For SIs under direct ECB supervision, the supervisory colleges provide the framework for cooperation and coordination between competent authorities both in normal times and in crises situations. The group-level resolution authority participates in these colleges as an observer.</p> <p>In the college framework, the assessment of recovery plans, early intervention measures and the overall planning of the supervisory response of home and host authorities in preparation for and during emergency situations is performed in a coordinated way, the specific procedures for which are laid out in the WCCAs. They 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, and powers to address or remove impediments to the group resolvability, as set out in BRRD.</p> <p>With respect to group recovery plans, the ECB, as the consolidating supervisor, together with the competent authorities of subsidiaries, and with the competent authorities of significant branches insofar as is relevant to the significant branch, review the group recovery plan in the framework of the college. The assessment of the recovery plan is made in accordance with the procedure established in the BRRD through a joint decision process. This assessment also involves input from the resolution authorities (group-level – i.e., the Single Resolution Board as well as resolution authorities competent for subsidiaries domiciled in non-SSM jurisdictions) on potential actions in the recovery plan which may adversely impact the resolvability of the institution.</p> <p>In an emergency situation, the ECB, as the consolidating supervisor, and the members of the college which supervise group entities that are affected or likely to be affected by the emergency situation monitor and exchange information on the implementation of the coordinated supervisory response and coordinate to the extent possible their external communications.</p> <p>As laid out in the BRRD, where the conditions for early intervention or the appointment of a temporary administrator are met in relation to a group, the ECB, as a consolidating supervisor, consults the other competent authorities within the supervisory college and</p>

	<p>notifies the college of any early intervention measures. Where the conditions for early intervention or the appointment of a temporary administrator are met in relation to a subsidiary for which the ECB is a host authority, the ECB consults the consolidating supervisor on any measure it intends to take.</p> <p>With regard to the coordination with resolution authorities, once the ECB has determined that the preconditions for early intervention measures have been met in relation to an institution, relevant resolution authorities have to be notified without delay. Moreover, the ECB should inform relevant resolution authorities about any crisis prevention measures (including, e.g. the exercise of powers to direct removal of deficiencies or impediments to recoverability and the application of early intervention powers) and any actions taken pursuant to the CRD. Furthermore, if the situation of an institution turns into an emergency situation, the ECB should alert as soon as practicable the EBA, the NCB and the responsible ministry, and should communicate to these authorities all information essential for the fulfilment of their tasks.</p> <p>Furthermore, where the coordinated supervisory response to an emergency situation is likely to be more efficient by involving resolution authorities of subsidiaries or resolution authorities of jurisdictions in which significant branches are located, central banks, competent ministries and deposit guarantee schemes, the ECB should consider the involvement of these authorities.</p> <p>Moreover, the ECB participates in resolution colleges, which provide a framework of cooperation between the group-level resolution authority, the other resolution authorities and, where appropriate, competent authorities and consolidating supervisors concerned in order to perform the following tasks: (a) exchanging information relevant for the development of group resolution plans, for the application to groups of preparatory and preventative powers and for group resolution; (b) developing group resolution plans; (c) assessing the resolvability of groups; (d) exercising powers to address or remove impediments to the resolvability of groups; (e) deciding on the need to establish a group resolution scheme; (f) reaching the agreement on a group resolution scheme; (g) coordinating public communication of group resolution strategies and schemes; (h) coordinating the use of financing arrangements; and (i) setting the MREL for groups at consolidated and subsidiary level. In addition, resolution colleges can be used as a forum to discuss any issues relating to cross-border group resolution.</p> <p>In addition, the ECB participates as home and host authority of banking groups designated as G-SIBs by the Financial Stability Board in institution-specific CMGs for the purposes of developing recovery plans and resolution plans for such firms as crisis preparation. Within those CMGs, the ECB has concluded cooperation agreements that govern the activities and information sharing in some CMGs.</p> <p>In the case of third countries, the BRRD empowers the Commission to submit to the Council proposals for the negotiation of agreements with one or more third countries the regarding the means of cooperation between the resolution authorities and</p>
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	the relevant third country authorities, inter alia, for the purpose of information sharing in connection with recovery and resolution planning in relation to institutions, financial institutions, parent undertakings and third country institutions. The BRRD also entrusts the EBA with concluding non-binding framework cooperation arrangements with relevant third-country authorities to promote, inter alia, information sharing needed for the development of resolution plans.
13 EC6	Where appropriate, given the banking group'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 notify 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 framework for developing resolution plans is established by BRRD and SRMR. In line with this framework, the SRB as the competent (group) resolution authority is in charge of drawing up (group) resolution plans, after consulting the ECB as the competent authority for SIs. The ECB also cooperates with the SRB and the non-Banking Union NRAs to provide relevant information to them for drawing up resolution plans. The actual implementation of cooperation and information exchange is set out in a memorandum of understanding between the SRB and the ECB.</p> <p>The BRRD lays out the information that should be contained in a resolution plan. Union parent undertakings should submit this information to the group-level resolution authority, which is responsible for sharing this information with the EBA and the relevant competent supervisory and resolution authorities. In the case of information relating to EU subsidiaries of third-country groups, the group-level resolution authority should not be obliged to transmit that information without the consent of the relevant third-country supervisory authority or resolution authority.</p> <p>Group-level resolution authorities, acting jointly with the resolution authorities of subsidiaries, after consulting the relevant competent authorities, including the competent authorities of the jurisdictions of member states in which any significant branches are located, adopt resolution plans within the framework of resolution colleges. Group-level resolution authorities may also be involved in the drawing up and maintenance of group resolution plans by third country resolution authorities of jurisdictions in which the group has established subsidiaries or financial holding companies or significant branches. Group resolution plans are adopted through a Joint Decision of the resolution college in which the ECB participates as the competent supervisor in the case of SIs. Group resolution plans are reviewed, and where appropriate updated, at least annually.</p>
13 EC7	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.
Description and findings re EC7	<p>See also CP 3 EC 1 and 3 regarding the cooperation with non-SSM, EU/EEA, and third-country authorities.</p> <p>For branches of credit institutions established in EU member states that do not participate in the SSM, the ECB carries out its supervisory tasks in accordance with relevant Union law. As a</p>

	<p>host supervisor, it is responsible for assessing the risks, capital adequacy and liquidity position of supervised entities following SREP. It is also responsible for sharing all relevant and essential information with the home supervisor.</p> <p>Within the European Union, the EU-wide application of CRD and CRR ensures that, for every Member State, the operations of banks whose parent is incorporated in other member states are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.</p> <p>Subsidiaries of banks whose parent is incorporated in a third country are authorized by the ECB and subject to the same prudential and other supervisory requirements as domestic banks. Third-country branches, however, are authorized by each Member State and observe different requirements in different jurisdictions. They are supervised by NCAs under national law, and the cross-border operations of foreign banks through these branches are subject to NCA prudential and supervision requirements. They are not subject to ECB supervision regardless of their size, complexity, or interconnectedness of their operations. Only if a third country group's operations occur in a subsidiary that meets the definition of a SI it would be supervised by the ECB.</p> <p>This situation will change with the implementation of CRD 6, which categorizes third-country branches by their size and operations, lays down prudential and authorization requirements for them, and also empowers NCAs to require their subsidiarization in certain cases (as discussed in CP 5).</p>
13 EC8	<p>The home supervisor is given on-site access to local offices and subsidiaries of a banking group to facilitate its 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.</p>
Description and findings re EC8	<p>The framework of cooperation with regard to on-site visits between home and host supervisors is usually covered in MoUs with foreign supervisors. It provides for the authorities to assist each other, as far as practicable, with the conduct of on-site visits of cross-border establishments situated in the other authority's jurisdiction. It calls for prior notification of plans to visit a cross-border establishment or to appoint a third party to conduct an on-site visit on its behalf. With mutual consent, the supervisory authorities may accompany each other on such a visit.</p> <p>As regards subsidiaries and branches of a banking group where the ECB acts as the consolidating supervisor, the SSMR entitles it to conduct all necessary on-site inspections, typically with prior notifications, at the business premises of the supervised entities, subject to the relevant provisions of Union law. In this respect, when the ECB, as home supervisor, wishes to check the information concerning an institution situated in a non-participating Member State, it may ask the host supervisor, in accordance with Article 118 CRD as implemented in the jurisdiction of the host supervisor to have the check carried out. The host supervisor can carry out the check itself, allow the ECB to carry it out, or allow an auditor or expert to carry it out. The ECB may, if it would not be allowed to carry out the check itself and if it so wishes, participate in the check carried out by the host supervisor. In addition, the ECB can decide to recourse to external experts when this is considered</p>

	<p>appropriate. External experts will be appointed as team members and will carry out the tasks assigned under the lead of a Head of Mission coming from NCAs or from the ECB's Directorate General On-site & Internal Model Inspections.</p> <p>Regarding on-site inspections in third countries where the ECB acts as host supervisor, the right to inspect branches and subsidiaries would usually be granted based on MoUs.</p> <p>The ECB consults with the host authority before it visits the local offices and subsidiaries of banking groups. In general, the host authority is invited to a preparatory meeting and can also request to participate in the on-site inspection.</p>
13 EC9	<p>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.</p>
Description and findings re EC9	<p>There is no explicit legal requirement that prohibits either the authorization or the continued operation of shell banks.</p> <p>However, in terms of the CRD, a banking license is granted only where at least two persons effectively direct the business of the applicant, and the 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. Therefore, the ECB is of the view that the authorization process and the requirements of the CRD would not allow new shell banks to be licensed in the European Union. The assessors could however not get any confirmation that there are no legacy shell banks in operation in the member states and no survey to this end had been conducted.</p> <p>The ECB had clarified its interpretation of "empty shell" and its supervisory expectations of booking models in 2018 in the context of Brexit. The extent of outsourcing arrangements by the SSM entity should not result in it having the characteristics of an "empty shell" property, and banks should ensure the adequacy and quality of the governance and control environment, especially - but not limited to - intragroup outsourcing agreements. Banks are expected to have an adequate (i.e. regarding capacity and suitability) onshore-based management body exercising its executive function, which has a clear understanding of the SSM entity's booking model and associated control environment and has effective decision-making powers regarding issues related to the entity's booking model, as well as full control of its balance sheet and of transactions booked to the entity. Consequently, the expectation is that "it is unlikely that an EU-headquartered bank will be an "empty shell" when viewed in its entirety. That said, some functions or business lines of such a bank may exhibit empty shell characteristics."</p> <p>As regards booking arrangements for third-country branches, CRD 6 has introduced provisions covering the supervision of their booking arrangements, which require the recording and tracking of all assets and liabilities booked by the branch in the Member State as well as the off-balance sheet items and assets and liabilities originated in the branch but booked or held remotely elsewhere. This should limit their use as shells or mere booking offices. EBA has been tasked with preparing technical standards in this regard.</p>

13 EC10	A supervisor that takes action based on information received from, or that is consequential for the work of, another supervisor consults that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	As mentioned in ECs 1,2 and 3, the ECB shares information on a regular basis with host authorities, both in a bilateral setting, or in the context of colleges of supervisors. The ECB consults with the competent authority or authorities in the other EU member states before it takes extraordinary or significant supervisory actions (or immediately after having taken the decision, in case of urgency or if a consultation could jeopardize the effectiveness of the measure decided). In general, the Colleges are the main forum for the exchange of information and consultation, and this can take place both in college meetings as well as on an ongoing basis through calls and email exchanges. The colleges also provide the forum for taking joint supervisory decisions on certain prudential requirements as provided for in the CRD. The ECB is involved in these colleges both as a Home and Host supervisor. Third country authorities may also be invited to the Colleges and included in the WCCAs to facilitate sharing of information and consultation. In addition, bilateral MoUs on supervisory cooperation also provide a channel for communication. The ECB discussed examples where consultations with other supervisors took place prior to actions taken by the ECB.
Assessment of Principle 13	Compliant
Comments	<p>The ECB participates effectively in different types of groupings and colleges as home and host supervisor and has formal and informal cooperation and information-sharing arrangements that help facilitate its supervisory tasks. Similar arrangements with China, where some SIs operate and which is a home country for major G-SIBs, have not yet been concluded, which was pointed out in the last assessment as well.</p> <p>The agenda of college meetings and industry feedback suggests that the colleges are working well. This is also confirmed by the 2023 stock take exercise done by EBA on colleges, which has commented positively on the quality of the key deliverables and the key performance indicators (KPIs) being achieved to a great extent for the majority of colleges. It pointed out, though, that information sharing could still be enhanced on early warning signs, potential risks and vulnerabilities. It also points to the limited joint work outside of the organization of the college meetings, which was also confirmed to the assessors by the industry. The assessors also noted that there are some peer jurisdictions, who despite MoUs with the ECB, pose challenges in sharing of data .</p> <p>Although there is no explicit legal authority to prohibit shell banks, the authorization process and the supervisory expectations issued in 2018 should help ensure that new shell banks are not authorized. CRD 6 also introduces provisions limiting the use of third country branches as booking offices. There is however no information at the SSM level that could confirm whether all legacy shell banks had discontinued their operations.</p>

B. Prudential Regulations and Requirements

Principle 14	Corporate governance. ⁴¹ The supervisor determines that banks have robust corporate governance policies and processes covering, for example, corporate culture and values, strategic direction and oversight, group and organisational structure, the control environment, the suitability assessment process, the responsibilities of the banks' boards and senior management, and compensation practices. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
14 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 on expectations for sound corporate governance.
Description and findings re EC1	<p>The CRD requires 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 effective risk management."</p> <p>Further, the CRD lays down the responsibility of the management body and requires member states to ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interest. These provisions have since been subject to national transposition, although they are not entirely harmonized. Corporate Governance structures may vary based on national law and traditions, and EU banks can have either one or two-tier boards.</p> <p>The ECB places a lot of emphasis on ensuring that supervised entities have strong corporate governance arrangements. EBA has issued guidelines on Internal Governance, which elaborate on the responsibilities of a bank's board and senior management regarding corporate governance. In addition, the EBA and the ESMA have published their Joint Guidelines on the assessment of the suitability of members of the management body and key function holders. These guidelines are applied by the ECB in its FAPs and included in the FAP Guide and in the Supervisory Manual. The ECB can only assess key function holders where currently envisaged in national law. Under Article 91 CRD 6, supervisors will be able to (i) assess that key function holders meet the suitability criteria at all times in all SSM participating member states and (ii) remove key function holders who are not suitable.</p>

⁴¹ Reference documents: BCBS, High-level considerations on proportionality, July 2022; FSB, Strengthening governance frameworks to mitigate misconduct risk: a toolkit for firms and supervisors, April 2018; FSB, Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices, March 2018; BCBS, Corporate governance principles for banks, July 2015; FSB, Guidance on supervisory interaction with financial institutions on risk culture: a framework for assessing risk culture, April 2014; FSB, Principles for Sound Compensation Practices, April 2009.

	The assessment of governance arrangements is an important module in the SREP process and the EBA guidelines on SREP include “supervisory measures” that can be taken and communicated to an institution in case of deficiencies in its governance framework, in particular, as related to the responsibilities of the board and senior management.
14 EC2	The supervisor regularly conducts comprehensive evaluations of 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 to correct deficiencies in a timely manner.
Description and findings re EC2	<p>The ECB assesses Corporate Governance regularly as part of the SREP. In addition, the SEP also includes regular meetings with management bodies along with other key staff. After completing the governance assessment and establishing its view, the JST must produce an overall assessment identifying key deficiencies, mitigations and other corrective factors.</p> <p>The ECB conducts regular on-site examinations of the institutions in close cooperation with NCAs, and topics include internal control functions (risk management, compliance, and internal audit), risk data aggregation and risk reporting, risk culture and incentive system, and the implementation of the risk appetite framework (RAF). Breaches are sought to be addressed by both binding and non-binding actions, and the assessors saw several such examples.</p> <p>Several horizontal analyses and benchmarking exercises have been performed, supported by governance data collections, to support JSTs in their ongoing supervision. These have covered topics like risk culture and incentives, credit risk governance, compliance functions, and composition of the management body effectiveness and diversity.</p> <p>As part of its oversight function for LSIs, material events or draft supervisory decisions related to deficiencies in corporate governance are notified to the ECB by the NCAs.</p>
14 EC3	The supervisor determines that board membership comprises individuals with a balance of skills, diversity and expertise, who collectively possess the necessary qualifications commensurate with the size, complexity and risk profile of the bank. Board membership includes a sufficient number of experienced independent directors. ⁴² Board members are qualified (individually and collectively) for their positions, effective and exercise their “duty of care” and “duty of loyalty”. ⁴³
Description and findings re EC3	The ECB carries out the assessment of the suitability of members of management bodies of significant credit institutions in the participating member states both via the FAP process

⁴² Independent director refers to a non-executive member of the board who does not have any management responsibilities within the bank and is not under any other undue influence, internal or external, political or ownership, that would impede the board member’s exercise of objective judgment.

⁴³ The Committee defines: (i) “duty of care” as the duty of board members to decide and act on an informed and prudent basis with respect to the bank. This is often interpreted as requiring board members to approach the affairs of the company the same way that a “prudent person” would approach his or her own affairs; and (ii) “duty of loyalty” as the duty of board members to act in good faith in the interest of the company. 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 shareholders.

and through ongoing supervision. The CRD lays out expectations on the members of the management body in terms of having good repute, knowledge, skills and experience, committing sufficient time, being collectively suitable and acting with honesty, integrity and independence of mind. Formal independence of an appointee is, however, only assessed if the national legal framework of the participating Member State requires that a member of the management body in its supervisory function is formally independent. Members of the management body must at all times remain suitable for the role they are appointed for, and the emergence of new facts may lead to a reassessment of the member of the management body by the ECB. Where envisaged in national law, the ECB can also assess key function holders and the managers of branches of credit institutions. The scope and depth of such assessments is based on the national implementation of the relevant CRD provisions, taking into account the EBA Guidelines on suitability.

The joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders provide further comprehensive guidance regarding the assessment of board members. The ECB may also communicate its expectations on collective suitability via other means – for example, the ECB recently published its expectations of management bodies having at least one non-executive member with expertise in ICT and security risks in a newsletter and updated the applicable internal guidance and methodologies accordingly.

Internal guidance and methodologies also support JSTs and NCA cases when preparing a draft FAP assessment and includes additional operational and procedural guidance aimed at promoting the quality and consistency of such assessments across the SSM. Recent updates to have focused on gender diversity, climate risk and expertise in ICT and Security risks.

There is no specific requirement at the EU level for a minimum number of independent directors and this is subject to national laws. The FAP Guide and internal guidance, which are aligned with the EBA Guidelines, “expect” banks to have a “sufficient” number of independent directors; less significant and unlisted ones are expected to have “at least one” independent director.

An appointee is either considered fit and proper or is rejected. However, the ECB has the power to include recommendations, conditions and/or obligations in positive decisions in order to address certain concerns. If any concerns cannot be adequately addressed through these ancillary measures, a negative decision needs to be taken. Decisions containing an ancillary provision decreased from 32 percent of all decisions in 2022 to 9.5 percent in 2023. The most common concerns raised in the fit and proper assessments in 2023 were about time commitment, experience and conflicts of interest. This led to 47 conditions, 179 obligations and 21 recommendations. Failure to comply with a condition means that the ECB approval either never becomes effective or it ceases to be effective. An ECB decision can also include an obligation to provide information or an obligation to take a specific action relating to fitness and propriety; in the case any remaining concerns cannot be adequately addressed through these ancillary measures, a negative decision will be taken. Where all the fit and proper requirements have been met, but an issue has been identified and needs to

	<p>be addressed, the ECB may include recommendations or set out expectations within the fit and proper decision itself.</p> <p>If there are material concerns about an appointee's suitability, the ECB may deem it necessary to carry out a more in-depth assessment and may ultimately communicate its intention to adopt a negative decision. Banks then tend to withdraw the application during the supervisory dialogue. This occurred in 10 cases in 2023.</p> <p>The requirements for fit and proper assessments will be further enhanced by CRD 6 and banks will be obliged to submit the suitability application as soon as there is clear intention to appoint members of the management body and at the latest, 30 working days before the prospective members take up the position. However, the scope is limited to the management body in its executive function and Chair of management body in its supervisory function and restricted to the largest entities.</p>
14 EC4	<p>The supervisor determines that governance structures and processes for nominating and appointing board members are appropriate for the bank. Boards regularly assess the performance of the board as a whole, its committees and individual board members (including their ongoing suitability). Board membership is regularly renewed to refresh skills and independence. Commensurate with the bank's risk profile and systemic importance, board structures include audit, risk, compensation and other board committees with experienced, independent directors.</p>
Description and findings re EC 4	<p>The CRD requires member states to ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interest. It further requires that they ensure that SIs establish a nomination committee composed of members of the management body who do not perform any executive function in the institution concerned to identify and recommend, for the approval of the management body or for approval of the general meeting, candidates to fill management body vacancies; evaluate the balance of knowledge, skills, diversity and experience of the management body; prepare a description of the roles and capabilities for a particular appointment; and assess the time commitment expected. Furthermore, the nomination committee should decide on a target for the representation of the under-represented gender in the management body and prepare a policy on how to increase the number of the underrepresented gender in the management body in order to meet that target.</p> <p>The SREP Manual provides guidance on assessing the management body, complementing the fit and proper assessments. In particular, supervisors should assess any relevant aspects which may impact the ability of the management body to maintain on an on-going basis its collective suitability and adequate composition. The effectiveness of the management body is covered in ongoing supervision, including in horizontal analysis. The assessors viewed several reports covering these areas. A targeted horizontal analysis of management bodies' effectiveness and diversity was discussed at the Supervisory Board, which identified concerns related to (i) the committees' composition, (ii) the suitability & succession planning policies & processes, and (iii) the committees' functioning. The findings have supported the prioritization of these key concerns as part of the JST supervisory strategy and assisted in the update of the supervisory toolkit for JSTs (e.g. benchmarking, good and bad practices).</p>

14 EC5	The supervisor determines that the bank's board approves and oversees implementation of the bank's strategic direction, risk appetite and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), ⁴⁴ and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	<p>The CRD requires member states to ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interest in the management body. It should have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance. The setting of risk appetite and corporate culture are further elaborated in the EBA Guidelines on Internal Governance and the Guidelines on the assessment of the suitability of members of the management body.</p> <p>For ongoing supervision, this topic is covered as part of the Governance and Risk Management Element of the SSM SREP. Supervisors determine that the management body considers the institution's risk appetite in its discussions, strategic decision-making processes and group-wide risk management. The management body is responsible for the approval and regular review of the RAF. The RAF should be closely aligned with the institution's business plan, strategy, capital planning, and employee remuneration practice. In addition, it should define tolerance for disruption to critical operations. The challenge function and monitoring role of the management body in its supervisory function should effectively contribute to the institution's risk strategy. The Supervisory Manual includes as guidance several questions for JSTs to use in their analysis on risk appetite.</p> <p>The module on Risk Culture in the SREP Manual addresses how supervisors should review corporate culture and values. It calls for an assessment of the tone from the top; risk culture throughout the institution and the risk culture as reflected towards external stakeholders. The risk culture throughout the institution should be assessed by reviewing the banks' internal documents, such as the codes of conduct, whistleblowing policy, and conflicts of interest policy and how these are applied in practice: whether the principles set in the internal policies are cascaded throughout the organization; and whether they are adhered to in practice by the staff at all levels. These topics are also covered in horizontal reviews. Based on a thematic review of Risk Governance and Appetite sampling 113 SIs, several findings related to the boards' composition and effectiveness, as well as on the banks' Risk Appetite Framework, fed into the SREP cycle and were then followed up.</p> <p>Finally, as acknowledged by the ECB, despite the increased supervisory attention and the improvements already made by some institutions, "the progress made to date has not generally been sufficient," and hence, it has issued a draft Guidance on Governance and Risk Culture which sets out supervisory expectations based on the current regulatory framework and incorporates learnings based on the supervisory experience of the past decade.</p>

⁴⁴ This includes whistleblowing policies and procedures that protect employees from reprisals or other detrimental treatment.

14 EC6	<p>The supervisor determines that the bank's board, except where required otherwise by laws or regulations:</p> <ul style="list-style-type: none"> (a) has established fit and proper standards in selecting senior management and heads of the control functions; (b) has developed effective processes to allocate authority, responsibility and accountability within the bank; (c) maintains plans for succession; and (d) actively and critically oversees senior management's execution of board strategies, including monitoring the performance of senior management and heads of the control functions against the standards established for them.
Description and findings re EC6	<p>The CRD imposes on member states the responsibility to ensure that the management body complies with certain standards having the overall responsibility for the institution and having to provide effective oversight of senior management. The joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders require the competent authorities to specify the supervisory procedures applicable to the selection, appointment and succession planning of members of the management body of institutions, as well as the heads of internal control functions and the CFO.</p> <p>The SSM Manual provides guidance to supervisors on fit and proper standards, effective processes to allocate authority, succession plans and self-assessments as elements they should consider when assessing the ability of the management body to keep on on-going basis its collective suitability and an adequate composition. Accordingly, supervisors assess the ongoing suitability of the board and key function holders, banks' succession planning policies, allocation of roles and responsibilities, composition and functioning of the committees and other relevant factors. These areas have also been covered in horizontal stock takes. For instance, succession planning was identified as one of the focus areas in 2023 following a horizontal stock take, which found that most of the sampled banks neglected collective suitability aspects in the succession planning process. It also observed the lack of formalized and detailed succession planning processes, particularly for CEOs. However, good practices were also identified e.g. having an internal list of successors which is updated and reviewed or having in place mechanisms to avoid cases where several board members leave at the same time. These findings fed back into the direct supervision conducted by JSTs.</p> <p>Despite these above shortcomings, ECB supervision has been using the tools available to them to identify and address deficiencies. The assessors reviewed reports that incorporated these elements in their supervision. They also noted the many speeches and blogs by the senior executives of the ECB on the topic of governance, including collective suitability, diversity and succession planning.</p> <p>CRD 6 acknowledges that new supervisory tools are needed to support the work of competent authorities under SREP, and institutions should be required to draw up individual statements setting out the roles and duties of all members of the management body in its</p>

	management function, senior management and key function holders and a mapping of duties, including details of the reporting lines, of the lines of responsibility, and of the persons who are part of the governance arrangements of the institution, and of their duties. This is because individual duties and responsibilities are not always clearly or consistently defined and leave gaps or overlaps. Those tools should also ensure accountability of the members of the management body in its management function, of senior management and of key function holders.
14 EC7	The supervisor determines that the bank's board actively oversees the design and operation of the bank's compensation system and that it has appropriate incentives, which are aligned with prudent risk-taking and effective in addressing misconduct that potentially results in losses. The compensation system and related performance standards, policies and procedures are non-discriminatory and consistent with long-term objectives and financial soundness of the bank and are rectified if there are deficiencies.
Description and findings re EC7	<p>The design and implementation of the banks' compensation systems and their alignment with prudent risk-taking is one of the areas of focus of ECB supervision and both internal and external guidance has been provided to cover these areas.</p> <p>The CRD provides detailed requirements on the board in setting remuneration policies and their alignment with risk-taking, and these are further elaborated in the EBA Guidelines. Boards are responsible for actively overseeing the design and operation of the remuneration system, the compensation system and incentive structure through which the board and senior management disincentivize excessive risk-taking behavior and reinforce the bank's operating and risk culture. SIs should have a supervisory board-level remuneration committee composed of non-executive board members 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. For employees in risk, compliance and other control functions, compensation is to be determined independently of any business line overseen, and performance measures should be based principally on the achievement of their own objectives so as not to compromise their independence.</p> <p>The institution's remuneration policy should at least include adequate provisions for the definition of fixed and variable remuneration, the remuneration schemes (including performance criteria, bonus pool, long-term incentive plans, malus and clawback arrangements and instruments used for payment as a minimum), the pension policy as well as the senior executives' remuneration. The compensation structure should promote long-term performance and be in line with the business and risk strategy, objectives, values, and long-term interests of the bank and incorporate measures to prevent conflicts of interest. Compensation programs should facilitate adherence to risk appetite, promote appropriate risk-taking behavior and encourage employees to act in the interest of the company as a whole (also taking into account client interests) rather than for themselves or only their business lines.</p> <p>Practices by which compensation is paid for potential future revenues whose timing and likelihood remain uncertain should be carefully evaluated by qualitative and quantitative key</p>

	<p>indicators. Banks should ensure that variable compensation is adjusted to take into account the full range of current and potential risks an employee takes as well as realized risks, including breaches of internal procedures or legal requirements. Compensation should reflect not only risk-taking but also risk outcomes. The bank's variable remuneration policy and practices should ensure it can maintain a sound capital base.</p> <p>Non-discrimination is addressed to the extent that the CRD requires banks to follow a gender-neutral remuneration policy in line with the principles laid down in the TFEU.</p> <p>The EBA Guidelines and the SREP Manual lay out guidance for the supervisory assessment of the remuneration framework. At a minimum, the supervisors should ensure that remuneration policies within a group and at institution level comply with the CRD requirements and that a remuneration committee has been established and fulfilled at least the tasks specified in the CRD. The assessors saw several SREP reports which covered these in detail and offered remedial recommendations.</p> <p>Further, the effectiveness of the oversight performed by the Remuneration Committee was covered in a targeted analysis of select banks to identify root causes of potential deficiencies, areas of concern, and good practices. It was followed up by the issuance of specific recommendations to the SIs under the scope of the analysis. An earlier exercise on risk culture and incentives also benchmarked a sample of SIs on how the risk perspective is reflected in banks' incentive frameworks to support JSTs in their work related to risk culture and remuneration. The coverage included the involvement of the members of the board in the supervisory function (MBSF) and/or Remuneration Committee regarding the setup of the bonus pool, the determination of individual awards, and the alignment of remuneration systems with risks and long-term interests of the banks.</p>
14 EC8	<p>The supervisor determines that the bank's board and senior management know and understand the bank'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.</p>
Description and findings re EC8	<p>The EBA Guidelines on Internal Governance provide specific guidance related to the group structure of the bank, including checks and balances in the group structure, the "know your structure" principle), and regarding non-standard or non-transparent activities, such as special purpose or related structures. The guidance also covers "complex structures, non-standard or non-transparent activities". Furthermore, the EBA SREP Guidelines recommend that supervisors assess whether the management body knows and understands the operational structure of the institution and the associated risks. The SREP Manual lays down guidance for supervisors that when forming its view with regard to the group's organizational structure the supervisors should focus on (a) the transparency of the organizational structure ("know your structure"), (b) the coordination between parent group and other entities and reporting lines, and (c) the proper implementation of policies. The organizational structure (legal entities, business lines, booking models etc.), and the potential related risks, are assessed as part of the analysis of banks' business model and strategy. Recovery planning assessment and discussion around resolvability are also supervisory tools used to challenge banks' management understanding and responsiveness on these topics.</p>

	<p>The JSTs determine the capabilities of the board members in this regard in the course of their interactions with the board. For smaller institutions, the JSTs meet the board once a year when they present the outcome of the SREP exercise and for the larger ones they meet with the board from time to time for additional meetings. They also periodically review the minutes and records of the board meetings toward this end. The assessors saw reports that reference their observations in this regard.</p>
14 EC9	<p>Laws, regulations, or the supervisor require banks to notify the supervisor or publicly disclose 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.</p>
Description and findings re EC9	<p>The SSMFR requires significant supervised entities to inform the relevant NCA of any new facts that may affect an initial assessment of suitability or any other issue which could impact on the suitability of a manager without undue delay, once these facts or issues are known to the supervised entity or the relevant manager. There is no requirement for public disclosure.</p> <p>The relevant NCA, in turn, should notify the ECB of such new facts or issues without undue delay. The ECB may initiate a new assessment based on the new facts or issues or if the ECB becomes aware of any new facts that may have an impact on the initial assessment of the relevant manager or any issue which could impact on the suitability of a manager. The ECB should then decide on the appropriate action in accordance with the relevant Union law and national law and inform the relevant NCA of such action, also without undue delay.</p>
14 EC10	<p>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.</p>
Description and findings re EC10	<p>The CRD requires members of the management body to meet the suitability requirements at all times, for the role they are appointed for. Where they do not fulfil the suitability requirements set out in the Article, competent authorities have the power to reassess and remove such members from the management body. The SSMR (Article 16(2)(m)) also empowers the ECB to remove at any time members from the management body of credit institutions who do not fulfil the requirements set out in the acts referred to in Article 4(3) <i>ibid</i>. The ECB has established a policy and supervisory practices for such reassessments. Typically, the ECB conducts several reassessments per year, and in 2023, it carried out 19 reassessments of members of the management bodies of banks, mainly owing to concerns about their reputation.</p> <p>Changes in the overall composition of the board (typically the board in the Supervisory function) have also been requested by JSTs when their composition reflected a lack of ability to challenge the board in its Management function, such as in the insufficient number of independent or diverse or specialist directors or because of the unsuitability of an individual following a reassessment. Requests for changes in the composition of MBSF can be made directly (by requesting the appointment/ removal of specific members to ensure the collective suitability of the MBSF) or indirectly (by requesting the bank to design a specific policy that ensures a more suitable composition of the MBSF, for example, a diversity policy aligned with the ECB's expectations and national law).</p>

	The SSMFR also requires NCAs to notify the ECB when they decide to remove one or more of the members of the management body of LSIs.
Assessment of Principle 14	Compliant
Comments	<p>The ECB has significantly strengthened its supervision of corporate governance of banks since the last assessment. More guidance has been issued both for the industry and the supervisors by the ESA and the ECB, including via guidelines, handbooks and by updating the supervisory manual. Supervision of internal governance is a key module of the SREP. Supervision in this area is both comprehensive and intrusive and goes into depth and great detail. The assessors saw supervisory reports covering all aspects of management body functioning covering remuneration policy, succession policy, conflict of interest policy, functioning of Board Committees etc. Deficiencies in governance are routinely picked up in ongoing supervision and are also the subject of periodic horizontal assessments. Governance is also a main focus of the formal sanctioning proceedings conducted by competent authorities in 2023, and the penalties imposed focused mainly on breaches of prudential requirements in the area of internal governance. This is in line with the SSM's supervisory priorities for 2023-25, which include the general objective of fostering further improvements in banks' governance.</p> <p>This enhanced focus on internal governance and suitability is being regularly communicated to the industry and is the subject of many management speeches. The FAP approval process has also been substantially delegated by the alternative FAP process but still occupies a lot of supervisory resources at both the ECB and NCA level. Currently, all individuals appointed as members of the management body in any supervised bank are subject to a formal fit and proper assessment and there is no legal option to not conduct those assessments. There could be benefit from further deploying risk-based approaches by using supervisory resources for the most complex case (as illustrated by the successful implementation of a targeted approach for Italian SIs which could be used for other SIs). This will be in keeping with the text of CRD 6, which calls for the EBA, in close cooperation with the ECB, to review and report on the application and efficiency of the 'fit-and-proper' framework, taking into account the principle of proportionality.</p> <p>Despite the creditable supervisory efforts, effective supervision of governance remains constrained in a number of areas as governance practices and supervisory responsibilities, which remain governed by national laws, vary across member states. Some of the requirements that are covered by the BCP but are not harmonized or addressed in all national laws relate to gender diversity, minimum number of independent directors, requirement for establishment of independent audit committees, suitability requirements for key function holders, etc. The ECB uses recommendations to address these deficiencies in supervision and has also been proactive in amending guidance to meet emerging needs.</p> <p>CRD 6 will help towards providing greater consistency of approaches through harmonization in EU legislation. Towards this end, it includes certain key function holders into the scope of supervisory assessments and applies new requirements to these key function holders, strengthens the primary responsibility of banks in appointing suitable candidates, refers to the necessity to have deadlines for the supervisory process, and introduces more clarity on</p>

	some procedural aspects of the process. However, CRD 6 still does not require the suitability assessment to be completed by the bank prior to the taking up of the appointment in all cases or of prior approval by the supervisor for key positions in the largest banks, but will be an important step forward when transposed in a harmonized manner.
Principle 15	Risk management process. ⁴⁵ The supervisor determines that banks have a comprehensive risk management process (including effective board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate all material risks ⁴⁶ (which can include risks related to digitalisation, climate-related financial risks and emerging risks) on a timely basis and to assess the adequacy of their capital, their liquidity and the sustainability of their business models in relation to their risk profile and market and macroeconomic conditions. This extends to the development and review of contingency arrangements (including robust and credible recovery plans where warranted) that consider the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank. ⁴⁷
Essential criteria	
15 EC1	<p>The supervisor determines that banks have appropriate risk management strategies that have been approved by the bank's board, and that the board establishes an effective risk appetite statement and framework to define the level of risk the bank is 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 culture is established throughout the bank, to promote the development and execution of its strategy; (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 recognised; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile, capital strength and liquidity needs. These limits are understood by, and regularly communicated to, relevant staff; and (e) senior managers take the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.

⁴⁵ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Principles for the effective management and supervision of climate-related financial risks, June 2022; BCBS, Stress testing principles, October 2018; BCBS, Sound Practices: implications of fintech developments for banks and bank supervisors, February 2018; BCBS, Identification and management of step-in risk, October 2017; BCBS, Corporate governance principles for banks, July 2015; BCBS, Supervisory guidance for managing risks associated with the settlement of foreign exchange transactions, February 2013; BCBS, Principles for effective risk data aggregation and risk reporting, January 2013; BCBS, Principles for the supervision of financial conglomerates, September 2012; FSB, Guidance on supervisory interaction with financial institutions on risk culture: a framework for assessing risk culture, April 2014.

⁴⁶ 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.

⁴⁷ 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.

Description and findings re EC1	<p>The CRD and EBA Guidelines on the SREP set out the basis for the supervision of risk management.</p> <p>Risk management is assessed as part of the SREP. The assessment covers four main aspects:</p> <ul style="list-style-type: none"> a) The bank's internal governance framework, in particular the Management Body and the Risk Management Function; b) Its risk management framework; c) Its risk culture; d) Its data governance and IT infrastructure, data aggregation and reporting. <p>Pursuant to the SSM Manual, JSTs assess whether institutions are implementing appropriate standards for professional and responsible behavior throughout the institution, which should help reduce the risks to which an institution is exposed. To make prudent decisions, the RAF and risk limits should be considered in strategic discussions. The JSTs assess whether the management body approves the methodologies, policies, procedures, and definitions of the institution's risk management framework that are developed by the Risk Management function and that should ensure adequate identification of all material risks the institution is currently or may be exposed to. JSTs should also assess whether (i) the design of Risk Limits within the RAF is adequate and (ii) the management body is properly aware of the group's key risks (e.g., funding, capital, liquidity) and information on those risks is provided to the management body on a regular basis. To this end, JSTs assess whether the management body ensures that the institution has an adequate independent risk management function, the head of the risk management challenges decisions taken by the institution's management, the risk management function is designed as an independent function within the organisation, the Risk Management function is sufficiently independent from commercial interests and of the business units.</p>
15 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.⁴⁸ 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; (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; and (d) to assess risks that could materialize over longer time horizons (including risks related to digitalization, climate-related financial risks and emerging risks). Where appropriate, banks use scenario analysis as a tool.
Description and findings re EC2	<p>In addition to the CRD and SREP requirements, the SSM Manual on Internal Governance states that risk management should provide both forward- and backward-looking, quantitative, and qualitative analyses of risks. This assessment should include the full range of risks, with a comprehensive internal risk inventory that measures risks with tailored indicators. In particular, the bank should have a holistic and well-documented view of the</p>

⁴⁸ This includes, where relevant, risks not directly addressed in the subsequent principles, such as reputational, step-in and strategic risks.

	<p>impact of climate-related and environmental risks on the remaining risk categories, as also articulated in the ECB Guide to climate-related and environmental risk and assessed in various reviews. In particular, it is noted that among the category of emerging risk considered in EC 2 (d), the SSM assessed banks' materiality assessment and risk management framework of nature-related risks.</p> <p>Both climate and digitalization are SSM priorities and have been the subject of targeted reviews and enhanced supervision.</p> <p>Supervisors use scenarios, but they are typically focused on recovery (see EC 13) and capital (see EC 14).</p>
15 EC3	The supervisor determines that risk management strategies, policies, processes and limits are properly documented and aligned with the bank's risk appetite statement and framework; regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and communicated within the bank. The supervisor determines that adequate procedures are in place for breaches of risk limits and significant deviations from established policies, ensuring they receive prompt attention and authorization from the appropriate level of management and the bank's board (where necessary) and are adequately followed up with proportionate and timely remedial action.
Description and findings re EC3	SSM Supervisors regularly review risk management documentation. Banks are required to maintain internal limits consistent with their risk appetite. The risk management framework should also include processes for escalation should breaches of policy or risk limits occur. More targeted assessments can be performed to understand the bank's reaction to limit breaches and whether escalation mechanisms were well used. Assessors saw examples of such inspections and follow-up actions.
15 EC4	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.
Description and findings re EC4	As part of the SREP, supervisors assess whether the senior management and the Management Body have both the knowledge and the information necessary to provide adequate oversight and fulfil their tasks within the bank and, therefore, are able to understand the nature and level of the risks that the bank is taking.
15 EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy and the sustainability of their business models in relation to their risk appetite, risk profile ⁴⁹ and forward-looking business strategies. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	The ICAAP and ILAAP are both part of the SREP. The EBA Guidelines and a further ECB 'clarification note' set out expectations regarding their quality.

⁴⁹ Banks should include climate-related financial risks assessed as material over relevant time horizons, including in their stress testing programmes where appropriate.

	For the ICAAP and ILAAP, supervisors make a quantitative assessment that reviews the assumptions and transmission mechanisms underpinning capital or liquidity projections and a qualitative evaluation of governance, i.e., management board responsibility, use of ICAAP for decision-making, setting the risk appetite framework and strategies, the internal control framework, data quality, etc. (see BCPs 16 and 24).
15 EC6	<p>Where banks use models to measure components of risk, the supervisor determines that the following conditions are met:</p> <ul style="list-style-type: none"> (a) banks comply with supervisory standards on the use of models; (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>In addition, the supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Models are reviewed using a combination of on-site and off-site activities. Supervisors seek to benchmark banks by using backtesting and validation of results to identify (possible) deficiencies and remediate issues.</p> <p>Models used by the significant credit institutions under Pillar I are monitored in line with the SSM Supervisory Manual.</p> <p>Since 2019, SSM has had access to standardized reporting. This allows the validation of results together with standardized data templates for all banks in the SSM with IRB approval. Based on the collected data, supervisors evaluate key KPIs, back-testing results, and model performance for risk-based follow-up and effective supervision of internal models, leveraging the bank's validation function.</p> <p>Further automated solutions have been implemented to simplify and standardize the submission process for non-material model changes in 2023. Similarly, the system will be enhanced to facilitate the submission of standardized reporting of banks' validation results.</p>
15 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 that they 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	<p>See EC 8 for work on data more generally.</p> <p>Under CRD, supervisors are required to assess the comprehensiveness and clarity of the reports, their frequency, and how they change during times of stress or crisis. They also must evaluate the quality of supervisory reporting, the risk appetite risk limit system, and the role of the management body and senior management.</p>
15 EC8	The supervisor determines that banks develop and maintain appropriate risk data aggregation and reporting capabilities commensurate with the risk profile and systemic

	importance of the bank. The supervisor also determines that the board and senior management review and approve the bank's risk data aggregation and risk reporting framework, and that they ensure that adequate resources are deployed to support these efforts.
Description and findings re EC8	<p>Data aggregation is currently a priority for the SSM. During the BCP Assessment, a Targeted Review of a selected pool of banks on BCBS239 principles occurred. Some of the preliminary findings of this review were shared with assessors, as well as plans for the escalation of remediation measures.</p> <p>In addition, as part of a 3-year work plan, a joint initiative with the ECB Directorate General Statistics, the SSM also launched an annual data collection on the bank's supervisory and internal risk reporting practices, the Management Report on Data Governance and Data Quality. In 2024, a Targeted Review of 15 SIs was performed to assess banks' progress in this area and any key deficiencies. Efforts to consolidate and further enhance the assessment of data quality of supervisory reporting and its follow-up were continued, for instance, for regular supervisory reporting (FINREP/COREP), Pillar 3 disclosures, supervisory stress testing and liquidity monitoring.</p>
15 EC9	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, ⁵⁰ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business models and major acquisitions). The supervisor determines that the bank's board and senior management 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 the board or a specific committee of the board.
Description and findings re EC9	<p>The CRD and EBA Guidelines on SREP and Internal Governance set out the framework for the accountability of banks' boards and senior management and the need to review the conditions of products and services offered so that they align with the business model and strategy. Guidelines set out that a bank should:</p> <ol style="list-style-type: none"> have in place a well-documented new product approval policy (NPAP), approved by the management body, that addresses: <ul style="list-style-type: none"> the development of new markets, products and services, and significant changes to existing ones, as well as exceptional transactions. The policy should encompass material changes to related processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes). The NPAP should ensure that approved products and changes are consistent with the bank's risk strategy and risk appetite and the bank's corresponding limits, or that necessary revisions are made. <p>Assessors reviewed the findings of a thematic review on compliance that took place in 2020-21. This review specifically examined the controls surrounding new products and the role of the board.</p>
15 EC10	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

⁵⁰ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	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 EC10	<p>CRD and EBA Guidelines on SREP and Internal Governance set out the framework for risk management functions. These set out that:</p> <ul style="list-style-type: none"> a) As part of the overall internal control framework, banks should have a holistic bank-wide risk management framework extending across all their business lines and internal units, including internal control functions, fully recognizing the economic substance of all their risk exposures. b) Regular and transparent reporting mechanisms should be established so that the management body receives timely, accurate, concise, understandable, and meaningful reports and can share relevant information about identifying, measuring, assessing, monitoring, and managing risks. c) The Risk Management Function should have access to all business lines and other internal units that have the potential to generate risk, as well as to relevant subsidiaries and affiliates and that staff within the function should possess sufficient knowledge, skills and experience. <p>On and offsite supervision is carried out to review the resources and performance of the risk management function.</p> <p>Assessors saw the results of a horizontal review conducted in 2022. The review focused on credit-risk governance and was performed better to understand the different credit governance setups across SSM banks.</p>
15 EC11	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 their 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 EC11	<p>The national transposition of the CRD has produced a fragmented framework regarding the CRO's position within the management body. If the CRO is part of the management body, then the default is that those in the role are subject to a fit-and-proper assessment. If the CRO is not part of the management body, then the default relies on whether, under National Law, the CRO is a key function holder subject to a fit-and-proper test.</p> <p>EBA Guidelines require banks to inform the SSM of a decision to remove a head of an internal control function and the main reasons for that removal.</p> <p>The SSM requires significant banks to appoint a Chief Risk Officer (CRO) at the management committee level with distinct risk management responsibilities. Under the leadership of the CRO, the risk management function should be, at a minimum, responsible for designing the risk appetite framework and monitoring the bank's compliance with it on an ongoing basis. The SSM accepts that some internal governance arrangements may involve the appointment of a Chief Governance Risk Officer and Chief Credit and Market Risk Officer rather than one individual carrying out the role of CRO. These arrangements might allow risk management</p>

	<p>oversight at a more granular level within the bank and are not considered a negative factor in an assessment.</p> <p>An annual benchmarking of the governance of the risk management function is carried out. With the transposition of CRD6, legal requirements concerning the CRO will be harmonized. A CRO will be required for all larger banks in the SSM, and role holders will be subject to fit and proper assessment by the SSM. In case of potential serious concerns with their suitability, the SSM will have the power to request the removal of the CRO (and other key function holders) (see Articles 91 and 91a of CRD6). This will substantially improve the SSM's ability to meet this criterion.</p>
15 EC12	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book, operational risk and large exposures.
Description and findings re EC12	<p>The CRD addresses all risks that can be classified as material for almost all banks: credit risk, market risk, interest rate risk, operational risk, and liquidity risk.</p> <p>The EBA's SREP guidelines describe a full range of supervisory activities to review and evaluate a bank's risk management. They aim to combine findings into a comprehensive supervisory overview.</p> <p>The SSM has published its Guide to the ICAAP and its Guide to the ILAAP to encourage banks to reflect on their capital and liquidity risks in a structured way and use bank-specific approaches to measure and manage these risks.</p> <p>The SSM also published a 2023 Guide on sound practices in counterparty credit risk (CCR) governance and management and a 2017 guide on nonperforming loans. The SSM Manual also provides guidance on assessing these risks from an internal model investigations perspective for the SSM's supervision of credit and counterparty risk.</p> <p>Furthermore, the SSM has published Credit Risk and Market Risk SREP methodologies, including the risk control module 'governance and organizational framework', which covers whether the bank has an appropriate organizational framework for market risk management, measurement, monitoring, and control functions and sufficient qualitative and quantitative human and technical resources.</p>
15 EC13	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialise 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 consider the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements given 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 EC13	The BRRD, CRD, SRM Regulation and Commission Delegated Regulations form the Level 1 and Level 2 legal framework. EBA Guidelines provide Level 3.

	<p>Recovery plans are updated at a minimum annually and reviewed by supervisors. Feedback is provided within six months of submission. The assessment is focused on whether the measures included in recovery plans could maintain or restore the bank's or group's viability and financial position. The bank's overall recovery capacity (ORC) is also assessed. When assessing recovery plans, supervisors consider the appropriateness of the bank's capital and funding structure, the level of complexity of the organizational structure and its risk profile, and any idiosyncratic and system-wide events that might affect recoverability.</p> <p>Assessors reviewed several assessments that demonstrated the approach's thoroughness and intensity. As noted in BCP24, the assessors noted a tendency for remediation measures to be timed to coincide with the subsequent submission of the recovery plan. In most cases, this timing is adequate, but for some risks – for example, that of contingent liquidity requirements and access to central bank funds, the risks may warrant a shorter timeframe.</p> <p>The assessors have made a recommendation on the specific point of liquidity in BCP 24, but the point can also be applied more generally.</p> <p>The assessors noted that SSM can supplement supervisory resources for some banks that are considered a priority due to challenges they face, which is welcome.</p>
15 EC14	<p>The supervisor requires banks to have forward-looking stress testing programmes covering all material risks commensurate with their risk profile and systemic importance as an integral part of their risk management process. At a minimum, banks' stress testing programmes cover credit risk, market risk, interest rate risk in the banking book, liquidity risk, country and transfer risk, operational risk and significant risk concentrations. The supervisor regularly assesses a bank's stress testing programme and determines that it captures all 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. 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 considered in the bank's decision-making process. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing programme:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control on a bank-wide basis; (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the board and senior management; and (d) is appropriately documented and regularly maintained and updated.
Description and findings re EC14	<p>CRR requires the use of Stress Testing and forms the Level 1 Framework.</p> <p>EBA Guidelines on SREP and Stress Testing provide a Level 3 legal framework. SSM Guides on ICAAP and ILAAP provide additional information on expectations. These guidelines set out what should be in banks' stress testing programs, including covering all material risks to which the bank is exposed.</p>

	<p>Banks are expected to identify all of their key vulnerabilities, combine them into plausible adverse scenarios, and then assess the impact of those scenarios on their capital position, both in terms of regulatory capital ratios and economic capital adequacy. The severity level regarding the relevant stress testing assumptions should be highly severe, reflecting crisis-like developments.</p> <p>The quality of banks' stress testing is part of the ICAAP and ILAAP process.</p> <p>The assessors noted that the use of scenarios is typically focused on recovery (see EC 13) and capital. It would be useful to consider a broader range of scenarios, perhaps reputation, and operational for example.</p>
15 EC15	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 EC15	<p>CRD/CRR provide the Level 1 framework.</p> <p>The SSM Manual sets out how Business Model Analysis assessment is carried out. The assessment aims to:</p> <ul style="list-style-type: none"> a) create a sound understanding of the functioning of the bank. b) provide insights into the key vulnerabilities of a bank that may, or already have, emerge(d) and c) assess the viability and sustainability of the bank's business lines over a twelve-month and minimum three-year time horizon. <p>Identifying key vulnerabilities helps identify specific risks to solvency and liquidity that are material to the bank, particularly in large, complex banking groups with multiple business units, product lines, and activities in multiple jurisdictions.</p> <p>The SSM Manual on Internal Governance and Business Model Assessment references loan pricing, new products or activities pricing, and fund transfer pricing. Still, the assessors did not see any supervisory attention or action in these areas. Notwithstanding this, the assessors concluded that the processes adopted by the SSM would capture this risk.</p> <p>With respect to fund transfer pricing (FTP), the assessors noted that an internal document had been shared with supervisors in 2023 outlining good practices with respect to the design of FTP frameworks. Moreover, it was noted that the ECB further examined the design and calibration of FTP methods of selected banks in a dedicated targeted review in 2024.</p>
Assessment of Principle 15	Compliant
Comments	The SSM provides substantial coverage of risk management based on CRD/CRR and additional EBA guidelines. The SSM has been very active in publishing its own guides to supplement the Level 1 and 3 framework. Assessors reviewed several pieces of supervisory work, showing an intensive approach. SSM has made significant progress in assessing risks that could materialize over longer time horizons (including risks related to digitalization, climate-related financial risks and emerging risks including nature-related risks specifically).

	<p>Both climate and digitalization are SSM priorities and have been the subject of targeted reviews and enhanced supervision.</p> <p>The assessors feel that the SSM is working hard to fill gaps in the Level 1 framework. The transposition of CRD 6 will substantially improve the SSM's oversight of the CRO.</p> <p>However, regarding issues such as internal pricing, performance measurement, and new product approval processes, the SSM remains reliant on the SSM Manual on Business Model Analysis.</p> <p>The assessors were also pleased to note that, as the previous BCP Assessment recommended, there has been substantial progress in working arrangements with the SRB. Finally, the assessors noted that the criteria also looked for the use of scenarios, and whilst this takes place, it is typically focused on recovery (see 15.13) and Capital (see 15.14).</p>
Principle 16	Capital adequacy. ⁵¹ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken and presented by a bank in the context of the markets and macroeconomic conditions in which it operates. ⁵² 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 stringent than the applicable Basel standards.
Essential criteria	
16 EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds with 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>EU Banks are subject to capital requirements as prescribed by the CRR. It establishes the requirements to calculate and consistently observe prescribed capital requirements, including thresholds to which a bank might be subject to supervisory action and which banks are required to satisfy at all times. It also prescribes the qualifying components of capital, the deduction requirements, and the conditions for reducing own funds. CRR defines different qualifying components of capital as common equity tier 1, additional tier 1 and tier 2. These provisions are supplemented and further specified by Delegated Regulations. CRR 3, which transposes in the EU the final elements of the Basel III standards, including the output floor is in effect since January 2025.</p> <p>The CRR applies the minimum capital requirements by 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]. The SSMR empowers the ECB to require institutions to</p>

⁵¹ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Guiding principles for the operationalisation of a sectoral countercyclical capital buffer, November 2019; [SCO10], [SCO30], [CAP10], [CAP30], [CAP50], [CAP99], [RBC20], [RBC30], [RBC40], [LEV10], [LEV20], [LEV30], [SRP10], [SRP20].

⁵² Implementation of the Basel Framework is not a prerequisite for compliance with the Core Principles. Compliance with the Basel Framework capital adequacy regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	<p>have additional own funds in excess of the requirements set out in CRR. The ECB assess the need for excess capital for each bank in its supervisory review and evaluation process.</p> <p>In addition to the minimum capital requirements that must be met by institutions at all times, the CRD also provides for a set of capital buffers. The capital buffers enshrined in the CRD consist of the capital conservation buffer (CCoB), capital buffers for global and other systemically important institutions (G-SIIs and O-SIIs), the systemic risk buffer (SyRB) and the countercyclical capital buffer (CCyB). These capital buffers, which must be met with CET1 capital, together constitute the combined buffer requirement (CBR). The SSMR mandates that the ECB has the power to apply higher requirements for these capital buffers, or more stringent measures aimed at addressing systemic or macroprudential risks, than those applied by the national competent authorities or national designated authorities of member states participating in the SSM.</p> <p>If minimum capital requirements are no longer met, the competent authorities need to consider intervening, including the application of early intervention and supervisory measures and, in extremis, withdrawal of authorization. A breach of minimum capital requirements should also be considered in determining if an institution is failing or likely to fail.</p> <p>In contrast, banks can dip into their CBR to absorb losses in times of stress, with the consequence of being subject to restrictions on their distributions (dividends, share buy-backs, coupon payments on AT1 instruments and bonuses) and to the obligation of submitting a capital conservation plan which includes a timeframe for the increase of own funds with the objective of meeting fully the CBR. The consequences that banks face for breaching their CBR (restrictions on capital distributions) are milder than those stemming from a breach of their minimum capital requirements.</p>
16 EC2	At least for internationally active banks, ⁵³ the definition of capital, the risk coverage, the 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 (approximately 4,500 institutions in total in the EU), which includes all the internationally active banks within the EU. The EU applies the risk-based capital requirements (including the output floor) to each banking group at: (i) the highest level of consolidation within the EU, (ii) at consolidated level within each Member State and (iii) at solo entity level (supervisors have the option to waive the application of capital requirements at solo level). Although it is not mandatory under the Basel standards, the application of the Basel capital requirements to all EU credit institutions (beyond the scope

⁵³ Capital adequacy requirements for internationally active banks should be applied on a fully consolidated basis, including any holding company that is the parent entity within a banking group. The framework will apply to all internationally active banks at every tier within a banking group, on a fully consolidated basis. As an alternative to full sub-consolidation, the application of this framework to the standalone bank (ie on a basis that does not consolidate assets and liabilities of subsidiaries) would achieve the same objective, providing the full book value of any investments in subsidiaries and significant minority-owned stakes is deducted from the bank's capital. Supervisors must also test that individual banks are adequately capitalised on a standalone basis.

	<p>of internationally active banks) helps strengthen banks' safety and soundness and financial stability and eliminate the potential for regulatory arbitrage in the area of capital regulation.</p> <p>The provisions regarding capital adequacy of CRR and CRD are based on the currently applicable Basel standards, including the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements (with disclosed deviations). In December 2014, the BCBS issued its RCAP Assessment of Basel III regulations—EU: https://www.bis.org/bcbs/publ/d300.pdf. The RCAP concluded that the prudential regulatory framework in the EU and the nine member states was "materially non-compliant" with the minimum standards prescribed under the Basel framework. In the Pillar 1, the counterparty credit risk framework was seen as non-compliant and the credit risk – IRB approach as materially non-compliant, while most of the other aspects were largely compliant (definition of capital, credit risk: standardized approach and securitization, market risk: Standardized Measurement Method) or compliant (capital buffers, market risk: internal models approach and operational risk, for all of its approaches). Some of these deviations from the Basel standards (Danish Compromise⁵⁴, SME supporting factor for retail SMEs and IRB exposures to SMEs, and limited scope of the CVA) have not been addressed in the EU framework. That said, the introduction of a 85 percent risk weight under Basel III revisions to the standardized approach has limited the deviation due to the SME supporting factor for unrated corporate SMEs to the part of exposures up to EUR 2.5 million which benefit from a 76.19 percent risk-weight in the EU. The impact is less material because Basel III applies an 85 percent risk weight instead of the 100 percent risk weight for corporate exposures under Basel II. For exposures to unrated corporate SMEs above EUR 2.5 million, there is no deviation anymore because the 0,85 percent multiplier results in the same 85 percent risk weight applicable according to Basel III.</p> <p>The CRR 3 also has introduced new deviations, such as a longer phase-in period for output floor, software not timely deducted from CET1 capital, lower risk weights for, upon permission of the competent authorities, a specific subset of equity exposures under those national legislated programs for which the only subsidies are guarantees with a guarantor that has a risk weight higher than 100 percent, and for specialized lending in the form of project finance of physical structures or facilities, systems and networks that provide or support essential public services and meet conditions similar to those for high quality finance under Basel III revisions for which the risk weight is 75 percent instead of 80 percent, lower input floors for exposures to regional governments and local authorities under the IRB approach, transitional arrangements limited to the calculation of the output floor for exposures to real estate and unrated corporates, as well as for securitization and counterparty credit risk, to allow banks to apply reduced risk weights for these exposures when determining risk-weighted assets under the standardized approach as part of the calculation of the output floor, making the output floor less binding during the transition period, unrealized losses and gains related to certain exposures measured at Fair Value</p>
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⁵⁴ The "Danish Compromise" is a CRR provision that allows banks, subject to supervisory approval to risk-weight their insurance holdings instead of fully deducting them from their capital. It was introduced during the negotiation of CRR and, since CRR3, is a permanent option. It is important to note financial conglomerates are subject to supplementary supervision

	<p>through OCI are, for 2025 only, filtered out from CET1). Regarding sovereign exposures towards EU member states, the CRR allows banks to use, upon permission from the competent authority, the standardized approach on a permanent basis for these material exposures within an exposure class (i.e., sovereign exposures) where the IRB approach is also used, which does not comply with the Basel Framework.</p> <p>The impact of the EU specific adjustments on capital requirements is material. The EBA impact analysis shows that the overall increase in T1 MRC under Pillar 1 requirements for all EU banks is reduced by 4.4 percentage points (p.p.) relative to the faithful implementation of Basel III. Concerning SIs in the euro area, the impact analysis conducted by the ECB points to a slightly higher impact of the deviations from the Basel Framework on CET1 MRC (the increase in capital requirements is reduced by more than 12 p.p.).</p>
16 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., securitisation transactions) 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>SSMR empowers the ECB to require institutions to hold own funds in excess of the capital requirements laid down for Pillar 1, 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. The minimum capital requirements prescribed by the CRR consider whether risks have been adequately transferred or mitigated through transactions (e.g. securitization transactions) and impose specific capital charges on risk exposures, including for securitizations.</p> <p>The SSM SREP is performed in accordance with the CRD and EBA guidelines and evaluates the risks to which the institutions are or might be exposed, including risks and risk elements not covered by Article 1 of the CRR; risks that an institution poses to the financial system in general; and risks revealed by stress testing, taking into account the nature, scale and complexity of an institution's activities. The SSM SREP encompasses, inter alia, a capital and liquidity quantification methodology, which evaluates credit institutions' capital and liquidity needs given the results of the risk assessment.</p> <p>For banks under direct ECB supervision, regular supervisory stress tests also provide the ECB with a very rich set of data and qualitative information (see also explanations provided for BCP 9). The supervisory stress-test outcomes are reflected in the SREP decisions, in particular, the outcomes of the Stress Test conducted by EBA/ECB are taken into account to compute the P2G as well as are reflected in the assessment of Governance and risk management practices (incl. data quality).</p> <p>The ECB's application of the SREP methodology has resulted in the imposition of additional own funds requirements based upon SIs' risk profiles. On the SSM web page the P2R buffers applied to SIs are disclosed.</p> <p>(https://www.bankingsupervision.europa.eu/banking/srep/html/p2r.en.html)</p>

16 EC4	<p>The prescribed capital requirements reflect the risk profile and systemic importance of banks in the context of the markets and macroeconomic conditions in which they operate, constrain the build-up of leverage in banks and the banking sector, and reduce the risk of contagion. In assessing the adequacy of a bank's capital levels given its risk profile, the supervisor focuses, among other things, on:</p> <ul style="list-style-type: none"> (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 expected losses; and (d) the quality of its risk management and controls. <p>Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support its risk profile. Laws, regulations or the supervisor in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.</p>
Description and findings re EC4	<p>The capital requirements prescribed by the CRR already reflect major parts of the risk profile of institutions. Furthermore, with the CRR, the Pillar 1 requirements are subject to "maximum harmonization" across the EU, leaving, creating consistency, but also removing the ability of any individual Member State to apply a more onerous standard (which is possible under "minimum harmonization"). In principle, there is no room for diverging requirements, even if "gold plating," at the level of the individual member states. On top of this harmonized minimum capital requirements, competent or designated authorities may apply more stringent requirements for exposures secured by immovable properties (Article 124 (9) and Article 164(6) of the CRR), if they deem that the relevant risk weights are inadequate to reflect the actual risks in immovable property markets (this is the only exception to the maximum harmonization). According to Article 458 of CRR, member states that identify changes in the intensity of macroprudential or systemic risk in their financial system and deem that the macroprudential tools set out in Articles 124 and 164 of the CRR and Articles 133 and 136 of CRD would be less suitable and effective to deal with those risks, may also implement a set of stricter national measures to address the identified risks. These stricter measures are subject to review and veto by the European Institutions and are limited to 2 years' duration.</p> <p>In its SREP the ECB assesses the risk profile and adequacy of capital to risk profile. As mentioned in EC3 the ECB is empowered to require institutions hold additional capital requirements. In this process ECB supervises quality of risk management which feeds into the bank specific Pillar 2R capital requirement decisions.</p> <p>CRR requires a Pillar 1 minimum leverage ratio of 3 percent. To constrain the build-up of excessive leverage, the ECB has developed a methodology that determines whether a supervised bank has an elevated risk of excessive leverage and, therefore, whether the bank may be subject to a Pillar 2 requirement regarding the leverage ratio in addition to the Pillar 1 leverage ratio requirement. Banks are additionally expected to follow the leverage ratio Pillar 2 guidance issued by the ECB.</p>

	<p>National competent authorities in the EU are in charge of designating O-SIIs that reflect their systemic importance and calibrate the applicable O-SII buffers. While an EBA methodology has been introduced to identify and designate O-SII, there is no common EBA methodology for the calibration of O-SII buffers that would avoid unwarranted heterogeneity in the way they are determined and ensure full consistency in the resilience of O-SIIs. Pursuant to the SSMR, the ECB can apply higher buffer requirements to O-SIIs. To this end, the ECB has recently introduced a minimum floor methodology, to ensure a more consistent treatment of O-SIIs across member states. Some differences across countries are normal—given that banks are designated based on their national systemic importance, but further harmonization could help reduce heterogeneity and support greater consistency in the resilience of O-SIIs. Available data suggest indeed significant differences in O-SII buffers across the euro area. While being an important tool which has contributed to the reduced heterogeneity of O-SII buffers, the ECB's top-up power is not a substitute for a harmonized calibration methodology.</p>
16 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 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>The CRR requires prior permission from the competent authority before an institution uses internal assessments of risk as inputs into the calculation of regulatory capital requirements and sets out the requirements that need to be met for permission by the competent authority.</p> <p>For SIs for which the ECB is the competent authority, the ECB approves banks' internal assessments for the calculation of own funds requirements ("internal models") in accordance with Article 9(1) SSMR. The assessors were provided samples of the ECB's independent in-depth review and validation of SIs' internal capital models and examples of required modifications and conditions that were imposed.</p> <p>The ECB's decisions on internal models are based on the requirements of the CRR, RTS adopted by the EU Commission, and Guidelines issued by the EBA. In addition, the ECB guide to internal models (publicly available) provides transparency on how the ECB understands the relevant regulation related to internal models and how it intends to apply it when assessing whether institutions meet these requirements. The current version of the</p>

	<p>guide, published in February 2024, clarifies among others, how banks should consider the inclusion of material climate-related and environmental risks in their models. It also contains comprehensive sections on permanent partial use and return to less sophisticated approaches.</p> <p>Over the years, the ECB has been very active to ensure that regulatory requirements are complied with and models' outcomes are reliable. The ECB conducted in close cooperation with the NCAs a multi-year project (2016-2021), the Targeted Review of Internal Models (TRIM) exercise, which aimed at enhancing the credibility and confirming the adequacy and appropriateness of approved Pillar 1 internal models permitted for use by SIs when calculating own funds requirements. The outcomes of the TRIM investigations confirmed that the internal models of SIs can continue to be used for the calculation of own funds requirements. Following these investigations, the ECB raised a certain number of issues in IRB models, which are being addressed by the institutions. As before, the ECB continues to assess individual applications of banks for permanent partial use on a case-by-case basis to ensure compliance with the regulatory requirements in a consistent and harmonized manner as set out in the updated Guide.</p> <p>Typically, decisions granting permission for the initial use of an internal model or from implementing material changes to an internal model are granted following the outcome of an on-site investigation (collectively called "internal model investigations") by an independent assessment team. After the initial assessment of the (on-site) investigation team the draft assessment report is reviewed for consistency and adherence to standards via a joint consistency check procedure performed by model experts of the NCAs and by ECB's Internal Model division.</p> <p>Investigation teams have access to a practical guide ("Methodology for Internal Model Investigations") for fieldwork. It presents the most relevant inspection techniques for each risk category (credit, CCR/CVA, market, and operational risk).</p> <p>Any material change to an approved internal model needs prior permission from the competent authority, according to the CRR. The conditions for assessing a model modification as a material change of an internal model are laid out in Commission Delegated Regulation.</p> <p>Similarly, ceasing the use of an internal model and thereby reverting to a standardized approach (reversion to a less sophisticated approach) requires permission from the competent authority according to the CRR.</p> <p>The SSM also developed the ECB guide on materiality assessment (EGMA), which explains the criteria applied by the ECB for approving changes and extensions to internal models which banks use to calculate the counterparty credit risk and credit valuation adjustment risk.</p> <p>The yearly SEP planning cycles ensure to allocate internal model investigation activities and their resource needs in the most efficient manner across all institutions that are supervised</p>
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	<p>by the ECB. This yearly planning exercise is accompanied by monthly updates to address potential ad-hoc needs and leverage on freed-up resources.</p> <p>Following the Basel Standards, the scope of internal models to be reviewed will change under CRR 3. In this context, the workload is unlikely to be reduced. Institutions will have to apply for supervisory permission to use their newly developed FRTB market risk models. As in Basel Standards, the CRR3 replaces all current approaches for own funds requirement calculation for operational risk with a unique (revised) standardized approach and thus Advanced Measurement Approach (AMA) models have been decommissioned. CRR 3 also contains several other novelties concerning the requirements for the use of the IRB approach for credit risk and of CVA (with the standardized approach for CVA (SA-CVA) substituting the advanced approach (A-CVA)). In order to meet these new requirements, institutions may need to apply changes to their existing models. The ECB is preparing for this situation through several initiatives: strategies to handle model changes, updates to the ECB guide to internal models, updates to the inspection techniques for internal model investigations and new/updated guidance for JSTs are being developed.</p> <p>Until now, most of the work on internal model reviews has been reactive by nature, as it is usually triggered by firms' model change applications. Going forward, as waiting for the SIs to initiate model change applications is comprehensive but certainly has intrinsic limitations in terms of resource allocation, a more structured proactive review approach implemented in a systematic fashion would help identify banks, portfolios and modelling techniques that deserve in-depth investigations.</p> <p>Given this comprehensive approach, the ECB is facing significant resource constraints in internal model validation. As indicated in the 2023 Supervisory Examination Program, the number of staffed IMIs was significantly below what was needed, with substantial reputational risk for the SSM as several IMI requests have a legal trigger. Resourcing issues have also been emphasized in external reports (e.g., from the ECA). During the meeting with the assessors, banks have also observed long delays in the treatment of requests for model change approval.</p>
16 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). The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> (a) to set capital levels and manage available capital and planned capital expenditures in anticipation of possible business cycle effects, market conditions and changes in factors specific to the bank 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 given the risk profile and systemic importance of the bank.
Description and findings re EC6	<p>The CRD requires institutions to have in place sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed. ECB's expectations regarding forward-looking capital management are detailed in its ICAAP Guide. Banks are expected to manage</p>

	<p>their capital adequacy in two separate, yet mutually informing perspectives: the “normative” perspective and the “economic” perspective.</p> <p>When it comes to stress testing, the design of adverse scenarios should reflect the entity’s own risk identification, its key vulnerabilities, and severe developments in relevant external conditions.</p> <p>If banks identify that adverse scenarios would lead to a breach of management buffers, they are expected to act on this by either demonstrating that they could take management actions if the scenarios should materialize or –if this would not be feasible during the scenario – to take action right away. Additional references to contingency arrangements can be found in BCP 15, EC 14.</p> <p>In addition to stress testing in the ICAAP process, the ECB sets a non-binding Pillar 2 guidance for individual banks based on their performance in the regular EU-wide stress tests using a two-step bucketing approach (in Step 1, supervisors place banks in one of four buckets according to the depletion of their capital ratios in the stress test and, in Step 2, supervisors set the Pillar 2 guidance for each bank within the range of the bucket).</p>
16 EC7	Laws or regulations require, or the supervisor has the power to impose a simple, transparent, non-risk-based measure that captures all on- and off-balance sheet exposures to supplement risk-based capital requirements to constrain the build-up of leverage in banks and in the banking sector.
Description and findings re EC7	<p>The CRR introduced a minimum leverage ratio requirement of 3 percent based on the ratio of Tier 1 Capital to a non-risk-based Total Exposure Measure and a G-SIB buffer, as applicable. In addition to Pillar 1 leverage requirements, a bank may be subject to a Pillar 2 leverage requirement if the ECB determines that it has an elevated risk of excessive leverage. Pillar 2 leverage requirement intends to capture contingent leverage risk originating from a bank extensively using derivatives, securities financing transactions and off-balance-sheet items, as well as engaging in regulatory arbitrage and providing step-in support. The leverage ratio Pillar 2 requirement is legally binding, meaning that if banks fail to comply with it, they could be subject to supervisory measures, including sanctions.</p> <p>The ECB sets the leverage ratio Pillar 2 guidance for individual banks based on their performance in the regular EU-wide stress tests.</p>
Additional criteria	
16 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	The CRR and accompanying EU Regulations, as well as the specifications of the CRR and the transposition of the CRD in the member states, apply to all institutions within the meaning of Article 4(3) CRR. Differences between the CRR and Basel III standards are explained in EC 2.

16 AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁵⁵
Description and findings re AC2	<p>Under the CRR, an adequate distribution of capital within different entities of a banking group according to the allocation of risks is achieved by determining capital adequacy requirements for the banking group as a whole but additionally for each institution on an individual basis.</p> <p>The competent authority may waive the capital adequacy requirements on an individual basis, for the parent institution in their Member State (Article 7(3) CRR) and/or for the subsidiaries in this Member State (Article 7(1) CRR), however only under strictly defined conditions - where both the subsidiary and the institution are subject to authorization and supervision by the Member State concerned - and which in particular require that there is no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities. The conditions for the permission of a waiver, according to Article 7 CRR, aim at ensuring an adequate distribution of own funds between parent institution and subsidiaries even though the capital requirements are waived at the solo level.</p> <p>The ECB has adopted a Guide on options and discretions available in Union law that further specifies the principles for granting the waiver under the CRR waiver conditions.</p>
16 AC3	Laws or regulations permit the supervisor or relevant authorities to require banks to maintain additional capital (which may include sectoral capital requirements) in a form that can be released when system-wide risk crystallises or dissipates.
Description and findings re AC3	<p>The systemic risk buffer (SyRB) and the countercyclical capital buffer (CCyB) as set out in CRD are tools permitting competent or designated authorities to require banks to maintain additional capital buffers, including at sectoral level in relation to the SyRB, that can be released when systemic risks crystalize or dissipate.</p> <p>The CCyB is expected to be built up when aggregate growth in credit or other relevant asset classes are judged to be associated with a build-up of system-wide risk and drawn down during downturns. The SyRB is a buffer that can be used to prevent or mitigate macroprudential or systemic risks not covered by the CCyB, the buffers for global or other systemically important institutions or by instruments enshrined in the CRR.</p> <p>The SyRB can apply either to all exposures, to sectoral exposures, or to subsets of the latter. The EBA has provided guidelines on the appropriate subsets of sectoral exposures to which the SyRB may be applied according to Article 133 of CRD.</p> <p>In addition to the capital buffers in the CRD, the CRR allows member states to apply a range of stricter national measures – including changes to risk weights for real estate exposures, own funds, or higher requirements for large exposures or the capital conservation buffer – subject to the procedures set out in Article 458. When authorized to apply the stricter national measures in accordance with this Article, the authorities should provide relevant</p>

⁵⁵ Refer to Principle 12, essential criterion 7 [BCP40.28].

	<p>competent authorities or designated authorities in other member states with all relevant information.</p> <p>According to the CRR/CRD, the power to apply these macroprudential tools can be entrusted to either national competent authorities or national designated authorities, with the exception of the Countercyclical Capital Buffer (CCyB), which can be entrusted only to national designated authorities. With regard to member states participating in the SSM, the responsibility for macroprudential supervision is shared between relevant competent or designated national authorities and the ECB. Pursuant to Article 5(1) of the SSMR, national authorities that intend to use the macroprudential tools enshrined in the CRR/CRD must consult the ECB via a notification procedure before taking a final decision. In addition, under Article 5(2) of the SSMR, the ECB can apply higher requirements or more stringent measures within the scope of the tools established in the CRR/CRD aimed at addressing systemic or macroprudential risks (top-up power).</p>
Assessment of Principle 16	Materially Non-Compliant
Comments	<p>Although it is not mandatory under the Basel standards, the application of the Basel capital requirements to all EU credit institutions (beyond the scope of internationally active banks) at all levels of consolidation. The EU has introduced a detailed Pillar 2 framework as well as various prudential buffers in accordance with the Basel Framework. This helps strengthen banks' safety and soundness and financial stability and eliminate the potential for regulatory arbitrage between banks in the area of capital regulation.</p> <p>Recent developments have moved in contrasting directions. The adoption of the banking package—CRR 3 and CRD6—in the EU is a major milestone. While the final elements of the Basel III reforms have been transposed into EU legislation, which is not the case in all other peer jurisdictions, the deviations from the Basel prudential standards at the time of the last FSAP have not been rectified (non-deduction of unconsolidated insurance holdings from CET 1, SME supporting factor, limited scope of CVA). The impact of the deviation resulting from the SME supporting factor is, however, reduced given the introduction of 85 percent risk-weight in Basel 3. CRR 3 has also introduced strictly targeted deviations—mostly temporary. Lastly, the fundamental review of the trading book (FRTB) implementation has been postponed by one year (in response to decisions taken in some other peer jurisdictions) and further delays or changes to the requirements could be introduced.</p> <p>The impact of the EU specific adjustments on capital requirements is material. The EBA impact analysis shows that, as of December 2023, the overall increase in T1 MRC under Pillar 1 requirements for all EU banks is reduced by 4.4 p.p. relative to the faithful implementation of Basel III. For the group of EU G-SIBs, this reduction amounts to -4.8 p.p. Concerning SIs in the euro area, the impact analysis conducted by the ECB points to a slightly higher impact of the deviations from the Basel Framework on CET1 MRC (the increase is reduced by more than 12 p.p.). Going forward, until these gaps are fully addressed, (i) the EBA and ECB should regularly monitor the effects on banks' capital ratios of deviations from the Basel standard, and (ii) the ECB should also ensure that banks do not unduly maximize the benefits from the non-deduction of unconsolidated insurance holdings by acquiring, via their insurance unit, other financial sectors entities that would otherwise be deduced from CET 1.</p>

	<p>Credit risk models and market risks models are widely used by SIs for regulatory purposes. The ECB is facing significant resources constraints in internal model validation. As indicated in the 2023 Supervisory Examination Program, the number of staffed IMIs was significantly below what was needed, with substantial reputational risk for the SSM as several IMI requests have a legal trigger. Resourcing issues have also been emphasized in external reports (e.g., from the ECA).</p> <p>Over the years, the ECB has been very active to ensure that regulatory requirements are complied with and models' outcomes are reliable. Most of the work on internal model reviews has, however, been reactive by nature, as it is usually triggered by firms' model change applications, including several last-minute withdrawals due to unpreparedness of banks. Going forward, as waiting for the SIs to initiate model change applications is comprehensive but certainly has intrinsic limitations, a more structured proactive review approach implemented in a systematic fashion would help identify banks, portfolios and modelling techniques that deserve in-depth investigations.</p> <p>Regarding sovereign exposures to EU member states, the CRR allows banks to use, upon permission from the competent authority, the standardized approach on a permanent basis for material exposures within an exposure class where the IRB approach is used, which does not comply with the Basel Framework. The assessors acknowledge that modelling sovereign exposures presents significant challenges. That said, as the risk of cherry-picking is high with banks using both IRB and standardized approaches for their sovereign exposures, the ECB should, at a minimum, verify that the application of the standardized approach does not result in significantly lower capital requirements than if the IRB approach were used, understand why banks have not deployed IRB within the entire asset class (e.g., the bank cannot reasonably model some exposures due to a lack of data) and use appropriate supervisory tool such as for example Pillar 2 addons in case of regulatory arbitrage.</p> <p>While an EBA methodology has been introduced to identify and designate O-SII, there is no common EBA methodology for the calibration of O-SII buffers that would avoid unwarranted heterogeneity in the way they are determined and ensure full consistency in the resilience of O-SIIs. Available data suggest significant differences in O-SII buffers across the euro area. While being an important tool that has been strengthened with the introduction of a minimum floor methodology, the use of the ECB's top-up powers is not a substitute for a harmonized calibration methodology.</p>
Principle 17	<p>Credit risk.⁵⁶ The supervisor determines that banks have an adequate credit risk management process that considers their risk appetite, risk profile, market conditions, macroeconomic factors and forward-looking information. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk⁵⁷</p>

⁵⁶ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Guidance on credit risk and accounting for expected credit losses, December 2015; FSB, Principles for sound residential mortgage underwriting practices, April 2012; [CRE20], [CRE40], [CRE45], [CRE50], [CRE51], [CRE54], [MGN10], [MGN20].

⁵⁷ Credit risk may result from: on-balance sheet and off-balance sheet exposures, including loans and advances; investments; interbank lending; derivative transactions; securities financing transactions; and trading activities

	(including counterparty credit risk ⁵⁸) on a timely basis. The full credit life cycle is covered, including credit underwriting, credit evaluation and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
17 EC1	Laws, regulations or the supervisor require banks to have sound credit risk management processes that provide a comprehensive bank-wide view of all credit risk exposures, including a robust methodology for the early identification and appropriate measurement of credit losses. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, that they consider current and forward-looking market and macroeconomic factors, and that they result in prudent standards of underwriting, evaluation, administration, monitoring, measurement and control of credit risk.
Description and findings re EC1	<p>The CRD forms the Level 1 framework.</p> <p>The CRD has been supplemented by EBA guidance on loan origination and monitoring, credit banks' credit risk management practices and accounting for expected credit losses, internal governance, SREP and supervisory stress testing.</p> <p>These cover requirements for banks' practices and associated governance arrangements, processes, and mechanisms in relation to credit. This includes:</p> <ul style="list-style-type: none"> a) Internal governance and control frameworks for the credit-granting and credit decision-making process, including minimum expectations on banks' credit risk appetite. b) The need to set clear criteria for identifying, assessing, approving, monitoring, reporting and mitigating credit risk. c) The requirements for the creditworthiness assessment of borrowers are differentiated by portfolio/borrower type. d) The ongoing monitoring of credit risk and credit exposures, including regular credit reviews of borrowers and the use of early warning indicators. e) Expectations on sound credit risk management practices for credit institutions associated with the implementation and ongoing application of ECL accounting models of IFRS 9. Sound methodologies comprise: <ul style="list-style-type: none"> • a robust process that is designed to equip the bank with the ability to identify the level, nature, and drivers of credit risk, • criteria to consider the impact of forward-looking information, including macroeconomic factors and, • the identification and documentation of the ECL assessment and measurement methods. f) The requirements on the management of non-performing and forborne exposures (see BCP 18).

⁵⁸ Transactions that give rise to counterparty credit risk include: OTC derivatives, exchange-traded derivatives, long settlement transactions and securities financing transactions that are bilaterally or centrally cleared. Counterparty credit risk may result from (but is not limited to) transactions with banks, non-financial corporates and non-bank financial institutions.

	<ul style="list-style-type: none"> g) Requirements on the Risk management framework, such as the need for an appropriate risk strategy and risk appetite level. h) An appropriate framework for identifying, understanding, measuring, monitoring, and reporting credit risk that aligns with the bank's size and complexity. In this regard, the bank should have the appropriate skills, systems and methodologies to measure credit risk. i) The need for a credit risk culture that is fully embedded through policies, communication and staff training to ensure it is known and effectively implemented across all levels of the bank.
17 EC2	The supervisor determines that a bank's board approves and regularly reviews the credit risk management strategy and significant policies for identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk) and that these are consistent with the risk appetite set by the board. The supervisor also determines that the board oversees management in a way that ensures that these policies are implemented effectively and fully integrated into the bank's overall risk management process.
Description and findings re EC2	<p>The CRD establishes the general role of the management body in the strategy and policies for assessing, managing, monitoring, and mitigating the risks to which the bank is or might be exposed. The EBA Guidelines on IFRS 9, loan origination, and SREP further amplify this role.</p> <p>These require that the management body approve and periodically review the strategies and policies for managing, monitoring, and mitigating the risks the bank is or might be exposed to. Minimum expectations are set regarding the extent of the management body's involvement in credit granting, including—among other things—approving the bank's credit risk strategy and the framework for the credit approval process and ensuring that these align with the bank's risk appetite framework.</p> <p>In the SREP, supervisors verify whether:</p> <ul style="list-style-type: none"> a) the management body clearly expresses the credit risk strategy and appetite as well as the process for their review; b) senior management correctly implements and monitors the credit risk strategy approved by the management body; c) the bank's credit and counterparty risk strategy reflects the bank's appetite levels for credit risk and whether it is consistent with the overall risk appetite. <p>An on-site inspection typically includes reviewing documentation to determine the board's level of awareness of the credit risks generated by the different businesses, identifying the reporting lines, accountabilities, and approval processes, and following up on identified shortcomings.</p>
17 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;

	<p>(b) well defined criteria and policies and processes for:</p> <ul style="list-style-type: none"> (i) approving new exposures (including prudent underwriting standards), and ensuring a thorough understanding of the risk profile and characteristics of the borrowers (and in the case of securitisation exposures all features of securitisation transactions)⁵⁹ that would materially impact the performance of these exposures; (ii) renewing and refinancing existing exposures; and (iii) identifying the appropriate approval authority for the size and complexity of the exposures; <p>(c) effective credit administration policies and processes, including: continued analysis of a borrower's ability and willingness to make all payments associated with the contractual arrangements (including reviews of the performance of underlying assets, e.g. for securitisation exposures or project finance); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate exposure grading or classification system;</p> <p>(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;</p> <p>(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;</p> <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 relevance 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 CRR and CRD require banks to have a credit-granting process based on sound and well-defined criteria and that the process for approving, amending, renewing, and re-financing credit is clearly established.</p> <p>The EBA Guidelines on SREP, loan origination, internal governance, and the application of the definition of default further amplify the process.</p> <p>This framework establishes requirements for:</p> <ul style="list-style-type: none"> a) policies and procedures managing credit risk: <ul style="list-style-type: none"> • These should be adequate for the nature and complexity of the bank's activities and enable a clear understanding of the credit risk inherent to the products and activities;

⁵⁹ Securitisation includes both traditional and synthetic securitisations (or similar structures that contain features common to both). Where appropriate, supervisors should provide guidance about whether a given transaction should be considered a securitisation.

	<ul style="list-style-type: none"> • These should be clearly formalized, communicated and applied consistently across the bank; • These should include clear lines of responsibility for taking on, measuring, monitoring, managing, and reporting credit risk should be established. <p>b) the measurement of credit risk, both on- and off-balance-sheet, which should include:</p> <ul style="list-style-type: none"> • collateral coverage, • contractual terms and agreements, • covenants. <p>c) the appropriateness of skills, systems and methodologies to measure credit risk, including adequate data infrastructure to detect, measure, regularly monitor, and manage credit risk, which should meet the requirements of the EBA Guidelines on loan origination and monitoring and the EBA Guidelines on management of non-performing exposures.</p> <p>d) the internal reporting of credit risk exposures, including the outcome of stress testing, to the management body, senior management, and the relevant credit risk managers.</p> <p>e) internal controls and practices to ensure breaches of and exceptions to policies, procedures and limits are reported promptly to the appropriate level of management for action and that there are checks in place to identify, assess, and manage risks to which the bank is exposed.</p> <p>In the SREP, supervisors review the level and quality of credit risk mitigation. They will also review the appropriateness of the risk strategy, risk appetite levels, and the risk management framework to promote a sound risk culture at all levels of the bank.</p> <p>For IRB banks, supervisors assess whether the internal validation process is sound and practical, challenging model assumptions and identifying potential shortcomings in credit risk modelling, quantification, and the credit risk management system.</p> <p>Assessors noted the ECA's findings on resourcing Internal Model Reviews. The assessors were able to see the current position, and the resourcing is tight, which has meant further prioritization of internal model reviews and the introduction of a triage system. While the assessors agree that there is some scope for prioritization, there do not appear to be many resources available to staff supervisory priorities on models, as it is just sufficient to cover the high-priority requests from the banks.</p>
17 EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of obligors 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>The EBA Guidelines on loan origination, definition of default and SREP set out the policy framework.</p> <p>These set out that banks should:</p> <p>a) take into account relevant factors that could influence the present and future repayment capacity of the borrower, such as over-indebtedness;</p>

	<p>b) Consider a possible indication of unlikelihood to pay, that the borrower's overall leverage level has significantly increased, or that there are justified expectations of such changes to leverage.</p> <p>In the SREP, supervisors assess whether the bank has policies to control credit risk, particularly criteria for evaluating borrowers' creditworthiness. They also consider the risk management of FX lending risk, measurement and control frameworks, policies, and procedures, and, among other things, whether the bank periodically reviews borrowers' hedging status.</p>
17 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>The CRD introduced new provisions that ensure that the data on loans to management body members and their related parties are properly documented and made available to competent authorities upon request.</p> <p>EBA Guidelines on Internal Governance and Loan Origination provide further amplification. These set out:</p> <ul style="list-style-type: none"> a) the requirements on policies managing conflict of interests, in particular that the "management body should be responsible for establishing [...] and overseeing the [...] policies to identify, assess, manage and mitigate or prevent actual and potential conflicts of interest", both at the bank and staff level. For example, the bank's policy should cover situations where conflicts of interest may arise when granting a loan (e.g. loans granted by the bank to a company associated with the bank's own staff); b) objectivity and impartiality standards in credit decision-making to mitigate potential conflicts of interest. <p>Supervisors assess compliance in the SREP. They assess:</p> <ul style="list-style-type: none"> a) to what degree does the bank ensure that credit decisions taken are impartial, objective and not affected by any conflict of interest, in line with the EBA Guidelines on internal governance; b) to what degree is the credit risk function in the bank duly independent from the business function. <p>The practice of double-hatting, where the chair of the management body in its supervisory function also serves as the CEO, is not permitted.</p> <p>In the EU framework, banks are not explicitly required to make credit decisions on an arms-length basis; however, in some jurisdictions, this principle is enshrined in legislation or regulation.</p>
17 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 must be decided by the bank's board or senior management. The same requirement applies to credit risk exposures that are especially risky or are otherwise not aligned with the bank's core business activities.

Description and findings re EC6	<p>The CRR includes a large exposure regime (see CP 19).</p> <p>The EBA Guidelines set out expectations for the credit decision-making process, including risk-based escalation procedures. Banks are expected to specify the scope of potential veto rights, the related escalation or appeal procedures, and how the management body will be involved.</p> <p>Supervisors in the SREP assess to what degree the bank implements a robust credit risk appetite with consistent links to the bank's overall business strategy, its overall risk strategy, risk appetite and risk management framework, with particular attention to:</p> <ul style="list-style-type: none"> a) whether the management body approves and periodically performs an adequate review of the risk appetite for taking up, managing, monitoring and mitigating the credit risk the bank is or might be exposed. b) whether the risk appetite has metrics and limits meaningful in that they specify client segments, portfolios, currency, collateral types and credit risk mitigation and are set at levels commensurate with the size and complexity of the bank credit risk activities. c) The definition of adequate limits, metrics, and tolerance thresholds is expected to be regularly reviewed and adapted when necessary, and adherence to the set limit levels should be regularly monitored. d) Limits are set considering different segmentations of the portfolios and considering different perspectives such as product, geography, industry, collateral features, quality of portfolios, and sub-portfolios. e) That breaches are escalated to the appropriate level of the bank's senior management, who should design actions to mitigate the risk. <p>Except for the rules on large exposures, there is no specific requirement that a bank's board or senior management approve credit risk exposures exceeding a particular threshold at the EU-wide level.</p> <p>In some jurisdictions, a board or senior management decision is required to approve credit transactions exceeding given thresholds.</p>
17 EC7	<p>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.</p>
Description and findings re EC7	<p>The CRD and CRR provide the level 1 legal framework that requires member states to ensure that supervisory authorities can obtain the information needed to assess the compliance of banks and banking groups with the requirements of the Directive and of the CRR and that banks and banking groups provide the supervisory authorities with such information and register all their transactions, and document systems and processes so that supervisors can check their compliance.</p> <p>The EBA supervisory reporting framework provides supervisors with extensive information on the credit and investment portfolios of the supervised banks. It includes a breakdown of the client's legal nature and exposure class. Most credit risk-related information is provided quarterly. Credit registers (AnaCredit, which covers EU exposure) and securities holding</p>

	<p>statistics supplement this information, allowing supervisors to identify individual counterparts' risk characteristics (See also CP 19).</p> <p>On-site inspections provide greater assurance, particularly regarding the quality and integrity of the data and the proper allocation of exposures across risk categories within the portfolio's scope.</p> <p>If the information in the sources stated above is unavailable, Article 10 of the SSM Regulation allows the SSM to require banks to provide all information necessary for it to conduct its supervisory tasks.</p>
Assessment of Principle 17	Largely Compliant
Comment	<p>The CRD, CRR and EBA Guidelines provide a good base for banks' credit risk management requirements, but not all those envisaged by this CP.</p> <p>Since the last assessment there have been some improvements to the supervision of credit risk. Assessors were able to see the tools available to assist with this assessment of this risk. The introduction of loan-by-loan information on banks' credit exposures to all legal entities (including SMEs) in the euro area (AnaCredit database) has been a major improvement. The security-by-security data available in another database (Security Holding Statistics) provides a comprehensive picture of all legal entities' indebtedness in the Euro area. These data can lend themselves to beneficial and powerful uses for supervisory purposes, such as monitoring banks' progress in reducing NPLs and granting loan forbearance and the availability of early warning signals on the indebtedness of specific borrowers and groups of connected borrowers.</p> <p>Resourcing internal model reviews has been an issue for some years and remains a problem (see also CP 16).</p> <p>In the EU framework, there is no explicit requirement for banks to make credit decisions on an arm's-length basis (EC 5); however, in some national jurisdictions, this principle is enshrined in legislation or regulation. There is also no requirement in the EU-wide framework or in the SSM supervisory methodology for a bank's board or senior management to approve credit risk exposures exceeding a certain amount or percentage of a bank's capital or that are especially risky or otherwise not in line with the mainstream of the bank's activities. However, some or all these elements are required by some national laws/regulations (EC 6).</p>

Principle 18	Problem exposures, provisions and reserves. ⁶⁰ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem exposures ⁶¹ and the maintenance of adequate provisions ⁶² and reserves. ⁶³
Essential criteria	
18 EC1	Laws, regulations or the supervisor require banks to formulate policies, processes and methodologies for grading, classifying and monitoring all credit exposures (including off-balance sheet and forborne exposures ⁶⁴) and identifying and managing problem exposures. In addition, laws, regulations or the supervisor require regular reviews by banks of their credit exposures (at an individual level or at a portfolio level for credit exposures with homogeneous characteristics) to ensure appropriate exposure classification, detection of deteriorating exposures and timely identification of problem exposures.
Description and findings re EC1	<p>The CRR/CRD and EBA Guidelines on SREP, Loan Origination, Default, and NPLs provide the definition of default and of nonperforming exposures, the method of calculating the CET1 deduction for exposures that are classified as non-performing considered as insufficiently covered by SIs' accounting provisions, and the policy framework for problem exposures, provisions, and reserves.</p> <p>These set out requirements for the ongoing administration and monitoring of the various credit risk-bearing portfolios and banks' exposures, including identifying and managing problem credits and making adequate value adjustments and provisions.</p> <p>The EBA Guidelines set out:</p> <ul style="list-style-type: none"> a) technical criteria for the identification of past-due borrowers; b) technical criteria for the identification of problem borrowers (e.g. unlikely-to-pay or UtP) and thus in default status; c) several possible triggers that banks could consider for classifying borrowers as UtP; d) expectations with regard to the recognition and management of NPLs.
18 EC2	Laws, regulations or the supervisor require banks to formulate policies, processes and methodologies for consistently establishing provisions and ensuring appropriate and robust

⁶⁰ Reference documents: BCBS, Prudential treatment of problem assets – definitions of non-performing exposures and forbearance, April 2017; BCBS, Guidance on credit risk and accounting for expected credit losses, December 2015.

⁶¹ For banks' internal risk management purposes, a problem exposure is an exposure for which there is reason to believe that all amounts due, including the principal and interest, may not be collected in accordance with the contractual terms of the agreement with the counterparty.

⁶² Principle 18 covers all provisioning approaches (eg incurred loss models, expected credit loss models, calendar provisioning) that are used for prudential purposes. In some jurisdictions, cumulative provisions are referred to as loss allowances.

⁶³ 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).

⁶⁴ A forborne exposure is an exposure for which a bank's counterparty is experiencing financial difficulty in meeting its financial commitments and the bank grants a concession that it would not otherwise consider.

	provisioning levels. ⁶⁵ In addition, laws, regulations or the supervisor require banks to formulate policies and processes for writing off problem exposures where recovery is unlikely or where the exposures have very little recovery value.
Description and findings re EC2	<p>The CRD sets out general terms and is supplemented by the EBA Guidelines on SREP, credit institutions' credit risk management practices, accounting for expected credit losses, and managing non-performing and forborne exposures.</p> <p>These state that supervisors should assess whether a bank has an appropriate framework for identifying, understanding, measuring, monitoring, and reporting credit risk.</p> <p>Banks are provided with principles on credit risk management practices and accounting for expected credit losses.</p> <p>Banks are expected to write off an exposure partially or fully when there is no reasonable expectation of recovering contractual cash flows.</p> <p>On-site inspection provides additional assurance. It sets specific objectives to check the computation of provisions from an IFRS 9 perspective for both an internal model-based approach and the classical discounted cash-flow approach.</p>
18 EC3	The supervisor determines that the bank's board approves and regularly reviews significant policies for classifying exposures, determining provisions and managing problem exposures and write-offs. The supervisor also determines that the board oversees management in a way that ensures that these policies are implemented effectively and fully integrated into the bank's overall risk management process.
Description and findings re EC3	<p>The EBA Guidelines on the SREP, management of non-performing and forborne exposures and NPLs provide the framework.</p> <p>They require supervisors to assess:</p> <ul style="list-style-type: none"> a) whether a bank's management body and senior management understand the assumptions underlying the credit measurement system and whether they are aware of the degree of relevant model risk; b) banks have policies and methodologies in place to evaluate the viability of forbearance measures, recognize and classify NPEs and FBEs, and ensure timely measurement and recognition of impairments and write-offs; c) the roles and responsibilities of management bodies in the governance and operational set-up of NPLs. <p>Additional assurance is provided by on-site inspection, which sets specific objectives to check that a bank has proper governance, an adequate decision-making process, and an apparent involvement of the management body in both functions.</p>
18 EC4	The supervisor determines that banks have adequate and appropriate policies, processes, methodologies and organisational resources for establishing provisions and write-offs. The

⁶⁵ Provisions are not limited to problem exposures. Depending on the relevant jurisdiction's accounting and prudential frameworks, provisions may be required for a wider range of exposures (eg all exposures, including performing exposures, under expected credit loss frameworks).

	<p>supervisor determines that policies, processes and methodologies for the measurement of provisions are appropriate to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations and, where relevant, include appropriate expectations about future credit losses based on reasonable and supportable information. The supervisor determines that banks' credit loss provisions and write-off methodologies and levels are subject to an effective review and validation process conducted by a function independent of the relevant risk-taking function.</p>
Description and findings re EC4	<p>The CRD sets out general terms and is supplemented by the EBA Guidelines on SREP, credit banks' credit risk management practices, accounting for expected credit losses, and management of non-performing and forborne exposures.</p> <p>These establish expectations on the measurement of impairment and write-offs, such as:</p> <ul style="list-style-type: none"> a) methodologies and processes for appropriate provisioning; b) the inclusion of market and macroeconomic conditions; c) write-offs; d) the timeliness of provisioning and write-offs; and e) having policies and procedures in place to appropriately validate models used to measure expected credit losses by a function with adequate independence and competence. <p>Supervisors assess that a bank's methods for determining accounting allowances lead to an appropriate measurement of ECL in accordance with the applicable accounting framework.</p>
18 EC5	<p>The supervisor determines that banks have adequate and appropriate policies, processes and organisational resources for:</p> <ul style="list-style-type: none"> (a) reviewing and classifying exposures; (b) the early identification of deteriorating exposures; (c) ongoing oversight of problem exposures; and (d) collecting past due obligations.
Description and findings re EC5	<p>The CRD sets out general terms and is supplemented by the EBA Guidelines on SREP, credit institutions' credit risk management practices, accounting for expected credit losses, and managing non-performing and forborne exposures.</p> <p>These establish expectations on:</p> <ul style="list-style-type: none"> a) Early warning mechanisms to monitor performing loans and prevent the deterioration of credit quality; b) Monitoring of NPLs through a framework of KPIs; and c) Customer engagement and cash collections. <p>Supervisors assess a bank's methods for identifying, measuring, managing, monitoring, and mitigating NPEs and FBEs, including early recognition of NPEs and appropriate workout activities.</p> <p>Additional assurance is provided by on-site inspection, which sets specific objectives to check the classification of exposures or debtors according to default, NPE and forbearance</p>

	criteria (regulatory definitions) and classification of the financial instruments into the different measurement categories according to IFRS 9 requirements.
18 EC6	The supervisor obtains information on a regular basis and in relevant detail or has full access to information concerning the classification of exposures, collateral and other risk mitigants, provisions and write-offs. The supervisor requires banks to have adequate documentation to support their classification and provisioning.
Description and findings re EC6	<p>The EBA Technical Standards set out banks' supervisory reporting obligations.</p> <p>Specific templates for non-performing exposures (F18) and forborne exposures (F19) are reported quarterly. In addition, banks report data at individual instrument level, including its performing and forborne status for all exposure to legal entities that are originated in the euro area.</p> <p>Banks use different accounting frameworks (IFRS 9 or Directive 86/635).</p> <p>The ECB Guidance on NPLs outlines supervisory expectations regarding calculating provisioning levels. It also states that banks should maintain internal supporting documentation, which supervisory authorities may review upon request.</p>
18 EC7	<p>The supervisor assesses whether banks' classification of exposures is appropriate and whether their determination of provisioning levels is adequate for prudential purposes. The supervisor evaluates banks' treatment of exposures with a view to identifying any material circumvention of the classification and provisioning standards (e.g. forbearance). If policies, processes or methodologies are inadequate, or if exposure classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g. if the supervisor considers existing or anticipated deterioration in exposure quality to be of concern, or if the provisions do not fully reflect losses expected to be realised), the supervisor has the power to take appropriate action, for example through requiring the bank to:</p> <ul style="list-style-type: none"> (a) revise its policies, processes or methodologies for classification and provisioning; (b) adjust its classifications of exposures; (c) increase its levels of provisioning, reserves or capital; or (d) if necessary, impose other remedial measures. <p>Assessments supporting the supervisor's opinion in relation to this and other essential criteria under this principle may be conducted by external experts, with the supervisor reviewing the work of the external experts, including to determine the adequacy of the bank's policies, processes and methodologies for classifying exposures and determining provisions.</p>
Description and findings re EC7	<p>The CRD, CRR, and EBA Guidelines on SREP outline the policy framework.</p> <p>Supervisors assess 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. They also review the adequacy of the credit exposures' classification and assess the impact of potential misclassification.</p>

	<p>Supervisors can require banks to apply a specific provisioning policy or treat assets according to their own funds' requirements. However, they do not have the power to adjust exposure classifications or increase provisioning levels, as this is deemed to be part of Public Reporting requirements. Supervisors can also require banks to apply P2R add-ons where the accounting treatment used by the bank to aged-NPEs is considered imprudent from a supervisory perspective, and the bank does not meet the supervisory coverage expectations.</p> <p>The assessors saw examples of the use of P2R and the successful use of moral suasion in provisioning and classification. The latter was no doubt assisted by the introduction of a formal definition of non-performing exposure in the CRR.</p>
18 EC8	<p>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 realisable value, considering prevailing market conditions and the time required for realisation.</p>
Description and findings re EC8	<p>The CRR and EBA Guidelines on Loan origination and monitoring, NPL and FB, and SREP set out the policy framework.</p> <p>They set out requirements for:</p> <ul style="list-style-type: none"> a) banks' valuation of immovable and movable properties at origination, requiring banks to set out internal policies and procedures for the valuation of collateral; b) collateral valuation of immovable and movable properties pledged for NPE, including the governance, procedures and controls in the collateral valuation; the frequency of the valuations; and the methodology for valuation of the collateral. <p>Supervisors assess whether a bank has an appropriate framework for identifying, understanding, measuring, monitoring, and reporting credit risk, including guarantee and collateral coverage and eligibility of this coverage. Supervisors also consider the level and quality of guarantees (including credit derivatives) and available collateral that would mitigate credit losses where credit events occur.</p> <p>Additional assurance is provided by on-site inspection, which sets specific objectives to assess if appropriate and effective processes for collateral management, valuation, and enforceability exist. There is also a check on whether the real estate values used by the bank and the underlying valuation assumptions are realistic and reasonable, as well as considering climate-related and environmental risks (when relevant).</p>
18 EC9	<p>Laws, regulations or the supervisor establish criteria for an exposure to be:</p> <ul style="list-style-type: none"> (a) identified as a problem exposure; (b) identified as non-performing (exposures where full repayment is unlikely or which are 90 days past due for a material amount, or defaulted exposures under either the Basel Framework or the applicable prudential regulation, or credit-impaired exposures according to the applicable accounting framework); (c) reclassified as performing (the counterparty does not have any material exposure more than 90 days past due, repayments have been made when due over a continuous repayment period, the counterparty's situation has improved so that full

	<p>repayment of exposure is likely in accordance with the contractual terms, and the exposure is no longer defaulted or impaired); and</p> <p>(d) classified as a forborne exposure.</p>
Description and findings re EC9	<p>The CRR and EBA Guidelines on the Definition of default set out the policy framework. These set out:</p> <ul style="list-style-type: none"> a) definition of default, which is used for capital requirement calculation purposes; b) the technical aspects related to the unlikely-to-pay (UtP) concept and around the counting and materiality of past-due days; c) the definition of non-performing exposures; d) The technical criteria for the return to non-default status; e) The criteria for the return from non-performing status; f) Forbearance measures; g) Criteria for the identification of exposures as forborne (both performing and non-performing); and h) criteria to exit from the status of non-performing forborne and performing forborne. <p>The SSM encourages banks to use the broader concept of NPE in their internal risk management and public financial reporting, not just for supervisory reporting purposes.</p>
18 EC10	<p>The supervisor determines that the bank's board obtains timely and appropriate information on the condition of the bank's credit portfolio, including classification of exposures, the level of provisions and reserves, and major problem exposures. The information includes, at a minimum, summary results of the latest credit exposure review process, comparative trends in the overall quality of problem exposures, and measurements of any existing or anticipated deterioration in exposure quality and losses expected to be realised.</p>
Description and findings re EC10	<p>The CRD sets out general terms and is supplemented by the EBA Guidelines on SREP, credit institutions' credit risk management practices, accounting for expected credit losses, and managing non-performing and forborne exposures.</p> <p>The banks' management body is required to:</p> <ul style="list-style-type: none"> a) ensure an effective oversight of credit risk quality; Banks should establish regular and transparent reporting mechanisms so that the management body, its risk committee and all relevant units or functions are provided with reports in a timely, accurate and concise manner and can make informed and effective actions within their respective mandates, to ensure the identification, measurement or assessment, monitoring and management of credit risk; b) establish that any NPE reduction strategy and operational plan should be approved and regularly reviewed by the banks' management body; and c) devote with senior management sufficient time and capacity to NPE workout-related matters. <p>The ECB Guidance on NPL sets supervisory expectations that banks develop a framework of KPIs to allow the management body and other relevant managers to measure progress.</p>
18 EC11	<p>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</p>

	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>The EBA Guidelines on Loan Origination, credit institutions' credit risk management practices, and accounting for ECL set out the policy framework.</p> <p>This sets out expectations that:</p> <ul style="list-style-type: none"> a) banks should manage and monitor their credit risk exposures when relevant and material at the individual exposure level; b) the credit risk monitoring framework should cover individual borrowers, including their exposure value, probability of default (PD), credit rating and loss given default, when applicable; c) the classification of exposures as non-performing should be done on an individual basis or for the overall exposure to a given debtor, following the definition in the Article 47a of the CRR; and d) the ECL assessment should always be the most appropriate in the specific circumstances, for example, where collective assessment is often used for large groups of homogeneous lending exposures with shared credit risk characteristics, such as retail portfolios, and individual assessments are frequently conducted for significant exposures, or where credit concerns have been identified at the individual loan level, such as watch list and past-due loans. <p>There is no requirement at an EU-wide level that classification, valuation and provisioning have to be conducted on an individual item basis, at least for significant exposures.</p>
18 EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem exposures and considers 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 given this assessment.
Description and findings re EC12	<p>The CRD and EBA Guidelines on SREP and management of non-performing and forborne exposures set out the policy framework.</p> <p>Supervisors assess the concentration risk arising from exposures to each counterparty, including:</p> <ul style="list-style-type: none"> a) central counterparties; b) groups of connected counterparties; c) counterparties in the same economic sector, geographic region or from the same activity or commodity; and d) the application of credit risk mitigation techniques, including, in particular, risks associated with large indirect credit exposures such as a single collateral issuer. <p>Where a bank has a gross NPL ratio below 5 percent (the threshold for being classified as high-NPL) but a high share or material amount of NPEs in an individual portfolio or subsidiary with a specific concentration of NPEs in a geographical region, an economic sector, or a group of connected clients, supervisors may require the bank to define an NPL reduction strategy.</p>

Assessment of Principle 18	Largely Compliant
Comments	<p>Supervision continues to progress in the area of NPLs, resulting in a much-reduced level of NPLs in banks. While the policy framework has also improved, much remains soft law.</p> <p>The SSM cannot impose a reclassification as NPL and the power to require specific provisioning policy does not allow the ECB to impose specific provisions for certain exposures, e.g., to provide a certain outcome. However, as competent authority the SSM has the power to influence a bank's provisioning policy within the limits of the applicable accounting framework and to apply the necessary adjustments (deductions and similar treatments) in case, for example, accounting provisioning is not sufficient from a supervisory perspective. Insufficient provisions coverage may result in a lower credit score and overall SREP score and a higher P2R in accordance with the SREP methodology. In addition, the ability to use a P2R add-on (on top of the P2R resulting from the SREP) is a welcome development. It provides a fallback option to ensure appropriate prudential treatment of problem loans and further supports supervisors' efforts to use moral suasion on classification and provisioning levels. While the assessors did see evidence of the P2R being used when provisions were considered insufficient from a prudential perspective (e.g., after a review of IFRS 9 ECL provisioning model), the use of the P2R add-on is, however, limited to instances in which banks book accounting provisions that are lower than minimum levels of provisions for NPLs based on a uniform provisioning calendar. The SSM may use a number of escalation tools - such as discussing with auditors and requiring certain disclosures. Such interventions were by their nature addressing overall capital adequacy and not individual provisioning levels.</p> <p>The SSM cannot require that valuation, classification, and provisioning be conducted on an individual item basis, at least for significant exposures. Nor can it set an appropriate threshold for identifying significant exposures and regularly review the threshold's level.</p> <p>Conducting on-site inspections coordinated through "campaigns" or similar exercises, where the same type of investigation is conducted in different banks in parallel, helps share experiences, ensures the consistency of the outcome and should be a more efficient and effective use of resources. However, the review of the leverage finance portfolio in 2023-24, which was an ad hoc exercise conducted in parallel in 12 large banks included several components of an AQR (including a review of a large number of individual credit files, a valuation of collateral and a quantification of provisions) resulted in significant pushback from banks, and the ECB was still in the process of determining the results at the time of the FSAP mission.</p> <p>Given the lack of powers to impose specific accounting provisions and the limited use of the P2R add-on when provisions are deemed insufficient from a prudential perspective, the ECB should assess the merits of seeking to quantify precisely the amount of provisions at a portfolio level using its own tools on top of the work it is already doing (i) reviewing banks' ECL provisioning methodologies and (ii) undertaking transaction testing (e.g., credit file review) to assess the effectiveness of credit risk management processes, detect a deterioration in lending standards and identify specific individual exposures without enough</p>

	provisions). While resorting to some components of an AQR is certainly useful (i.e., as a one-off tool in specific circumstances), using such techniques on a more regular basis and on a large scale (i.e., covering several banks in parallel and a significant share of credit portfolios) may raise challenges and would require more preparatory work to weigh the pros and cons and adjust the supervisory toolkit (i.e., quantifying provisions without being able to require them given the limitation of the existing tools would be of little value).
Principle 19	Concentration risk and large exposure limits. ⁶⁶ 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. ⁶⁷ At least for internationally active banks, large exposure requirements are not less stringent than the applicable Basel standard.
Essential criteria	
19 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. ⁶⁸ Exposures (including counterparty credit risk exposure) arising from off-balance sheet as well as on-balance sheet items included in both the banking book and trading book are captured. At least for internationally active banks, large exposure requirements are not less stringent than the applicable Basel standard.
Description and findings re EC1	Article 81 of the CRD requires competent authorities to 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 concentration risk referred to in the CRD does not fully address all types of concentration risks mentioned in the Basel standard, though some national legislations have a more comprehensive definition of concentration risk. However, the CRR provides for the regulation of large exposure limits aligned with the Basel standard, as outlined in EC 6.

⁶⁶ Reference documents: BCBS, High-level considerations on proportionality, July 2022; Joint Forum, Cross-sectoral review of group-wide identification and management of risk concentrations, April 2008; BCBS, Principles for the management of credit risk, September 2000; [LEX10], [LEX20], [LEX30], [LEX40].

⁶⁷ Connected counterparties may include natural persons as well as legal persons. Two or more natural or legal persons shall be deemed a group of connected counterparties if at least one of the following criteria is satisfied: (a) control relationship: one of the counterparties, directly or indirectly, has control over the other(s); or (b) economic interdependence: if one of the counterparties were to experience financial problems, the other(s), as a result, would also be likely to encounter financial difficulties.

⁶⁸ Concentration risk may result from credit, market and other risk where a bank is overly exposed to particular asset classes, products, collateral, currencies or funding sources, and is broader than exposures subject to large exposure requirements. Credit concentrations include exposures to: single counterparties (including collateral credit protection and other commitments provided); groups of connected counterparties; counterparties in the same industry, economic sector or geographic region; and counterparties whose financial performance is dependent on the same activity or commodity.

	<p>The CRR, in general, expects member states to ensure that the risk management function ensures that all material risks are identified, measured and properly reported without making any specific reference to concentration risks. There is, however, no supervisory guidance applying directly to banks and providing detailed expectations on the management of all forms of concentration risks (i.e., specifying what is expected from banks). The EBA SREP Guidelines which are primarily intended to specify how banking supervisors should assess the risks do not to explain how banks are expected to manage concentration risks.</p> <p>Specific guidance on the management of concentration risk under the supervisory review process was contained in CEBS Guidelines issued in 2010, prior to the formation of the SSM. The CEBS Guidelines clarified that “risk drivers which could be a source of concentration risk should be identified by institutions, and this identification should be comprehensive enough to ensure that all risk concentrations which are significant to the institution are covered, including on- and off-balance sheet positions and committed and uncommitted exposures, and extending across risk types, business lines and entities.” Further, they provided principles for the management and supervision of concentration risk within individual risk areas of credit, market, operational and liquidity risks. Definitions of intra-risk and inter-risk concentrations were clarified as well. The CEBS Guidelines have been repealed in 2014 and have not been replaced by a similar document. Had they remained in place, they would have needed to be updated to reflect more recent developments (lessons from the SVB case, notably the concentration on the funding side).</p> <p>The EBA guidelines on SREP specifically require competent authorities to ensure that the institution’s systems and methodologies “identify and measure credit concentration risks (single-name, sectoral, geographical, etc.);” and state that competent authorities should consider whether the data, information systems and analytical techniques of institutions enable the institution “to detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities”.</p> <p>The ECB requires in its internal Operational Guidance that institutions under its direct supervision have a concise and practical definition of what constitutes a credit concentration. It lays out the types of concentrations to be assessed, the methodology to be used for the assessment, and the indicators to be used in the supporting analysis. Institutions are expected to report risk exposure, concentrations, and emerging risks. The internal operational guidance for supervisors covers concentrations under different risk types while using the term ‘concentration risk’ along with the definition in the CRR for credit concentration risks. It is however worth noting that the internal Operational Guidance has not been published and is not applicable to banks.</p> <p>Concentration risk (both individual and sectoral) is taken into account as part of the institutions’ ICAAP assessment and in the process of determining P2R. The EBA SREP Guidelines (section 6.2) set supervisory expectation for supervisors to assess the degree of concentration within all types of exposures to country risk, including sovereign exposures, in proportion to the whole institution’s credit portfolio (per obligor and amount). However, the assessment by the JSTs of excessive concentration risk does not include concentration to sovereign exposures in a systematic fashion. Indeed, concentration to sovereign exposures is</p>
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	<p>not included in the concentration risk indicators for the phase 2 score of the SSM SREP and only assessed in the phase 3, if deemed relevant by the JSTs.</p> <p>The assessors reviewed multiple supervisory documents where concentrations and credit concentration risks were assessed by the supervisor.</p>
19 EC2	<p>The supervisor determines that a bank's information systems identify and aggregate on a timely basis exposures creating risk concentrations and large exposure to single counterparties or groups of connected counterparties and facilitate active management of such exposures.⁶⁹</p>
Description and findings re EC2	<p>The CRR requires institutions to have sound administrative and accounting procedures and adequate internal control mechanisms for identifying, managing, monitoring, reporting and recording all large exposures (i.e., exposures equal to or exceeding 10 percent of the institutions' Tier 1 capital) and subsequent changes to them.</p> <p>The internal SSM Operational Guidance provides that an institution should have adequate data management systems to enable it to identify concentrations arising from different (types of) exposures. This internal guidance is, however, not applicable to banks. The CEBS Guideline contained a similar expectation but has been repealed.</p> <p>Additionally, institutions must have adequate information systems to comply with the existing EU reporting requirements set down in the CRR. EBA guidelines on SREP state that: "competent authorities should consider whether the institutions have adequate data infrastructure that meets the requirements of the EBA Guidelines on loan origination and monitoring, management of non-performing and forborne exposures, whether analytical techniques are appropriate to enable the institution to adequately manage their credit risk, and to fulfil 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), in particular with regard to relevant sources of credit concentration risk." At point b) it also mentions "credit exposures (irrespective of their nature) of borrowers and, where relevant, of groups of connected borrowers.</p> <p>The ECB requires banks under its direct supervision 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 the identification of business lines, legal entities, asset types, industries, geographical regions or other segments relevant for the risk in question. Such data will give the bank the ability to identify and report risk exposures, concentrations, and emerging risks.</p>

⁶⁹ The measure of credit exposure for large exposures should reflect the maximum possible loss from counterparty failure (i.e., it should encompass actual and potential exposures as well as contingent liabilities). The risk weighting concept adopted in the Basel Framework should not be used in measuring credit exposure for this purpose, as its use for measuring credit concentrations could significantly underestimate potential losses.

19 EC3	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.
Description and findings re EC3	<p>As stated above, the European Union framework requires banks to have internal risk control mechanisms established, which should identify, manage, monitor, report and record risks, in particular large exposures.</p> <p>The CRD requires that the member states ensure that the management body approves and periodically reviews the strategies and policies for taking up, managing, monitoring and mitigating the risks an institution is or might be exposed to. The institutions should establish reporting lines to the management body that cover all material risks and risk management policies and changes thereof. The management body must have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance.</p> <p>Specific to the management of concentration risk, the CEBS Guideline expected banks to "set top-down and group-wide concentration risk limit structures (including appropriate sub-limits across business units or entities and across risk types) for exposures to counterparties or groups of related counterparties, sectors or industries, as well as exposures to specific products or markets. Institutions should use internal limits, thresholds or similar concepts for actively controlling monitoring and mitigating concentration risks. The limit structures and levels should reflect the institution's risk tolerance and consider all relevant interdependencies within and between risk factors. The limit structures should cover both on- and off- balance sheet positions and the structure of assets and liabilities at consolidated and solo levels. The limit structures should be appropriately documented and communicated to all relevant levels of the organization."</p> <p>The EBA guidelines on SREP require competent authorities to assess whether the institution has a sound, clearly formulated and documented risk appetite, strategy and limits approved by the management body. These should include, for example, exposure type (commercial, consumer, real estate, sovereign), economic sector, geographical location, currency and maturity, including concentration limits".</p> <p>According to ECB internal SSM operational guidance, the monitoring framework for credit risk should support the identification of credit risk concentrations and allow the monitoring of concentration measures against the values specified in their credit risk appetite, policies, and procedures. This is also extended to market risk concentration and the banks' ability to identify and manage it.</p> <p>Further, JSTs are recommended to assess the banks' "ability to identify possible market risk concentrations across asset classes, risk factors and countries." Moreover, among the inspection objectives related to on-site activity, the team should ensure that credit institutions have an internal methodology to define correlated factors that reflect close</p>

	<p>linkages amongst exposures to set limits in concentration risk, such as geographical areas or economic sectors.</p> <p>Assessors reviewed multiple supervisory materials where concentrations, risk appetite framework and limits were assessed, and recommendations regarding setting limits, for example, for funding maturity concentration, were given.</p>
19 EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	<p>The CRR sets out reporting requirements for large exposures and certain largest exposures. These include the identification of a client or group of clients, the value of the exposure before and after taking into account CRM, type of credit protection, and expected run-off of the exposure. An institution reports all exposures to a counterparty or group of connected counterparties exceeding the threshold of 10 percent of its Tier 1 capital to the supervisor.</p> <p>Harmonized EU regulatory reporting framework on supervisory reporting utilizes common reporting templates and instructions in relation to large exposures. It includes information on individual counterparties. The code to be used to identify the counterparties should be the legal entity identifier (LEI) for institutions and insurance undertakings. For other entities, it should also be the LEI unless it is not available. The requirements further include information on the general sector (government, credit institutions, households) and statistical sectoral codes for individual counterparts, which are non-financial corporations following the Statistical Classification of Economic Activities in the EU (NACE). 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 to non-financial corporations on a creditor-debtor level plus information on the concentration in other portfolios on an aggregate level using the Herfindahl index (total gross performing exposures with a breakdown by portfolio, and total gross performing exposures to non-financial corporations with a breakdown by sector).</p> <p>In addition to the data collected through supervisory reporting, SSM Banking Supervision has access to granular credit register data (AnaCredit), allowing supervisors to assess the exposure to clients on a granular basis. AnaCredit reporting covers loans to legal entities other than natural persons where the debtor's commitment amount is equal to or larger than EUR 25,000. The reported information has been used in the context of the recent crises to assess the exposures towards troubled clients and has proven a valuable add-on to the supervisory data on large exposures. Beyond the ability to investigate individual counterparts, the granularity of the dataset alleviates the analysis of concentration risks by allowing supervisors to flexibly define ad-hoc portfolios along various combinations of its dimensions, e.g. residence, economic activity or size of the counterparty.</p>
19 EC5	For 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	The CRR explicitly defines conditions under which counterparties, owing to control or economic connections, have to be treated as a group of connected counterparties.

	<p>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 direct or indirect 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. CRR refers to the accounting framework for the definition of control.</p> <p>The EBA has further reinforced the framework, publishing detailed guidelines focused exclusively on the issue of connected clients. This level 2 text applies not only to the large exposures framework but to all areas of the CRR where the concept of connected clients is used, while ensuring consistency across the framework. Leveraging on these guidelines, the EU Commission issued the RTS 2024/1728 specifying in which circumstances the conditions for identifying groups of connected clients are met. The RTS together with the guidance for the alternative approach for exposures to central governments and for the control and management procedures for identifying clients that constitute a single risk included in the mentioned guidelines, provide the complete framework for the identification of groups of connected clients.</p> <p>The ECB complies with the guidelines, as do all SSM member states, while one member intends to comply.</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 their opinion. The assessors were presented with material supporting such actions having been taken.</p>
19 EC6	<p>Laws, regulations or the supervisor set prudent and appropriate 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 those giving rise to counterparty credit risk exposure), whether on-balance sheet or off-balance sheet. The supervisor also determines that banks assess connectedness between counterparties through control relationships and economic interdependence based on objective and qualitative criteria. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.</p>
Description and findings re EC6	<p>The rules on large exposures, including the respective limits, are mainly laid down in the CRR and complemented by Implementing Regulations, EBA guidelines, as well as the national transpositions of the Member State discretions in CRR. Institutions should have sound administrative and accounting procedures and adequate internal control mechanisms for identifying, managing, monitoring, reporting and recording all large exposures (i.e., exposures equal to or exceeding 10 percent of the institution's Tier 1 capital) and subsequent changes to them. It establishes reporting requirements, which are harmonized across the EU and further defined in Commission Implementing Regulation (EU) 2021/451. The CRR also requires that institutions use a credit risk mitigation technique in the calculation of an exposure where it has used that technique to calculate capital requirements for credit risk.</p>

The definition of an exposure for large exposures purposes is set out in CRR and includes both on-balance-sheet assets as well as off-balance-sheet items. An institution's exposure to a client or group of connected clients should be considered as a large exposure where its value is equal to or exceeds 10 percent of its Tier 1 capital. An institution should not incur an exposure to a client, or group of connected clients, the value of which exceeds 25 percent of its Tier 1 capital. If the client is a credit institution or investment firm, the limit is 25 percent of its Tier 1 capital or EUR 150 million, whichever is higher. The rules on large exposure limits also apply to consolidation at the group level. If, in an exceptional case, exposures exceed the limit set out in CRR, the competent authorities may, where the circumstances warrant, allow the institution a limited period of time in which to comply with the limit. The EBA has issued Guidelines (EBA/GL/2021/09) specifying the criteria to assess the exceptional cases when institutions exceed the large exposure limits and the time and measures to return to compliance.

The EBA Guidelines and RTS, as noted in EC 5, constitute the criteria regarding control and economic dependency for the determination of a connected counterparty group.

The CRR also stipulates that institutions must have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying, managing, monitoring, reporting and recording all large exposures and subsequent changes to them.

The implementation of the large exposures framework has been assessed as largely compliant with the Basel framework (see the July 2022 RCAP report). There was one potentially material finding in the RCAP and several findings that were assessed as non-material.

The material finding related to trading book exposures, for which the EU regulations allow for the large exposure limit to be exceeded up to 600 percent of a bank's Tier 1 capital. This limit should be monitored and each time it is exceeded, the institution should report to the competent authorities without delay the amount of the excess and the name of the client concerned and, where applicable, the name of the group of connected clients concerned. When breaching the large exposure limits in the trading book, institutions are required to calculate additional own funds requirements according to Articles 397 and 398 of CRR. The ECB has confirmed that no bank is benefiting from this deviation.

Large exposure limits are subject to some discretions in the EU framework. The ECB intends to permit the use of the intra-group exposure waiver and promote its consistent application throughout the euro area. In its Regulation of March 14, 2016, on the exercise of options and discretions (ONDs) available in Union law, it states that the waiver in relation to intra-group exposures is allowed in full for undertakings established in the EU provided that the conditions set out in Annex I of that Regulation are met. For counterparties in third countries, the ECB has clarified in its Guide on ONDs that it intends to grant such exemptions fully or partially only after conducting a case-by-case prior assessment. Nevertheless, a transitional rule in the CRR allows member states to exercise their own discretion on this waiver until 2028. It should be noted that where a Member State has

	exercised discretion on intra-group exposures, the relevant provisions in the ECB Regulation/Guide on ONDs do not apply. Indeed, once a Member State discretion is exercised, the ECB should apply the national legislation exercising those options and discretions.
Additional criterion	
19 AC1	<p>In respect of credit exposure to single counterparties or groups of connected counterparties, non-internationally active banks are required to adhere to the limits below:</p> <ul style="list-style-type: none"> (a) 10 percent or more of a bank's Tier 1 capital is defined as a large exposure; and (b) 25 percent of a bank's Tier 1 capital is the limit for an individual large exposure to a private sector non-bank counterparty or a group of connected counterparties. <p>Minor deviations from these limits may be acceptable, especially if they are explicitly temporary or related to very small or specialised banks.</p>
Description and findings re AC1	<p>The definition of large exposures and the corresponding limits of 10 percent and 25 percent of Tier 1 capital, which are given in CRR, are applicable to all banks in EU. However, there are minor deviations from these limits in addition to RCAP findings for the large exposure framework (Please refer to EC 6). Where the client is an institution or an investment firm, the exposure value should not exceed 25 percent of the institution's Tier 1 capital or EUR 150 million, whichever is higher. With respect to very small banks with Tier 1 capital of EUR 600 million or less (i.e. banks for which the EUR 150 million limit applies), the exposures to a single institution or investment firm can exceed 25 percent. However, they should still be within the limit of 100 percent of the institution's Tier 1 capital. In addition, EU G-SIIs should limit exposures to another G-SII (both EU and non-EU) to 15 percent of its tier 1 capital.</p> <p>The CRR expects that large exposure limits are generally complied with at all times. If, in an exceptional case, an exposure exceeds the limit, the institution has to report the value of the exposure without delay 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>
Assessment of Principle 19	Largely Compliant
Comments	<p>Only the definition of credit concentration risk is explicitly provided in EU laws. In the last FSAP, it was recommended that a more comprehensive framework for the analysis of concentration risk should be adopted, encompassing all forms of risk concentration, beyond those linked to credit risk. In practice, the various forms of concentration risks (e.g., credit concentration, market concentration, funding concentration, etc.) are addressed in the EBA SREP Guideline which are primarily intended to specify how banking supervisors should assess the risks to banks' business models, solvency and liquidity, and not to explain how banks are expected to manage their concentration risks. There is no supervisory guidance applying directly to banks and providing detailed expectations on the management of all forms of concentration risks (i.e., specifying what is expected from banks). The internal SSM Operational Guidance continues to refer to the CEBS Guideline 31, which was providing principles for the management and supervision of concentration risk within individual risk areas of credit, market, operational and liquidity risks. This guidance, which was last updated in 2010, predating the SSM and the CRD/CRR was repealed in 2014 and not replaced by a similar document. Considering that different aspects of concentration</p>

	<p>risk have been highlighted in recent bank failures, for instance, SVB's concentration on the funding side, there would be merit in issuing a comprehensive guidance on the management of concentrations risks, encompassing all forms of risk concentration.</p> <p>The last FSAP also highlighted some deviations in the large exposure framework. Since then, CRR has been amended to introduce a G-SIB-specific large exposure limit and has changed the definition of eligible capital to align with the Basel large exposure framework definition. However, there are still deviations from the Basel large exposure framework identified in the RCAP carried out in 2022, including a potentially material finding in the trading book based on the set of sample banks. Although the ECB confirms that this deviation is not currently used by any bank, it remains on the statute.</p> <p>In the SSM area, some banks have material concentrations to sovereign risk exposures. The ECB provided the assessors with their assessment examples and diversification plans for some banks. Assessors observed that the proposed diversification plans were often slow and that targeted levels would still be regarded as high concentrations. The SREP framework allows the use of Pillar 2 capital add-ons reflecting sovereign concentration risks although they are not used in a systematic fashion and have only been imposed in a few instances.</p> <p>Another recommendation from the last FSAP states that SIs should obtain LEIs for all supervised entities in their group and regularly use LEIs in reporting and identifying their corporate clients. Commission Implementing Regulation (EU) 2021/451 of December 2020 on supervisory reporting (ITS) includes a specific reference to the compulsory use of LEI for reporting. In particular, the instructions for reporting large exposures and concentration risk specify that the code to be used to identify the counterparties should be the LEI for institutions and insurance undertakings. For other entities, it should also be the LEI unless it is not available. In the AnaCredit database customers are identified based on their national identifiers where LEI is not used. The ESRB issued a recommendation in September 2020 which seeks the introduction of an EU legal framework to uniquely identify legal entities engaged in financial transactions by LEIs and to make the use of the LEI more systematic in respect of supervisory reporting and public disclosure. Although there is a strong move towards using LEI code as much as possible in the EU legal system it is not an obligation for all corporate clients.</p> <p>The last FSAP also recommended that a requirement or explicit supervisory expectations should be introduced that all material concentrations be regularly reviewed and reported to a bank's board. Since the last FSAP, no change has been introduced in the legal framework to address this recommendation.</p>
Principle 20	Transactions with related parties. ⁷⁰ To prevent abuses arising in transactions with related parties ⁷¹ and to address the risk of conflicts of interest, the supervisor requires banks to

⁷⁰ Reference documents: BCBS, Corporate governance principles for banks, July 2015; BCBS, Principles for the management of credit risk, September 2000.

⁷¹ Related parties can include: (a) the bank's subsidiaries and affiliates (including their subsidiaries, affiliates and special purpose entities) and any other party that the bank exerts control over or that exerts control over the bank;

(continued)

	enter into any transactions with related parties on an arm's length basis; ⁷² monitor these transactions; 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	
20 EC1	Laws, regulations, or the supervisor set out a comprehensive definition of "related parties" that should at least consider all of the elements detailed in footnote 60 ⁷³ . 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 definition of "related parties", which is consistently applied across the member states, and which is aligned with the comprehensive scope laid out in the Basel definition.</p> <p>The CRD (Article 88(1)) offers a definition of "related parties" which is limited relative to the intent of the Basel requirement and covers only "members of the management body; their family members and the entities in which the members and their close family have a qualifying holding of 10 percent or more of capital or of voting rights in that entity, or in which those persons can exercise significant influence, or in which those persons hold senior management positions or are members of the management body".</p> <p>The Guidelines of the EBA on Internal Governance (EBA/GL/2021/05) specify measures that should be implemented by institutions to prudently manage conflicts of interest that may arise from granting loans to and entering into other transactions with members of the management body and their "related parties". In accordance with the Guidelines, institutions may consider additional categories of "related parties" to whom they apply, in whole or in part, their conflicts of interest framework regarding loans and other transactions and recommend thresholds for documentation and also for approval of the management body.</p> <p>These definitions as adopted by member states, their coverage, and the thresholds above which exposures may merit closer attention, however, vary. "Related parties" range from managers of the credit institution, key function holders, shareholders, members of the family of these persons, persons who may exercise significant influence, as well as bodies in which the credit institution or any one or more of its directors jointly or severally maintains control and affiliates of the credit institution. For example, Austria has transposed the CRD definition directly, Belgium includes intra-group transactions with subsidiaries and sister companies, and Slovenia also includes auditors of the bank or natural persons acting on behalf of the auditor.</p>

(b) the bank's major shareholders, including beneficial owners; (c) the bank's board members, senior management and key staff, corresponding persons in affiliated companies, and parties that can exert significant influence on board members or senior management; and (d) for the natural persons identified in (a) to (c), their direct and related interests and their close family members.

⁷² Related party transactions include on-balance sheet and off-balance sheet credit exposures; dealings such as service contracts, asset purchases and sales, construction contracts and 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.

⁷³ Footnote 70 in this document

20 EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favourable terms (e.g. in credit assessment, tenor, interest rates, fees, amortisation schedules, requirements for collateral) than corresponding transactions with non-related counterparties. ⁷⁴
Description and findings re EC2	The relevant provisions of the CRD do not state any requirements for undertaking “related party” transactions. The EBA Guidelines on Internal Governance, however, require that decisions regarding the granting of such loans and entering into other transactions with members of the management body and their related parties are taken objectively, without undue influence by conflicts of interest and are, as a general principle, conducted at arm’s length. Again, the national transpositions vary though arm’s length requirements, typically above a threshold, are often present in those national laws which incorporate provisions on “related party” lending.
20 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 for granting and managing related party transactions.
Description and findings re EC3	<p>The EBA Guideline on Internal Governance lays out the expectations that as part of the conflicts of interest framework, the management body should set appropriate thresholds (e.g. per the product type or depending on the conditions) above which the loan or other transaction with a member of the management body or its related parties should always require approval by the management body. Further, when deciding on a loan or other transaction with a member of the management body or their related parties, before taking a decision, institutions should assess the risk to which the institution might be exposed due to the transaction. Decisions on material loans or other material transactions with members of the management body that are not being concluded under normal market terms but on conditions available to all staff should always be made by the management body. The member of the management body benefitting from such a material loan or other material transaction or the member who is related to the counterparty should not be involved in the decision-making.</p> <p>Since there is no harmonized framework under Union law, national laws regarding the approval practices and thresholds vary and range from all transactions above a threshold being subject to the unanimous approval of all directors to being notified to supervisors or even to be subject to the consent of the competent authority, which for significant supervised entities, would be the ECB.</p> <p>The assessors saw anonymized examples of approvals or assessment of non-objections granted in cases where national laws in SSM countries grants such power to the competent supervisor. Although no separate internal detailed guidelines were made available to supervisors in dealing with such applications, the approvals considered the specifics of the national law (ranging from non-objections to explicit approvals), including internal audit</p>

⁷⁴ Exceptions may be appropriate for certain transactions between entities within a banking group when the supervisor considers this to be consistent with sound group-wide risk management. An exception may also be appropriate for beneficial terms that are part of overall remuneration packages.

	reports confirming the approval transaction, characteristics of the transactions consistent with the risk policy adopted by the board of directors, FAP assessment and the alignment with similar transactions with other clients. They covered both individuals, as well as affiliates of the applicant institutions.
20 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) or who otherwise have a conflict of interest from being part of the process of granting and managing the related party transaction.
Description and findings re EC4	<p>The general principles for objectivity and impartiality in credit decision-making are laid out in the EBA Guidelines on Loan Origination and Monitoring. Institutions should have policies, procedures and organizational controls in place that guarantee and ensure objectivity and impartiality in the credit decision-making process. These policies, procedures and organizational controls, including any mitigating measures, should be clearly defined, understood, and should address any potential conflicts of interest. Institutions should ensure effective oversight of the decisions taken by credit decision-makers, including credit granting, to ensure their objectivity and impartiality.</p> <p>More specifically, institutions should ensure that decisions taken by credit decision-makers are impartial and objective and not adversely affected by any conflict of interest, in line with the EBA Guidelines on Internal Governance. Institutions should ensure that any individual involved in credit decision-making, such as members of staff and members of the management body, should not take part in credit decisions if any of the following occurs: a. any individual involved in credit decision-making has a personal or professional relationship (outside the professional relationship when representing the institution) with the borrower; b. any individual involved in credit decision-making has an economic or any other interest, including direct or indirect, actual or potential, financial or non-financial, associated with the borrower; c. any individual involved in credit decision-making has an undue political influence on or a political relationship with the borrower.</p> <p>Supervisors review the policies and processes as part of their ongoing supervision of internal governance and conflicts of interest.</p>
20 EC5	Laws or regulations establish, or the supervisor sets on a general or case by case basis, limits for exposures to related parties ⁷⁵ or require such exposures to be collateralised or deducted from capital. ⁷⁶ When limits are only set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties under Principle 19.
Description and findings re EC5	Neither the Union laws nor the EBA Guidelines lay down any limits, nor do the supervisors lay down any general or case-by-case limits for exposure to related parties or require them to be collateralized or deducted from capital.

⁷⁵ For this purpose, exposures should be calculated consistently with Principle 19 [BCP40.43].

⁷⁶ The supervisor may exclude banks' exposures to certain entities within the banking group where the supervisor considers this to be consistent with sound group-wide risk management.

	<p>The EBA Guidelines only go so far as to require that banks should document data on loans to members of the management body and their related parties properly and should be able to make available to competent authorities the complete documentation in an appropriate format upon request without undue delay, including additional information on loans above an amount of EUR 200 000. The information to be made available includes (a) the percentage of the loan and the percentage of the sum of all outstanding amounts of loans towards the same debtor compared to i) the sum of its Tier 1 capital and Tier 2 capital and ii) common equity Tier-1 capital of the institution; (b) whether the loan is part of a large exposure; and (c) the relative weight of the aggregated sum of all outstanding amounts of loans towards the same debtor, calculated as a percentage by dividing the total outstanding amount by the total amount of all outstanding loans to members of the management body and their related parties.</p> <p>As there is no treatment of related parties in EU legislation, national laws differ, and some are completely silent. Not all national frameworks include provisions to define specific limits for lending to all related parties as a percent of capital (going beyond the general restrictions for large exposures as mentioned in CP 19). However, some do define specific limits for direct or indirect transactions with qualifying shareholders and management board members. As an example, under the Portuguese legal framework of credit institutions and financial companies, the exposure to a related party should not exceed, on the whole, and at any time, 10 percent of the institution's own funds and the total exposure to all related parties should not exceed, at any time, 30 percent of the institution's own funds. Under German law, for instance, the competent authority may impose upper limits for the granting of loans to related parties on a case-by-case basis; it is also empowered to do so even after the loan has been granted.</p> <p>The assessors saw an anonymized case where the ECB had required exposure to a related party to be deducted from capital, given that the aggregate exposure had violated the large exposure limit for connected counterparties.</p>
20 EC6	<p>The supervisor determines that banks have policies and processes to:</p> <ul style="list-style-type: none"> (a) identify individual exposures to and transactions with related parties as well as the total amount of exposures; and (b) monitor and report on them through an independent credit review or audit process. <p>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.</p>
Description and findings re EC6	<p>While the laws do not address these requirements specifically in the case of 'related parties', the CRD includes a general requirement that credit institutions – as ensured by their management bodies - must have governance arrangements in place which ensure effective and prudent management of the institution, including the prevention of conflicts of interest. Further, it also requires that the management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies.</p>

	<p>The EBA Guidelines interpreting the CRD provide more substance and specify that institutions should ensure that all relevant internal control procedures fully apply to loans and to other transactions with members of the management body or their related parties and that an appropriate oversight framework is in place at the level of the management body in its supervisory function. In addition, they should document data on loans to members of the management body and their related parties properly and should be able to make available to competent authorities the complete documentation in an appropriate format upon request without undue delay. Further, where loans are arranged as a line of credit (e.g. overdrafts), the initial decision and amendments thereof should be documented.</p> <p>Accordingly, the ECB covers the general requirements of policies and processes as part of their supervision of the internal governance of the banks, which is a key component of the SREP exercise and may also comment on specific cases where general principles for related party transactions as laid out in the EBA Guidelines are violated.</p>
20 EC7	The supervisor obtains and regularly reviews information on aggregate exposures to related parties. Supervisors require banks to report (or the supervisor acquires this information through other means) individual related party transactions that are material (e.g. those exceeding a specified amount or a percentage of the bank's Tier 1 capital).
Description and findings re EC7	<p>While the CRD requires member states to ensure that data on loans to members of the management body and their related parties are properly documented and made available to competent authorities upon request, there is no supervisory requirement for banks to periodically report individual or aggregate information on related party exposure.</p> <p>The EBA Guidelines reiterate this requirement, adding that the information should be provided "in an appropriate format upon request without undue delay". As mentioned in EC 5, it adds a EUR 200,000 threshold for such loans above which institutions should be able to provide to the competent authority specified additional information.</p> <p>The EBA Implementing Technical Standards on Supervisory Reporting also includes instructions and financial information templates (FINREP) for reporting transactions with related parties. Institutions should report amounts and/or transactions related to the balance sheet and the off-balance sheet exposures where the counterparty is a related party in accordance with IAS 24. The FINREP report on related party transactions reflect the related parties' accounting definition under IAS 24, which is not as comprehensive as the definition under CP 20 but closer to the Basel definition than the much narrower CRD definition used for Pillar 3 disclosures (see CP 10 and 28 for more details). However, not all member states follow IFRS, and the reporting is only in aggregate, which reduces the utility of the report for ongoing supervision.</p>
Assessment of Principle 20	Materially Non-Compliant
Comments	The EU framework for related party transactions is neither comprehensive nor consistent. The definitions of related parties and exposures in the CRD and the EBA Guidelines are not as comprehensive as those required by the Basel standard. There are no regulatory limits or thresholds triggering supervisory notification or approval prescribed in EU law, regulation or guidance. While more detailed provisions may be included in some national frameworks, the

	<p>definition, scope, approval, and reporting requirements are not harmonized across member states. Related party policies, processes and transactions may be looked at in the course of ongoing supervision of internal governance by the ECB, but there has not been any horizontal or thematic review so far that could help develop benchmarks for materiality or for supervisory expectations to be more formalized.</p> <p>The ECB has attempted to get legislative attention for setting the related party framework at EU level but has so far not succeeded, and has voiced its concerns in its Opinions on CRD 6 and earlier: <i>"In spite of the existing provisions at national level, as well the above provisions in the CRD (and related EBA Guidelines), the ECB believes that further harmonization of specific supervisory powers, including those on related party transactions, remains necessary and would help to progress more towards a genuine single rulebook and reduce regulatory fragmentation across the SSM"</i>. The assessors agree with this opinion, but compliance with this principle would require a definition in law as comprehensive as envisaged in the CP and its EU-wide adoption together with materiality limits to trigger approvals, remedial actions, and reporting.</p>
Principle 21	Country and transfer risks. ⁷⁷ The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk ⁷⁸ and transfer risk ⁷⁹ in their international lending and investment activities on a timely basis.
Essential criteria	
21 EC1	The supervisor determines that a bank's policies and processes adequately consider 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, consider market and macroeconomic conditions, and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intragroup 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	The EU framework is silent on country and transfer risk. However, some jurisdictions, for example, Ireland and Latvia, have introduced specific regulations for country and transfer risks. In other jurisdictions, for example Luxembourg, a dedicated framework to monitor country risk, including from intragroup exposures, is in place.

⁷⁷ Reference documents: IMF, External debt statistics – guide for compilers and users, 2013; BCBS, Management of banks' international lending: country risk analysis and country exposure measurement and control, March 1982.

⁷⁸ 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 involving individuals, corporates, banks or governments are covered.

⁷⁹ Transfer risk is the risk that a borrower will not be able to convert local currency into a foreign currency and so will be unable to make debt service payments in a foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country.

	<p>Country and transfer risks (including those arising from foreign currency exposures) are covered in the EBA SREP Guidelines under the category of credit risk. All NCAs and the ECB intend to comply with this guideline.</p> <p>The SSM internal Guidance on SREP methodology is built on these Guidelines. From the Risk Control perspective, there is a section for country risk within the 'Loan monitoring' module, including the identification and monitoring of country risk, as well as classification of countries and allocation and provisioning of exposures.</p> <p>The Guidance acknowledges that although country risk should be reflected under credit risk, its assessment may also inform the analysis of other types of risk (e.g. business model or market risk).</p> <p>In the SSM SREP methodology, the country and transfer risks are defined and also the guidelines for making an overall assessment are given. The supervisors should take into account specific considerations about countries and markets to which these transactions are allocated, taking into account political, regulatory and institutional frameworks to perform the assessment:</p> <p>"When assessing country risk, the supervisor should take into account: 1) The degree of concentration within all types of exposures to country risk. 2) The allocation of the exposures to the risk-grouped countries on the basis of their economic performance, political situation, regulatory and institutional framework, and payment capacity and record". It details a list of macro and financial indicators that should be taken into account and calls upon the supervisors to assess the "adequacy of the policies and processes in place to identify, measure, evaluate, monitor, report and control or mitigate the country risk in lending and investment activities on a timely basis."</p> <p>The assessors viewed several examples of supervisors' discussions on country risk assessment for specific countries.</p>
21 EC2	<p>The supervisor determines that a bank's strategies and policies for the management of country and transfer risks have been approved and are regularly reviewed by the bank's board. The supervisor also determines that the board oversees management in a way that ensures that these policies are implemented effectively and fully integrated into the bank's overall risk management process.</p>
Description and findings re EC2	<p>The EBA SREP guidelines require the supervisors to verify whether:</p> <ol style="list-style-type: none"> 1. the management body clearly expresses the credit risk strategy and appetite, as well as the process for their review; 2. the senior management properly implements and monitors the credit risk strategy approved by the management body, ensuring that the institution's activities are consistent with the established strategy, that written procedures are drawn up and implemented, and that responsibilities are clearly and properly assigned. <p>Further, supervisors are required to verify whether:</p>

	<ol style="list-style-type: none"> 1. the management body approves the policies for managing, measuring and controlling credit risk and discusses and reviews them regularly, in line with risk strategies; 2. senior management is responsible for drawing up and implementing the policies and procedures for managing, measuring and controlling credit risk, as defined by the management body. <p>Within this framework, country and transfer risk, as a subcategory of credit risk is included in the strategies and policies for credit risk.</p>
21 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>The ECB guide on ICAAP expects banks to identify sub-categories of risks (for example country risk) and their materiality.</p> <p>The SSM internal Guidance for supervisors emphasizes that they verify that (i) institutions effectively implement adequate procedures to identify, assess and monitor the potential sources of country risk, the degree of concentration within all types of exposures to country risk and to trigger any necessary measures on a timely basis; (ii) the policies and procedures applied by the institution allow to adequately capture all the risks that are under the scope of country risk, including the indirect exposure that may be affected by a deterioration of a country and the potential contagion effect arising from other countries; (iii) institutions should also be able to follow-up on the evolution of such risks and its impact on the institution's exposure and should have implemented and apply mechanisms that trigger the necessary management or mitigating actions in a timely manner.</p> <p>Further, the institution should have procedures to assess and group the countries according to their overall risk and allocate the exposures to such risk-based groups. JSTs should assess the methodologies and information sources applied by the institution to assess and classify the countries and allocate the transactions correctly.</p>
21 EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk, which may include the following:</p> <ol style="list-style-type: none"> (a) The supervisor (or relevant authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country, considering prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or relevant authority) regularly sets percentage ranges for each country, considering prevailing conditions, and the banks may decide, within these ranges, which provisioning to apply for their individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself sets percentages or guidelines or even decides on the appropriate provisioning for individual exposures. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.

Description and findings re EC4	<p>The SSM SREP methodology expects supervisor to take into account the adequacy of the country risk impairment estimation and level of provisioning in its assessment.</p> <p>In terms of Risk Level, the SSM internal guidance tasks JSTs with assessing the adequacy of the country risk impairment estimation and level of provisioning. The institution may develop internal methodologies to classify the countries into risk-groups and estimate the provision accordingly. To this end, the credit risk losses should be estimated taking into account both insolvency and country risk.</p> <p>In terms of Risk Control, the guidance states the expectation that the institution effectively implements adequate procedures to assess and group the countries according to their overall risk, leveraging on relevant sources of information and country-specific indicators. They should then allocate the exposures to such risk-based groups and estimate the country risk impairment and the related provisions accordingly. JSTs could also assess to what degree institutions' methodologies allow to adequately estimate the country risk impairment and the level of provisioning, ensuring that the credit risk losses are estimated taking into account both insolvency and country risk.</p> <p>In addition, the guidance on on-site inspections also provides procedures and techniques for reviewing country risk. Inspections are expected to obtain assurance that the institution has a mapping of country risk for allocating provisioning and that country risk exposures have adequate treatment in terms of classification and provisioning. They should sample country risk exposures identified by the institution to assess their level of provisioning, as well as exposures not denominated in the functional currency of the institution or exposures of non-resident borrowers; they should also review the sovereign risk by country to check that the criteria for loss calculation and impact on capital are fulfilled.</p> <p>The ECB employs a "Country Risk Assessment Tool" (CRAT), which serves to identify potential losses from emerging markets exposures via a regular monitoring framework. CRAT reports are produced on a quarterly basis and may also be produced ad-hoc in case of relevant developments. The CRAT identifies and quantifies potential credit losses by combining exposures derived from supervisory reporting with IRB PDs and LGDs floored by market-based estimates. The CRAT reports inform discussions and possible further investigations of risks from credit exposures to emerging markets; JSTs of SIs with relevant exposures can then initiate further analyses to assess, e.g. potential implications arising from indirect exposures as well as other transition channels. Reports generated by the tool have been extensively used, e.g. during the run-up of the Russian war against Ukraine, the crisis of Chinese real-estate companies, debt sustainability concerns regarding non-EU European countries, as well as to provide regular monitoring of SSM SIs' exposures and provision levels to overseas jurisdictions (esp. Latin America, Africa, non-EU Southeastern European countries). The CRAT module and sample assessments were presented to the assessors during the meetings.</p> <p>This EC requires supervisory oversight of the setting of appropriate provisioning against country risk and transfer risks. In that regard, although the onsite inspection manual covers this topic, the assessors did not come across examples to evidence its implementation.</p>
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21 EC5	The supervisor regularly obtains and reviews sufficient and timely information on the country risk and transfer risk of banks. The supervisor has the power to obtain additional information, as needed (e.g. in crisis situations).
Description and findings re EC5	<p>Specifically for country risk, banks are required to submit the following quarterly supervisory reports: FINREP 20.01-20.03 (geographical breakdown of assets, liabilities and main income by location of activities, i.e. the differentiation between domestic and non-domestic); FINREP 20.04-20.07 (geographical breakdown of assets, liabilities and off-balance exposures by residence of counterparties); and C 09 (geographical breakdown of exposures by residence of the obligor available in a quarterly basis. In addition, institutions are required to report exposure to the general governments (i.e., encompassing all level of government, including central, regional and local) of every country in C33. This is complemented by the statistical reporting collected by NCBs, which also includes a country and currency breakdown by asset class.</p> <p>Institutions are furthermore required to report large exposures in C 26-29, which comprises information on the residence of the counterparty.</p> <p>Besides supervisory reporting, credit registries (AnaCredit) provide granular information on exposures to non-natural persons, including information on the country of residence. This is complemented by the securities holding statistics, which contain detailed information on each individual security in the banks' books, including the issuer's country of residence and the currency of the instrument. Finally, the European Market Infrastructure Regulation (EMIR) and Securities Financing Transactions Regulation (SFTR) reporting frameworks also provide granular data on derivative and repo positions, including the country of residence of the counterparties.</p> <p>In addition to the above, JSTs may also reference political risk analysis reports, credit risk rating agencies reports, and external country analysis reports from international organizations to inform their assessment of country and transfer risks. Within the SREP, country risk is assessed from two different perspectives: risk level and risk control. Country risk, when material, is expected to be assessed in-depth at least once during a 4-year period. When country risk is not assessed in-depth as being material, the JST provides indications of its choice. As an example, in the 2024 SREP cycle, for ten supervised institutions, the country risk was assessed in-depth, and conclusions were included in the respective credit risk SREP assessments.</p> <p>The JSTs can require any information needed to perform the assessment, applying the conferred powers to the ECB by the Council Regulation (EU) No 1024/2013, which confers upon the ECB the power to request all information that will be necessary in order to carry out the supervision activity, including information to be provided at recurring intervals.</p> <p>During the build-up phase of the Russian war against Ukraine, the ECB initiated various activities to assess the impact on SSM SIs, including several ad-hoc analyses and data collections from banks.</p>

	A coordination group was formed that enable a very effective and quick supervisory reaction across ECB and NCAs, coordinating activities dedicated to a wide range of potential channels of the war on the SSM SIs such as direct and indirect credit exposures, impact of developments in energy and commodity markets, sanctions, walk-away scenarios and cyber risk. These and related supervisory activities dedicated to the ramifications of geopolitical and country risk have also been reflected in the SSM's supervisory priorities since 2023, where strengthening resilience to immediate macro-financial and geopolitical shocks has been included as a priority. For example, the ECB requested an ad-hoc basis, capital plans that comprise a baseline and the bank's most severe adverse scenario, both updated in light of the expected / potentially much worse impact of the Russian war against Ukraine. The assessors saw an example of a scenario analysis for a Russian Gas stoppage in Europe.
Assessment of Principle 21	Largely Compliant
Comments	<p>The previous FSAP had recommended introducing a harmonized framework for country risk. There has been no EU-wide regulatory initiative in this regard, although some countries do have a more articulated country and transfer in their national frameworks. However, the SREP supervisory methodology and tools for assessment of these risks have been further developed and which go a long way in serving the intent of this principle. The EBA SREP Guidelines now address these risks under the credit risk as a sub-category. Since 2019, the ECB has also been using a specific module called "country risk assessment tool" for the assessment of country risk in emerging markets. These risks have also come into greater supervisory focus, given the recent geopolitical developments. With the geopolitical tensions affecting the European economy, the ECB has focused on the indirect effects of third-country risks in its assessment of credit risk. In addition, the most recent updated SSM internal Operational Guidance for supervisors includes dedicated sections for country risk assessment and management.</p> <p>While there is now detailed guidance for supervisors, the ECB should consider laying out its supervisory expectations for the industry more clearly. Further, the existing supervisory guidance should also be implemented.</p> <p>This CP requires supervisory oversight of the setting of appropriate provisioning against country risk and transfer risks. In that regard, although the onsite inspection manual covers this topic, the assessors did not come across examples to evidence its implementation.</p>
Principle 22	Market risk. ⁸⁰ The supervisor determines that banks have an adequate market risk management process that considers risk appetite, risk profile, 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	
22 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 the processes are consistent with the risk appetite,

⁸⁰ Reference documents: BCBS, High-level considerations on proportionality, July 2022; [RBC25], [MAR10], [MAR11], [MAR12], [MAR20], [MAR21], [MAR22], [MAR23], [MAR30], [MAR31], [MAR32], [MAR33], [MAR40], [MAR50], [MAR99].

	<p>risk profile, systemic importance and capital strength of the bank; that they consider market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and that they clearly articulate the roles and responsibilities for identifying, measuring, monitoring, reporting and controlling market risk.</p>
Description and findings re EC1	<p>The CRR and CRD provide the Level 1 basis for the supervision of Market Risk. It has been supplemented by EBA Guidelines, which set out the high-level principles of risk management and the inclusion of market risk in the SREP.</p> <p>Internal SREP Guidance includes the adequacy and soundness of the banks' market risk management process and considers the relevance of their market activity. The questions are spread over five categories: Governance and organizational framework; Strategy and risk appetite; Framework for internal capital allocation; Risk identification, measurement, monitoring and reporting; and Internal controls of market risk. The supervisor performs an annual assessment following this methodology, resulting in scores assigned by scorecard and expert judgement.</p>
22 EC2	<p>The supervisor determines that a bank's strategies and policies for the management of market risk have been approved and are regularly reviewed by the bank's board. The supervisor also determines that the board oversees management in a way that ensures that these policies are implemented effectively and fully integrated into the bank's overall risk management process.</p>
Description and findings re EC2	<p>The EBA Guidelines on SREP provide that supervisors assess whether banks have a sound, clearly formulated and documented market risk strategy approved by their management body. This includes whether the management body clearly expresses the market risk strategy and appetite and the process for their review. Furthermore, there are provisions that the management body approves the policies for managing, measuring and controlling market risk and discusses and reviews them regularly, in line with risk strategies.</p> <p>The supervisor verifies that the bank ensures a clear and adequate involvement of the management body and the senior management in defining, approving, and regularly updating market policies and procedures with regard to an institution's market risk appetite and changing macroeconomic environment. This involves identifying whether the management body receives frequent and adequate information on industry best practices and detailed analysis on potential risks to allow for well-informed decisions and effective monitoring, as well as whether the management body assesses the effectiveness of the governance arrangements to enable an effective and prudent management of market risk.</p> <p>Internal guidance requires supervisors to request documentation on the governance structures for market risk management, including reporting lines and accountabilities, internal policies and procedures, meeting minutes, etc.</p> <p>In addition, documentation can be obtained as part of horizontal off-site reviews and on-site inspections with the objective of assessing the level of awareness of the board of the market risks generated by the different businesses, the identification of reporting lines, accountabilities and the approval processes.</p> <p>Assessors saw examples of documentation from banks.</p>

22 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) comprehensive risk measurement systems for the accurate and timely identification, aggregation, monitoring and reporting of market risk exposures to the bank's board and senior management; (b) appropriate market risk limits, which are consistent with the bank's risk appetite, risk profile, capital strength and 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 the allocation of exposures to the trading book.
Description and findings re EC3	<p>The EBA Guidelines on SREP provide that supervisors assess whether the bank's market risk policies and procedures are sound and consistent with its market risk strategy and cover all of the main businesses and processes relevant for managing, measuring and controlling market risks.</p> <p>This includes whether:</p> <ul style="list-style-type: none"> (a) the bank's information systems and the management control area reports are provided to the management body and senior management. (b) 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 bank's risk appetite. (c) the banks have sets of limits that suit the size and complexity of their market activities as well as procedures to keep traders up to date about their limits. (d) the banks 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. (e) risk managers and the bank's senior management are aware of the degree of model risk that prevails in their pricing models and risk measurement techniques and whether they periodically check the validity and quality of the different models used in market risk activities. (f) 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. <p>Internal guidance requires supervisors to:</p> <ul style="list-style-type: none"> (a) check that the institutions have Management Information Systems (MIS) that allow for accurate, timely identification, aggregation, monitoring, and reporting of market risk exposures. This includes data quality checks put in place to ensure 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.

	<ul style="list-style-type: none"> (b) assess the effectiveness of monitoring and reporting market risk activities and verify that the reported information to the senior management and management body by the bank includes information on current market exposures, P&L results and risk measures as a minimum to enable proper and timely management of market risk. (c) verify that the market risk management includes appropriate and well-documented policies, procedures and controls around the use of models to identify and measure market risk (d) verify that the market risk management includes policies and processes for the allocation of exposures to the trading book and other material market risk types. <p>IMIs for banks with internal models also take place.</p>
22 EC4	<p>The supervisor determines that there are systems and controls to ensure that banks' 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 modelling for the purposes of valuation, the bank is required to ensure that the model is validated regularly by a function independent of the relevant risk-taking business 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 CRR requires banks to establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates of trading book items extending the requirement to all financial instruments measured at fair value. These must include at least:</p> <ul style="list-style-type: none"> a) documented policies and procedures for the valuation process; b) reporting lines for the valuation process that are clear and independent of the front office. <p>Moreover, the CRR prescribes that:</p> <ul style="list-style-type: none"> a) trading book positions should be revalued at least daily; b) marking to market should be done whenever possible and using the more prudent side of the bid/ask; c) when marking to market is not possible, marking to model should be performed by using a conservative approach to valuation and by ensuring compliance to a number of conditions aimed, among others, at ensuring that the management body is fully aware of the positions that are marked to model and the uncertainties related to this; d) when marking to model, the model developed by the bank itself is based on appropriate assumptions, assessed and challenged by suitably qualified parties independent of the development process; e) independent price verification - in addition to daily prudent valuation - should be performed; f) institutions should establish and maintain procedures for considering valuation adjustments; g) less liquid positions should be subject to an appropriate treatment.

	<p>Banks are required to deduct from CET1 capital the amount of Additional Valuation Adjustments ('AVA').</p> <p>In the RTS on Prudent Valuation (adopted by the EU Commission Delegated Regulation 2016/01), which supplement the CRR and applies to all fair-valued positions regardless of whether they are held in the trading or banking books, there is:</p> <ul style="list-style-type: none"> a) a requirement for banks to establish policies for considering valuation adjustments for positions that otherwise cannot be prudently valued; b) a prescriptive method of calculation of valuation adjustments; c) a requirement to fully deduct resulting valuation adjustments from CET1 capital. <p>Two separate approaches for the calculation of AVA are available under this RTS:</p> <ul style="list-style-type: none"> a) a simplified approach for institutions with limited exposure to fair-valued positions (defined as those with fair-valued assets and liabilities adding up, in absolute value, to less than EUR 15 billion); and b) a "core" approach for institutions above that threshold. <p>The EBA SREP Guidelines recommend that supervisors assess:</p> <ul style="list-style-type: none"> a) the framework for ensuring that all positions measured at fair value are subject to prudent valuation adjustments in accordance with the relevant legislation; the framework should include requirements for complex positions, illiquid products, and products valued using models; and b) whether stress testing used by banks to complement their risk measurement system identifies relevant risk drivers, including illiquidity/gapping of prices, concentrated positions and one-way markets. <p>Internal Guidance also requires supervisors to assess:</p> <ul style="list-style-type: none"> a) whether an independent function is responsible for verifying market data and prices, <ul style="list-style-type: none"> i. whether that function is adequately staffed, both in qualitative and quantitative terms, so as to be in a position to challenge the front office models. b) daily revaluation and reporting of risk measures (including VaR, sensitivities, MtM, stressed exposures) of the trading book <p>Between 2019-22 the ECB performed an on-site inspection campaign on Valuation Risk, covering both Level 2 and Level 3 fair valued instruments. This on-site initiative aimed to promote a level playing field for banks, based on a common revised methodology. The campaign covered 20 SIs holding large and complex fair-valued portfolios, and reached out to the industry and the public via an ECB Newsletter and an industry workshop. Following the campaign, On-site Inspections on Valuation Risk remain part of the supervisory toolkit and are regularly taking place.</p> <p>As at the closing date of this review, the EBA is consulting on revisions to its RTS. The consultation aims to further enhance harmonization and to align definitions of</p>
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	"extraordinary circumstances" and the application of Prudent Value rules in those circumstances.
22 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>The CRD requires supervisors to ensure that internal capital is adequate for material market risks that are not subject to an own funds requirement. Supervisors verify 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. As with other risks, supervisors are provided with baseline data on to which they can apply their judgement and use this to challenge a bank's internal capital estimations.</p> <p>The on-site inspection campaign (see BCP22, EC 4) provided several requirements on banks regarding prudent valuation of fair valued instruments.</p> <p>The assessors saw evidence of supervisors applying additional capital in this respect.</p>
Assessment of Principle 22	Compliant
Comments	<p>There is a fully articulated and distinct framework within the EU for Market Risk. See CP 16 regarding the delay in implementing the FRTB.</p> <p>Given the business models of the SSM banks, market risk is inevitably the smaller of the three principal risk types (the others being Credit and Operational), but since the UK's departure from the EU, the risk is growing.</p> <p>The assessors found that there is strong emphasis and attention on market risks with ample evidence that supervisors are regularly making findings and adjusting capital requirements.</p> <p>Since the last assessment, the SSM has stepped up its oversight of valuation, spearheaded by its on-site campaign. Assessors were able to review the detailed findings of that campaign, and found it to be both a wide-ranging and in-depth analysis of the issues. The assessors were also able to see follow-up to this campaign as well as an acceptance that valuation issues continue to evolve and consequently need regular oversight.</p> <p>As with other areas of risk management, the assessors noted that the SSM has struggled at times to resource internal model reviews in banks (as noted in CP 16).</p>
Principle 23	Interest rate risk in the banking book. ⁸¹ The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk in the banking book on a timely basis. ⁸² These systems consider the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	

⁸¹ Reference documents: BCBS, High-level considerations on proportionality, July 2022; [SRP31].

⁸² 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 [BCP40.50].

23 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, that they consider market and macroeconomic conditions, and that they are regularly reviewed and appropriately adjusted, where necessary, in line with the bank's changing risk profile and market developments.
Description and findings re EC1	<p>The CRD provides the Level 1 basis for the supervision of IRRBB. It has been supplemented by EBA Guidelines, which set out the high-level principles of risk management and the inclusion of IRRBB in the SREP.</p> <p>The CRD sets out that:</p> <ul style="list-style-type: none"> (a) the management body should "approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating risks"; (b) banks implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates and credit spreads that affect both the economic value of equity (EVE) and the net interest income (NII) of an bank's non-trading activities; and (c) Supervisory powers should be exercised at least in the following cases: <ul style="list-style-type: none"> i. where a bank's EVE declines by more than 15 percent of its CET1 as a result of a sudden and unexpected change in interest rates as set out in any of the six supervisory shock scenarios applied to interest rates; ii. where a bank's net interest income experiences a large decline (5 percent of CET1) as a result of a sudden and unexpected change in interest rates as set out in any of the two supervisory shock scenarios applied to interest rates. <p>The EBA "High level principles for Risk Management" provide an overall framework in which interest rate risk in the banking book sits. More specific EBA guidance was also issued in 2018 and updated in 2022. This guidance provides:</p> <ul style="list-style-type: none"> (a) criteria for the identification, evaluation, management and mitigation of IRRBB in banks' internal systems, while explicitly referring to EVE and NII, including market value changes (MVC). (b) a framework for satisfactory internal measurement systems (IMS) of banks, where supervisors might require a bank with non-satisfactory IMS to apply the standardized methodology. (c) a definition of Credit Spread Risk in the Banking Book (CSRBB) that accords with Basel expectations where fair value assets are included, while a priori no other instrument is excluded without a reasonable justification. <p>The EBA's SREP Guidelines set out elements that supervisors should cover when assessing the management of interest rate risk from non-trading activities, including:</p> <ul style="list-style-type: none"> a) interest rate risk strategies and appetites; b) organizational frameworks;

	<ul style="list-style-type: none"> c) policies and procedures; and d) risk identification, measurement, monitoring and reporting; internal control framework. <p>From SREP 2024 onwards, CSRBB is no longer part of the assessment of market risk and is assessed within the revised SREP methodology for IRRBB & CSRBB. The methodology was updated in order to align SSM methodologies with the new EBA Guidelines for IRRBB & CSRBB.</p>
23 EC2	<p>The supervisor determines that a bank's strategies and policies for the management of interest rate risk have been approved and are regularly reviewed by the bank's board. The supervisor also determines that the board oversees management in a way that ensures that these policies are implemented effectively and fully integrated into the bank's overall risk management process.</p>
Description and findings re EC2	<p>The CRD specifies the duties of the management body to:</p> <ul style="list-style-type: none"> (a) approve and periodically review the risk strategies and policies and processes for managing interest rate risk; (b) ensure that adequate resources are allocated to the management of all material risks; (c) oversee the implementation of risk strategy by senior management" to the management body; (d) have responsibility for approving and overseeing the implementation of the institutions' strategic objectives, risk strategy and internal governance. <p>The CRD also mandates supervisory authorities to review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with this Directive and the CRR.</p> <p>The EBA Guidelines on IRRBB and CSRBB require that banks implement robust internal governance arrangements so that the management body bears the ultimate responsibility for controlling IRRBB.</p> <p>The EBA's SREP Guidelines require supervisors to assess whether:</p> <ul style="list-style-type: none"> (a) the bank has an IRRBB strategy and policies approved by the management body; (b) the management body discusses and reviews them regularly; (c) senior management adequately implements the management body's guidance; (d) policies are clearly formalized, communicated and applied consistently across the bank; (e) the governance arrangements as well as the risk appetite framework related to IRRBB are adequate; (f) policies and procedures are adequately formalized and communicated across the bank; (g) the board and the senior management receive frequent and relevant reporting, considering the size and complexity of the institution. <p>On-site inspections complement the off-site checks described above.</p>

23 EC3	<p>The supervisor determines that a bank's policies and processes establish an appropriate and properly controlled interest rate risk environment, including:</p> <ul style="list-style-type: none"> (a) comprehensive risk measurement systems for the accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposures to the bank's board and senior management; (b) a regular review and independent (internal or external) validation of any models used by the functions tasked with managing interest rate risk (including a review of key model assumptions, e.g. regarding optional elements (whether implicit or explicit) embedded in a bank's assets, liabilities and/or off-balance sheet items, in which the bank or its customer can alter the level and timing of their cash flows); (c) appropriate limits, approved by the bank's board and senior management, that reflect the bank's risk appetite, risk profile and capital strength and that are understood by and regularly communicated to relevant staff; and (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the bank's senior management or board, where necessary.
Description and findings re EC3	<p>The CRD addresses the need for institutions to implement systems to identify, evaluate, manage and mitigate the risk arising from potential changes in interest rates that affect non-trading book activities. It also requires supervisory authorities to include the exposure of banks to IRRBB in their SREP process.</p> <p>The EBA's SREP Guidelines require supervisors to assess whether:</p> <ul style="list-style-type: none"> (a) the bank has the information systems and measurement techniques (including internal hedges) in place; (b) the bank has adequate staff and methodologies to measure IRRBB; (c) the bank has risk limits set up for IRRBB; (d) the IRRBB strategy is effectively communicated to relevant staff; (e) the escalation process on a limit breach is timely; and (f) the monitoring and reporting systems are in place. <p>Institutions' IMS are assessed within the broader assessment of the risk management framework in the SREP, covering, among others:</p> <ul style="list-style-type: none"> (a) The existence of an information system and measurement techniques able to capture the inherent IRRBB Risk in all of the material on and off-balance sheet exposures; (b) The access of the management to timely results produced by the information system; (c) The existence of an appropriate organizational framework, with competent staff and sufficient technical resources. <p>The output of those measurement systems is further assessed by supervisors, who analyze both the impact of interest rate changes on</p> <ul style="list-style-type: none"> (a) the EVE; and (b) the Net Interest Income (NII), including MVC.

	<p>Banks' own estimates are benchmarked against internal metrics based on the supervisory information flow.</p> <p>When assessing IRRBB risk control in SREP, supervisors verify if IRRBB risk measures systems are reviewed and validated by internal functions, with respect to assumption-dependent 'behavioral' models such as:</p> <ul style="list-style-type: none"> (a) models which cover embedded options sold to customers (e.g., prepayment/optionality on loans such as mortgages); (b) modelled duration of liabilities (customer deposits); (c) whether, in turn, they are adequately assessed by the Internal Audit function; and (d) whether Senior Management is aware of the model risk that IRRBB assumptions carry. <p>Risk limits are assessed by supervisors in the context of the risk appetite framework of the bank. In particular:</p> <ul style="list-style-type: none"> (a) the consistency of the risk limit system with overall risk appetite and risk strategy of the bank; (b) the internal consistency between limits on EVE and NII (incl. MVC); (c) the adequacy of processes for the regular review and update of risk limits; (d) the adequacy of monitoring and reporting of limits; (e) whether exceptions to risk limits are adequately captured by risk reporting as a means to ensure that the management body and senior management take appropriate actions. <p>This off-site work is supplemented by on-site inspections as well. This provides further assurance that:</p> <ul style="list-style-type: none"> (a) that IRRBB policy and procedures are adequately documented, updated and available for key users; (b) the scope, general methodology, objectives, risk appetite, risk limits and responsibilities are clearly communicated to all relevant staff; (c) there is an appropriate limit system in place and that the limit system ensures prompt management attention in case of a violation of limits and that a set of indicators and an early warning system have been defined and are used to monitor IRRBB; (d) there is a structured reporting on IRRBB to the appropriate management levels and to the relevant business and control units and to obtain assurance that the reports produced are of satisfactory quality and completeness and not under the sole control of risk-taking units.
23 EC4	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to both economic value and earnings, using standardised interest rate shocks on the banking book.
Description and findings re EC4	<p>The EBA developed RTS, which entered into force in May 2024, specifying supervisory shocks, and modelling and parametric assumptions for the supervisory outlier test (SOT) on EVE and NII. The SOT identifies banks for which:</p> <ul style="list-style-type: none"> (a) in a stress scenario EVE would decline by more than 15 percent of Tier 1, or (b) the NII would experience a large decline (5 percent of Tier 1).

	<p>If either of those limits is breached, supervisors should exercise their supervisory powers (e.g. setting additional own funds requirements, limiting activities with excessive risks, specifying modelling and parametric assumptions) unless they conclude that, notwithstanding the breach, the bank is not excessively exposed to IRRBB and its IRRBB management is adequate.</p> <p>The EBA has also developed uniform formats, definitions, submission frequencies, remittance dates and IT solutions, in a final draft ITS on supervisory reporting with respect to IRRBB. This ITS also follows up on the policy work on IRRBB that the EBA completed in October 2022. The ITS ensures appropriate data quality and appropriate coverage in terms of number of reporting banks. The ITS enables supervisors to implement the RTS on the SOT, the RTS on the Standardized Approach (SA) and the Guidelines to assess the effects of interest rate changes on IRRBB management.</p> <p>With the final EBA ITS reporting package, the reporting requirements of the results of the SOT defined in the EBA Guidelines on IRRBB and CSRBB are established. These reporting requirements go beyond the SOT and include, for example, granular fixed-interest balances, model parameters and market value changes in the NII SOT stress scenarios.</p> <p>The first reference date for the application of the ITS was September 30, 2024.</p>
23 EC5	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re EC5	<p>The CRD requires banks to have a “sound, effective and comprehensive” ICAAP in place which is subject to regular review.</p> <p>The ECB Guide to the ICAAP (Principle 6) specifies expectations towards banks on the ICAAP risk quantification methodologies.</p> <p>The EBA’s SREP Guidelines require supervisors to assess whether the banks have maintained an adequate level of internal capital to cover risks to which the institutions are exposed to and whether the institutions have allocated sufficient internal capital to IRRBB.</p> <p>For SIs, the adequacy of banks’ IMS in capturing IRRBB is assessed by supervisors as part of the SREP assessment.</p> <p>Internal guidance supports the supervisors in assessing how strong are the risk identification, measurement and aggregation methodologies and processes applied to produce the quantitative ICAAP outcomes for IRRBB.</p> <p>In line with SSM’s overall approach, IRRBB exposures are benchmarked against peers as well as against supervisory models. These cover:</p> <ul style="list-style-type: none"> (a) optionality, (b) non-maturing deposit (NMDs), (c) loan prepayment risk, and (d) effects on EVE/NII sensitivities from changing NMD behavioral assumptions.

	<p>Supervisors assess the sensitivity of banking book items to interest rates by comparing the outcomes with and without hedging as well as behavioral assumptions made by the banks for adjusting cash flows and repricing maturities of main aggregate vs contractual ones.</p> <p>Supervisors can set additional capital requirements under P2R. The assessors saw examples of this in practice.</p> <p>While the above refers to off-site activities, further assurance is obtained from on-site inspections.</p> <p>Finally, on top of recurring off-site and on-site activities, the ECB also performs supervisory stress tests and targeted reviews in accordance with the SSM supervisory priorities. For instance, a targeted IRRBB sensitivity analysis in 2017 aimed at understanding how a set of interest rate shocks would affect SIs. Similarly, ad hoc analyses in the context of the EBA Stress tests provided insights about the sensitivity of banks vis-à-vis variations in interest rates and the adequacy of banks' risk management practices.</p> <p>In 2022 and 2023, the ECB performed a targeted review of interest rate and credit spread risk management. The assessors were shown the results of this review.</p> <p>In parallel to the 2023 EBA stress test, an ad-hoc data collection was conducted to assess unrealized losses on debt securities held at amortized cost in EU banks. The ECB included all of the banks in the scope of this exercise. Bank-specific data as well as aggregate analyses were published together with the results of the 2023 stress tests.</p> <p>IRRBB has been a SSM's supervisory priority since 2022.</p>
Assessment of Principle 23	Compliant
Comments	<p>There is a fully articulated and distinct framework within the EU for IRRBB.</p> <p>Given the business models of the SSM banks, IRRBB can be significant. There is strong emphasis and attention on IRRBB through supervisory processes – assisted by the fact that it has been a priority since 2022.</p> <p>The EU framework has been able to keep pace with developments in international standards thanks to updates in the EBA Guidelines but also sensible use of stress tests.</p> <p>At the time of finalizing this assessment, full reporting had only existed for two quarters of data, so it is too early to assess what difference this reporting will make and whether supervisory efforts will be delayed by the inevitable issues of data quality whenever new reporting requirements are introduced. From an assessment of the templates, live data and the dry runs that were carried out in 2024, the data should be a material improvement to the supervision of IRRBB.</p>

Principle 24	Liquidity risk. ⁸³ The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) that reflect the liquidity needs of banks. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy considers the bank's risk profile, 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 (including funding) requirements are not lower than the applicable Basel standards.
Essential criteria	
24 EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements, including thresholds with reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than those prescribed in the applicable Basel standards, 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>The CRR, CRD, Delegated Regulations and an EBA ITS on Reporting set out the Level 1 and 2 context for Liquidity Risk and it is these texts that implement Basel requirements in the LCR and NSFR.</p> <p>In addition, there is an ECB ILAAP guide, an SSM Operational Guide and EBA SREP Guidelines.</p> <p>In the RCAP carried out in 2017 by the Basel Committee, both the LCR and NSFR received a Largely Compliant Rating. In the case of the LCR this was due to a material finding in respect of the inclusion of covered bonds in High quality liquid assets (HQLA). In the case of the NSFR the Basel Committee judged that nine non-material findings in the required funding denominator were sufficient to merit an overall rating of Largely Compliant.</p> <p>A BCP assessment is not intended to carry out a re-assessment of the RCAPs, but the assessors have seen data from the SSM of the current materiality position of the RCAP findings, specifically in the light of changes to the covered bond regime, which required amendments to the LCR and NSFR. The assessors replicated the analysis published in the RCAP report using the latest data. In our view the circumstances set out in the LCR rating decision which acknowledged that holdings of covered bonds although low at the time, could potentially be substantial, remain. The assessors received information that, as of September, 30 2024 the share of Level 1 covered bonds amounted to 5.1 percent of the aggregate liquid assets (before the application of haircuts or caps). Although a small proportion, it was the scope to grow much larger that was noted in the BCBS findings. 5.1 percent is twice as much as the proportion noted by the BCBS in 2017.</p>

⁸³ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Principles for sound liquidity risk management and supervision, September 2008; [LCR10], [LCR20], [LCR30], [LCR31], [LCR40], [LCR99], [NSF10], [NSF20], [NSF30], [NSF99].

	<p>The CRR sets out prudential liquidity requirements at a consolidated and individual level. Competent authorities are permitted to apply a waiver of prudential liquidity requirements at an individual level. The ECB has further specified the conditions for such waivers in terms of process. The ECB may also grant partial waivers (e.g. waiving only some but not all of the prudential liquidity requirements) or may grant a waiver subject to compliance with additional institution-specific conditions. Liquidity prudential and reporting requirements remain applicable at the consolidated level of banking groups. The ECB O&D Guide also includes the expectations and policies of the ECB in relation to other discretions provided to competent authorities in applicable regulation with respect to the LCR and the NSFR.</p> <p>Banks are required to generally maintain a NSFR and a LCR of at least 100 percent on an ongoing basis. However, in the context of the LCR, during times of stress, institutions may use their liquid assets to cover their net liquidity outflows. For the LCR the 100 percent minimum has been effective since 2018. For the NSFR the requirement was effective from June 2021 (a delay of 30 months from the Basel timetable).</p> <p>The prudential liquidity requirements are supplemented with comprehensive liquidity reporting requirements. On top of reporting of data related to the LCR (monthly frequency) and the NSFR (quarterly), banks are required to report additional liquidity monitoring metrics which generally mirror the Basel liquidity monitoring tools, including a contractual maturity ladder, and information on available unencumbered assets.</p> <p>Banks additionally need to provide information on the prices for various lengths of funding, rollover of funding and high-level aggregate information on behavioral inflows, outflows and drawdowns by committed facilities (by expected maturity). The additional liquidity reporting requirements were amended in 2022 to bring the reporting up to date in the light of changing user needs (including the lessons learned from the 2019 ECB Sensitivity Analysis of Liquidity Risk).</p> <p>Banks are also required to provide the various reporting templates with respect to items denominated in significant currencies, if materiality criteria are met.</p> <p>Supervisory reporting requirements for liquidity are set out in regulations. In addition to standard regulatory reporting, in September 2023 the ECB has activated a weekly reporting of liquidity data for SIs.</p>
24 EC2	<p>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.</p>
Description and findings re EC2	<p>The LCR and NSFR are supplemented by an annual bank specific review. This may result in the application of higher outflow rates. Equally supervisors can apply different factors stable funding factors compatible with higher outflow rates.</p> <p>In the SREP, Supervisors are required to carry out a holistic assessment of liquidity and funding risk under Pillar 2 and address any risks. This includes:</p> <ul style="list-style-type: none"> (a) an assessment of an institution's capacity to meet its short-term financial obligations (short-term liquidity risk),

	<p>(b) a longer-term assessment of the sustainability of its funding profile (funding sustainability risk), and</p> <p>(c) an assessment of liquidity and funding risk management.</p> <p>This assessment will be in the context of short and long term, the position of markets and macro circumstances.</p> <p>Assessors saw examples of supervisors imposing quantitative and qualitative liquidity measures on banks.</p>
24 EC3	<p>The supervisor determines that banks have a robust liquidity management framework that requires them to maintain sufficient liquidity to withstand a range of stress events and that includes appropriate policies for managing liquidity risk, which have been approved by the bank's board. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the bank's liquidity risk tolerance, risk profile and systemic importance.</p>
Description and findings re EC3	<p>The assessment of a bank's liquidity risk framework is carried out in the annual SREP assessment, complemented by an assessment of the bank's ILAAP and potentially supported by information from on-site inspections, off-site horizontal reviews or other deep dives on the functioning of the bank's liquidity management framework.</p> <p>Supervisors also assess whether</p> <ul style="list-style-type: none"> (a) a bank has an adequate stress testing framework; (b) it regularly and adequately identifies, measures and monitors its liquidity and funding risk position in normal and stressed conditions; (c) it provides assurance for a sufficient market access even under stressed conditions; (d) its internal stress testing plays an essential role in developing liquidity strategies; (e) its management body approves and periodically reviews the strategies and policies for taking up, managing, monitoring and mitigating the liquidity risk it is or might be exposed to, including the risk posed by the macroeconomic environment in which it operates in relation to the status of the business cycle; (f) its policies are in line with the bank's liquidity risk tolerance, risk profile and systemic importance; (g) there is sufficient evidence that the liquidity risk tolerance and strategy are approved and regularly updated by the management body; (h) there is a liquidity risk appetite, tolerance and strategy determined on the basis of a sufficiently comprehensive process, including adequate definitions and documentation, and is it reviewed and updated on a frequent basis; (i) there is sufficient evidence that the liquidity risk tolerance and strategy are implemented and communicated to all relevant staff; (j) there is a liquidity risk strategy framework properly integrated within the overall risk appetite framework.

	This assessment contains a standardized stress scenario – incorporating retail and wholesale stress assumptions. Supervisors will also use adverse and extreme idiosyncratic stress scenarios to challenge the bank’s internal stress tests. The supervisory stress test framework takes on a top-down approach leveraging data from regular supervisory reporting on liquidity (notably the contractual maturity ladder).
24 EC4	<p>The supervisor determines that a bank’s 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 bank’s business and its role in the financial system, and that is approved by the bank’s board; (b) sound day-to-day and intraday liquidity risk management practices; (c) comprehensive risk measurement systems for the accurate and timely identification, aggregation, monitoring, reporting and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the bank’s board to ensure that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the bank’s liquidity risk appetite; and (e) regular review by the bank’s board (at least annually) and appropriate adjustment of the bank’s strategy, policies and processes for the management of liquidity risk given the bank’s changing risk profile and external developments in the markets and macroeconomic conditions in which it operates.
Description and findings re EC4	<p>A bank’s liquidity risk strategy, policies and processes are primarily assessed as part of the SREP. This includes:</p> <ul style="list-style-type: none"> (a) a compliance check on the existence of the bank’s strategies and policies regarding liquidity risk; (b) an assessment of: <ul style="list-style-type: none"> i. Governance, ii. Risk Appetite, iii. Risk Management and Internal Control, iv. Internal Audit. <p>In Q1 2024, ECB Banking Supervision also conducted a thematic review assessing current practices of six SIs regarding the monitoring and management of intraday liquidity risk. In the context of this exercise, the six entities had to complete a questionnaire which also covered intraday liquidity-related elements referred to in the existing Basel framework (i.e. BCBS Monitoring tools for intraday liquidity management, BCBS Principles for Sound Liquidity Risk Management and Supervision).</p> <p>The SSM shared many of its observations in a supervisory newsletter published in November 2024. This set out seven principles in relation to: Risk Management, Governance, Forecasting, Monitoring, Managing outflows, Sources of Liquidity and Stress Testing.</p>
24 EC5	The supervisor requires banks to establish, and regularly review, funding strategies, policies and processes for the ongoing measurement and monitoring of funding

	<p>requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g. credit, market, operational and reputational risks) 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 monetise assets.
Description and findings re EC5	<p>The CRD requires banks to develop methodologies for the identification, measurement, management and monitoring of funding positions. Those methodologies include the current and projected material cash-flows in and arising from assets, liabilities, off-balance-sheet items, including contingent liabilities and the possible impact of reputational risks.</p> <p>The EBA SREP Guideline sets out specific expectations for supervisors when assessing risks to liquidity and funding. This includes an evaluation of:</p> <ul style="list-style-type: none"> (a) the bank's funding profile; (b) risks to the stability of the funding profile; (c) actual market access; (d) expected change in funding risks based on the institution's funding plan (e) the feasibility and appropriateness of funding plans; (f) how other risks (e.g. credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy. <p>The SSM collects standardized data (qualitative and quantitative) on the banks' projected assets and liabilities in relation to the funding plan of the bank. There is also an assessment of:</p> <ul style="list-style-type: none"> (a) the strategies of SIs to cover targeted longer-term refinancing operations (TLTRO) repayments (scrutinizing, for instance, excessive reliance on certain forms of funding or unduly aggressive assumptions about deposits growth), and (b) the potential lack of diversification of funding sources and deficiencies in funding plans with an off-site horizontal review (scrutinizing, for instance, excessively mild or generic adverse scenarios). <p>The compliance with these requirements is assessed through:</p> <ul style="list-style-type: none"> (a) an analysis of ITS data on liquidity and asset encumbrance, performance of supervisory stress tests (b) analysis of the bank's internal reporting and its internal determination of liquidity needs (stressed and unstressed) on at least annual basis; (c) deep dives, on-site inspections, and horizontal analyses, such as the one cited in CP 24 EC 4.

24 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 the bank's contingency funding plan is feasible (given its risk profile and systemic importance) and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>The CRD requires banks to adjust their strategies, internal policies and limits on liquidity risk and develop effective contingency plans, considering the outcome of alternative scenarios.</p> <p>As far as SIs under the direct supervision of the ECB are concerned, expectations towards institutions on the design of liquidity contingency plans are referred to in the ECB ILAAP Guide. Specifically, banks are expected to have a formal liquidity contingency plan that clearly sets out the measures for addressing liquidity difficulties under stressed circumstances. The liquidity contingency plan is expected to address the risks identified in the institution's ILAAP and to set out the relationship with its recovery plan.</p> <p>The robustness of the liquidity contingency plan is regularly assessed by supervisors in the context of the annual SREP exercise, in particular as part of the ILAAP assessment. Specifically, supervisors will check if the ILAAP contains detailed information on liquidity contingency measures (in the form of a liquidity contingency plan). This will include:</p> <ul style="list-style-type: none"> (a) an assessment of the potential contingent liquidity that can be generated during stress, (b) the time needed for execution, (c) potential negative effects (profit and loss account, reputation, business model viability, etc.) and (d) the likelihood of completion of the measures under stressed conditions. This may also bring in information from the recovery plan. <p>This will be supplemented by on-site inspections where supervisors can gain additional assurance that a liquidity contingency plan is effective and closely linked to the other segments of the liquidity management framework (such as stress scenarios, early warning indicators and limits) and embedded in the governance, management and operational framework.</p> <p>The assessors reviewed a number of liquidity contingency funding plans. These showed a mixed risk profile including some potentially concerning profiles where the delays in accessing some central bank liquidity profiles were extensive and certainly beyond a period which would be desirable in a typical liquidity crisis. The assessors were informed that, in 2023/2024, the ECB has examined the sophistication of CFPs in the context of the targeted reviews of (i) contingency funding planning (for the sample of 28 selected SIs) and collateral optimization capabilities (sample of 26 SIs). Various deficiencies had been identified and</p>

	communicated to banks, but remediation measures were timed to coincide with the subsequent submission of the recovery plans.
24 EC7	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 programmes 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.
Description and findings re EC7	<p>The ECB performed in 2019 a sensitivity analysis of liquidity risk which examined the ability of SIs to withstand an adverse as well as extreme idiosyncratic stress event. For this exercise the calibration of the two shock scenarios (outflow rates for various types of liabilities, including deposits) leveraged previous stress cases observed in the euro area. Outcomes of this analysis were published and results were used to inform the subsequent SREP assessments.</p> <p>Subsequently the shock scenarios have been included in an SSM-internal stress test tool which - on top of the two scenarios referred to above - enables supervisors to apply even more severe and institution-specific scenarios on a case-by-case basis. The outcome of this tool feeds into the scoring used in the context of the annual liquidity SREP assessment.</p> <p>The ECB clarified its expectations with respect to bank-internal stress testing, in the ILAAP Guide. Compliance with the ECB ILAAP Guide is regularly checked in the context of the annual liquidity SREP assessment. This assessment covers whether:</p> <ul style="list-style-type: none"> (a) the bank is regularly and adequately identifying, measuring and monitoring its liquidity and funding risk position in normal and stressed conditions (i.e. taking sufficiently into account prospective cash flows, counterbalancing capacity, set of indicators, limits, MIS, etc.); (b) the bank maintains sufficient market access in normal conditions and can provide assurance for a sufficient market access even under stressed conditions; (c) the bank has an appropriate stress testing framework to ensure that liquidity and funding risks are well taken into account on regular basis; (d) the bank performs a regular stress testing exercise, covering liquidity and funding risk, taking into account different time horizons and often updating the assumptions. <p>The 2023 banking turmoil illustrated the changing and more volatile nature of depositors' behavior, where social media may be used to mobilize the crowd to withdraw deposits, and where online banking and digitalization, as well as the role of non-bank competitors have a greater impact on depositors' behavior and thus the stability of liquidity and funding sources of banks. The latter therefore need to adapt their approaches to monitor the liquidity and funding risks and, in this context, the channels through which deposits are collected. Assessors found that supervisors were well seized of these developments but further work (including a simulated event) would be beneficial in preparing the SSM for sudden changes in depositor behavior. In particular how the supervisor would respond to a social media sourced mobilization of depositors.</p>

	<p>The assessors were informed that in 2023/2024 the ECB has examined the sophistication of banks' internal behavioral NMD models (for the sample of 24 selected SIs) in the context of the targeted review of ALM Governance & Strategy. In this regard, the ECB also assessed, among others, to what extent the impact of digitalization, social media and increased competition with non-banks is reflected in the calibration of bank-internal behavioral models. Various deficiencies had been identified and JSTs are following-up with the supervised entities to remediate any potential shortcomings (in the context of the SREP or ongoing supervision). The assessors were informed that the potential impact of digitalization on depositors' behavior has also been scrutinized in the context of recent internal analyses (not public) on the calibration of the holding limits for the digital euro. The analyses encompassed several scenarios, some of which based on extremely conservative assumptions.</p> <p>The assessors also reviewed the SSM's response to the 2023 events and found that these were well handled. The assessors understand that the move to weekly liquidity reporting had challenges but felt that this was well managed and an appropriate response in the circumstances.</p>
24 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 CRR requires a bank to report LCR separately in the currencies in which it has more than 5 percent of total liabilities or it has a significant branch in an EU Member State using a different currency. The current COREP data collection on the LCR and NSFR collects information per significant currency (at least 5 percent over aggregated liabilities).</p> <p>As part of the SREP, the supervisor considers FX convertibility, access to FX markets and the ability to transfer liquidity across entities. The supervisor may set limits to the extent of liquidity transformation under stressed conditions via the LCR in a foreign currency.</p> <p>In addition, the EBA Guidelines on SREP and stress testing prescribe that the supervisor should consider the size, location and 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 convertibility risk. Furthermore, the supervisor assesses whether the denomination of the liquid assets is consistent with the distribution of liquidity needs by currency.</p> <p>Moreover, as part of short-term liquidity FX risk the supervisor assesses, in case of material short-term funding in foreign currency, the access to the foreign central bank (i.e. if the bank</p>

	<p>has direct access or not and in case it has, what amount of collateral is already pledged at the central bank that can be used to finance the short-term gap).</p> <p>Based on the assessment, the supervisor may consider qualitative and/or quantitative requirements for the composition of the institution's liquid assets profile in respect of counterparties, currency, etc. Banks must maintain a liquidity coverage ratio of at least 100 percent in the reporting currency. There is no binding requirement for a foreign currency LCR. However, the ECB may impose quantitative foreign currency LCR requirements.</p> <p>The assessors saw examples of both qualitative and quantitative requirements that have been imposed on individual banks.</p>
24 EC9	<p>The supervisor determines that a bank's level of encumbered balance sheet assets is managed within acceptable limits to mitigate the risks in terms of the impact on the bank's cost of funding and the implications for the sustainability of its 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 EC9	<p>The CRR requires banks to report to the competent authorities the level of all forms of asset encumbrance, including a breakdown by the type of asset encumbrance, such as repurchase agreements, securities lending, securitized exposures or loans. The EBA has published an ITS on supervisory reporting with annexes on asset encumbrance.</p> <p>Banks are required to apply the RTS on disclosure of encumbered and unencumbered assets. This contains principles and templates for disclosing information on encumbered and unencumbered assets by products on a consolidated basis.</p> <p>The CRD requires competent authorities to ensure that institutions distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations, and take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account and their eligibility and monitor how assets can be mobilized in a timely manner.</p> <p>The EBA SREP Guidelines require an assessment of whether the bank has a strong and comprehensive internal limit and control framework and sound safeguards to mitigate or limit its liquidity risk in line with its risk appetite, and for that whether the bank has implemented adequate limits and monitoring systems that are consistent with its liquidity risk appetite and that make use of the outcomes of liquidity stress tests. Supervisors will assess whether potential shortcomings arising from the bank's funding profile, such as concentration and asset encumbrance, could lead to an unacceptable increase in the cost of funding for the bank or impair its ability to access funding markets.</p> <p>The assessors saw examples of actions taken to amend a bank's funding profile, including by reducing the amount of its encumbered assets, potentially differentiating between total encumbrance and overcollateralization (e.g., for covered bonds, margin calls, etc.).</p> <p>Within the SREP ILAAP assessment, supervisors assess if the internal limits, scenarios and metrics ensure an appropriate coverage of risks and may impose liquidity measures if:</p>

	<ul style="list-style-type: none"> (a) the internal limits for the minimum amount of liquid assets are insufficient to cover the risks; (b) the internal limits for the minimum survival period are inadequate, either because they are based on incorrect / too optimistic assumptions, or the survival period is too short for the bank to respond timely to a liquidity crisis event; (c) the internal limits for the liquidity buffer allow it to be too concentrated; (d) the bank has excessive concentration in funding, not mitigated by the internal limits. <p>Since the last assessment, collaboration with the central bank unit of the ECB has been extended so to enable ECB Banking Supervision to obtain information on the amount of pledged unencumbered central bank-eligible assets that could immediately be used to cover liquidity outflows during times of stress (as well as information on the amount of assets that have been pledged and that are already encumbered).</p>
Assessment of Principle 24	Largely Compliant
Comments	<p>The SSM delivers a thorough assessment and mitigation of liquidity risk and has progressed substantially from the position found in the 2018 report. The assessors felt that they responded well to the 2023 liquidity problems in some banks – including a sensible and well managed move to weekly reporting.</p> <p>However, supervision is still based on a policy platform that was judged by the Basel Committee to be largely compliant and from our analysis would remain so.</p> <p>The assessors found good supervisory practice in the review of contingency funding plans, but less urgency in responding to some banks' contingency funding plans which revealed a very mixed risk picture.</p> <p>The assessors had a good discussion on the changing liquidity profile of liabilities, particularly retail deposits and concluded that the SSM has a good grip on these issues. Nevertheless, the assessors feel that all supervisors are vulnerable to sudden changes in depositor behavior and that the SSM needs to continue to develop its capabilities in this area.</p> <p>The assessors were able to see some very good thinking and articulation of the challenges of intraday liquidity. Reflected in a Supervision Newsletter on "Sound practices for intraday liquidity risk management".</p>

Principle 25	Operational risk and operational resilience. ⁸⁴ The supervisor determines that banks have an adequate operational risk ⁸⁵ management framework and operational resilience ⁸⁶ approach that considers their risk profile, risk appetite, business environment, tolerance for disruption to their critical operations, ⁸⁷ and emerging risks. This includes prudent policies and processes to: (i) identify, assess, evaluate, monitor, report and control or mitigate operational risk on a timely basis; and (ii) identify and protect themselves from threats and potential failures, respond and adapt to, as well as recover and learn from, disruptive events to minimise their impact on delivering critical operations through disruption.
Essential criteria	
25 EC1	<p>Laws, regulations or the supervisor require banks to have appropriate operational risk management and operational resilience strategies, policies, procedures, systems, controls and processes to:</p> <ul style="list-style-type: none"> (a) identify, assess, evaluate, monitor, report and control or mitigate operational risk; and (b) identify and protect themselves from threats and potential failures, respond and adapt to, as well as recover and learn from, disruptive events to minimise their impact on their delivery of critical operations. <p>These strategies, policies, procedures, systems and controls are consistent with the bank's risk profile, systemic importance, risk appetite, tolerance for disruption and capital strength, and consider market and macroeconomic conditions and emerging risks.</p>
Description and findings re EC1	<p>The EU is undergoing a significant change in the Level 1 legislative framework for operational resilience. CRR 3 came into force on January 1, 2025 and the Regulation on DORA supplemented and in some cases superseded CRR 2, CRD, and some Delegated Regulations.</p> <p>DORA in particular makes significant resource demands on supervisors. Furthermore, in some cases these resources are highly specialized and relatively scarce, certainly relative to the demand from banks and supervisors alike. At the time that this assessment was finalized,</p>

⁸⁴ Reference documents: FSB, Enhancing third-party risk management and oversight: a toolkit for financial institutions and financial authorities, December 2023; BCBS, High-level considerations on proportionality, July 2022; BCBS, Principles for the effective management and supervision of climate-related financial risks, June 2022; BCBS, Revisions to the principles for the sound management of operational risk, March 2021; BCBS, Principles for operational resilience, March 2021; BCBS, Cyber resilience: range of practices, December 2018; BCBS, Sound practices implications of fintech developments for banks and bank supervisors, February 2018; FSB, Guidance on identification of critical functions and critical shared services, July 2013; BCBS, Recognising the risk-mitigating impact of insurance in operational risk modelling, October 2010; BCBS, High-level principles for business continuity, August 2006; BCBS, Outsourcing in financial services, February 2005.

⁸⁵ Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk but excludes strategic and reputational risk

⁸⁶ Operational resilience refers to the ability of the bank to deliver critical operations through disruption. Operational resilience is an outcome that benefits from the effective management of operational risk

⁸⁷ Tolerance for disruption is the level of disruption from any type of operational risk a bank is willing to accept given a range of severe but plausible scenarios. The term "critical operations" encompasses critical functions and includes activities, processes, services and their relevant supporting assets, the disruption of which would be material to the continued operation of the bank or its role in the financial system. Whether a particular operation is critical depends on the nature of the bank and its role in the financial system.

	<p>additional budget had been secured, but hiring had not taken place. Furthermore, delays to some of the necessary infrastructure to support DORA has also served to delay effective implementation of some parts of DORA – e.g. the concentration provisions, which will be delayed because of delays in data submissions. Originally the first live reporting was expected to be February and now the expectation is that this will start in May 2025. This will mean that such data will only feed in the SSM SREP process in 2026. The three ESAs announced the formation of the EU systemic cyber incident coordination framework (EU-SCICF), in July 2024, but this will also take time to be fully operational. Finally, the role of ESA DORA Coordinator was filled on 1 October 2024.</p> <p>Whilst some EBA guidelines remain relevant to this Principle, additional technical standards and guidelines will be required and are in preparation.</p> <p>CRR 3 introduced clear requirements on the operational risk management framework for all institutions, such as:</p> <ul style="list-style-type: none"> (a) a well-documented assessment and management system for operational risk; (b) an operational risk management function that is independent from the institution's business and operational units; (c) a system of reporting to senior management that provides operational risk reports to relevant functions within the bank; (d) a system of regular monitoring and reporting of operational risk exposures and loss experience; (e) procedures for taking appropriate corrective actions; (f) routines for ensuring compliance; (g) policies for the treatment of noncompliance; (h) regular reviews of the institution's operational risk assessment and management processes and systems, performed by internal or external auditors that possess the knowledge necessary to carry out such reviews; (i) internal validation processes that operate in a sound and effective manner; (j) transparent and accessible data flows and processes associated with the operational risk assessment system.
25 EC2	<p>The supervisor determines that a bank's board approves and periodically reviews the strategies and policies for its:</p> <ul style="list-style-type: none"> (a) management of operational risk for all material products, activities, processes and systems (including the bank's risk appetite for operational risk); and (b) operational resilience approach (including tolerance for disruption to critical operations). <p>The supervisor also requires that the board oversee senior management to ensure that these policies are implemented effectively and fully integrated into the overall framework for managing risks across the bank. The supervisor determines that banks have adequate functions⁸⁸ for the management of operational risk to identify external and internal threats and potential failures in people, processes and systems on an ongoing basis.</p>

⁸⁸ Including control functions, risk management and internal audit.

Description and findings re EC2	<p>Supervisors review the effectiveness of board approvals of strategies, policies and processes for operational risk management and the adequacy of their effective oversight of operational risk and resilience.</p> <p>Offsite supervision is supplemented by on-site reviews. These reviews provide additional assurance on:</p> <ul style="list-style-type: none"> (a) the bank's own formalized assessment of its operational risk profile, of the risks it is exposed to and the major risk drivers for operational risk, and the management body's awareness of these issues; (b) whether the bank's formalized operational risk strategy is consistent with the business strategy; (c) whether the bank has a defined operational risk appetite that is approved by the management body); (d) whether all material operational risks within the operational risk management perimeter have been: <ul style="list-style-type: none"> i. adequately and regularly identified based on an internally defined risk taxonomy, and ii. regularly assessed and correctly mapped to the corresponding operational risk sub-categories and that the result is a comprehensive risk inventory; (e) whether a Business Continuity Management Plan and processes have been implemented, which identify and cover all time-critical activities, business processes or resources and determine their maximum tolerable downtimes for a range of severe but plausible scenarios. <p>In DORA, the management board duties of defining, approving and overseeing of operational risks are enshrined in Article 5(2). This substantially improves the ability of the SSM to enforce this criterion.</p>
25 EC3	<p>The supervisor determines that the bank has identified its critical operations (consistent with its operational resilience approach) and mapped the people, technology, processes, data, facilities, third parties or intragroup entities and the interconnections and interdependencies among them that are necessary for the delivery of critical operations through disruption.</p>
Description and findings re EC3	<p>Supervisors assess the adequacy of a bank's approach to the identification of critical functions in the SREP process. They are requested to draw conclusions on the institution's operational resilience in a dedicated summary in IMAS, as part of the SREP cycle.</p> <p>This is further supplemented by on-site supervision, which provides additional assurance on:</p> <ul style="list-style-type: none"> (a) a bank's IT asset management controls for its data, personnel devices and systems. Ensuring that assets are risk assessed, and security managed in accordance to their business criticality; (b) the implementation of IT continuity management, which covers all time-critical activities, business processes and IT systems, as defined by Business Impact Analysis, and determines their maximum tolerable downtimes and/or data losses; (c) the Business Continuity Management Plan and processes, which identify and cover all time-critical activities, business processes or resources and determine

	<p>their maximum tolerable downtimes for a range of severe but plausible scenarios.</p> <p>In DORA the tasks of identifying and mapping the ICT assets are defined in Article 8. The mapping of interdependencies with regards to BCM measures is defined in Article 11(5). This provides a strong underpinning for Supervisors to deliver against this criterion.</p>
25 EC4	<p>The supervisor determines that banks develop and implement response and recovery plans to manage incidents that could disrupt the delivery of critical operations in line with the bank's risk appetite and tolerance for disruption and that they continuously improve their incident response and recovery plans by incorporating the lessons learnt from previous incidents.</p>
Description and findings re EC4	<p>The EBA Guidelines on Internal Governance set out expectations for Business continuity management including a bank's exposure to severe business disruptions and their potential impact.</p> <p>In DORA the obligation to develop response and recovery measures is specified in Article 11. Testing and reflecting the results should be part of the continuous development of these measures. This strengthens further the ability to meet this criterion.</p>
25 EC5	<p>The supervisor requires that banks conduct business continuity exercises under a range of severe but plausible scenarios to test their ability to deliver critical operations through disruption. The supervisor reviews the quality and comprehensiveness of the bank's business continuity and disaster recovery plans to assess their ability to deliver critical operations. In doing so, the supervisor determines that the bank can operate on an ongoing basis and minimize losses and interruptions to service provision in the event of a severe business disruption or failure (including but not limited to disruption at a service provider and disturbances in payment and settlement systems).</p>
Description and findings re EC5	<p>The EBA Guidelines on SREP set out that supervisors should evaluate whether a bank has in place comprehensive and tested business resilience and continuity plans, covering at least critical and important functions, including those that are outsourced, to ensure that it is able to operate on an ongoing basis and limit losses in the event of severe business disruption. There is additional guidance that supervisors should assess the testing of the design and operational effectiveness of the business continuity plans.</p> <p>The Cyber Resilience Stress Test conducted in 2024 also provided further insights to supervisors on the quality of banks' responses and ability to recover from a severe but plausible cybersecurity incident. 109 banks were tested, of which 28 underwent more extensive testing. Overall, the stress test showed that banks have response and recovery frameworks in place, but areas for improvement remain.</p> <p>On-site supervision provides additional assurance on the adequacy and effectiveness of Business Continuity Management process, including adequate procedures, regular testing and crisis management framework.</p> <p>In DORA Chapter 4 on Digital Operational Resilience Testing and Chapter 5, Section II on the Oversight framework of critical ICT third-party service providers there is a requirement that</p>

	the supervisor takes a holistic perspective on how individual ICT third party providers affect the resilience of the financial system. This provides additional support against this criterion.
25 EC6	Laws, regulations or the supervisor require banks to implement a robust information and communication technology (ICT) ⁸⁹ framework (including cyber security) within their operational risk management framework and operational resilience approach. The supervisor determines that banks have established appropriate policies and processes to identify, assess, mitigate, monitor and manage ICT risks. ⁹⁰ These policies and processes also require the board to regularly oversee the effectiveness of the bank's ICT risk management and senior management to routinely evaluate the design, implementation and effectiveness of the bank's ICT risk management. The supervisor also determines that banks have resilient ICT that is subject to protection, detection, response and recovery processes that are regularly tested, incorporate appropriate situational awareness of vulnerabilities and convey relevant timely information for risk management and decision-making processes to fully support and facilitate the delivery of the bank's critical operations.
Description and findings re EC6	<p>The EBA Guidelines on Internal Governance encompasses sound IT systems, outsourcing arrangements and business continuity management.</p> <p>The EBA SREP guidelines cover:</p> <ul style="list-style-type: none"> (a) Internal governance framework; (b) Information and communication technologies and business continuity management; (c) Recovery Planning; (d) Assessment of operational risk sub-categories; (e) 'Systems-ICT risk'; (f) inherent operational risk. <p>IT Security and Cyber Risk are a supervisory priority for the SSM workplan 2024-2026. Particular attention is being made to banks' IT security and cyber risk as well as IT outsourcing arrangements, given the increasing number of initiatives in using cloud computing. Among the relevant elements to be monitored by the supervisors, there is a focus on:</p> <ul style="list-style-type: none"> (a) the existence of audit clauses for banks and supervisors; (b) control by the outsourcer on the data location; (c) private data confidentiality requirements; (d) IT security conditions; and (e) The existence of reversibility and exit plans. <p>On-site supervision provides additional assurance on:</p> <ul style="list-style-type: none"> (a) whether the bank has an appropriate IT risk management framework; (b) the appropriateness of the governance framework concerning the IT infrastructure and staff;

⁸⁹ Information and communication technology refers to the underlying physical and logical design of information technology and communication systems, the individual hardware and software components, data and the operating environments.

⁹⁰ These include cyber security, ICT response and recovery programmes, ICT change management processes, ICT incident management processes and relevant information transmission to users on a timely basis

	<p>(c) whether the bank has an appropriate IT security management framework; and</p> <p>(d) whether the bank has an appropriate Cybersecurity management framework.</p> <p>In the DORA regulation details on the requirements of introducing an ICT risk management framework are included in Articles 6 -16 and the Regulatory Technical Standards on ICT Risk Management Framework and on simplified ICT Risk Management Framework.</p>
25 EC7	<p>The supervisor assesses whether banks have appropriate processes and effective information systems to:</p> <ul style="list-style-type: none"> (a) regularly monitor operational risk profiles and material operational exposures; (b) compile and analyse operational risk event data, which include internal loss data, and, when feasible, external operational loss event data; and (c) facilitate appropriate reporting mechanisms at the level of the bank's board, senior management, the independent risk function and the business units that support proactive management of operational risk and operational resilience.
Description and findings re EC7	<p>Supervisors assess the effectiveness of the information systems through off-site activities such as analysis of management information, reporting of internal / external, dedicated meetings and walk-throughs. This is supported by peer analysis. Included within the SSM Supervisory Manual is the need to assess if the internal audit of a bank reviews the reliability of reporting systems and the accuracy of the MIS. In case of material weaknesses, the supervisors must assess how those have affected the management's perception of operational risk.</p> <p>Such analysis is included as part of the assessment of management information, as part of regular meetings with the operational risk and governance functions, as well as part of onsite examinations, especially those related to model changes/approvals.</p> <p>Further assurance is provided by on-site supervision. In particular on:</p> <ul style="list-style-type: none"> (a) whether there is structured reporting on operational risk to the appropriate management levels and to the adequate business and control units; (b) whether the reports produced are of satisfactory quality, timeliness and complete-ness and not under sole control of risk-taking units; (c) the quality of the operational risk data, such as losses – pending, timing and recovered – as well as relevant provisions or near misses; (d) the data management IT process for operational risk data; (e) the operational risk data are used internally, in particular for risk mapping; (f) whether the bank has its own formalized assessment of its operational risk profile, of the risks it is exposed to and the major risk drivers for operational risk, and that the management body is aware of it.
25 EC8	<p>The supervisor requires banks to have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting their operational risk, including reporting of incidents that disrupt critical operations, and their severity.</p>
Description and findings re EC8	<p>Supervisors do make a regular analysis of internal reporting of banks with regard to operational risk, as well as information disclosed in public reporting. Incident reporting is also well established and includes requirements under the Payment Services Directive.</p>

	<p>Further assurance is provided by on-site supervision, which look at:</p> <ul style="list-style-type: none"> (a) whether adequate internal reporting is in place, (b) whether legal requirements for external disclosure are adequately fulfilled, (c) whether information provided to supervisors about the internal operational risk management is in line with internal data and reporting, (d) whether the regulatory reporting production process ensures quality and accuracy, (e) whether information internally or externally reported or disclosed is in line with the internal operational risk management framework as the latter is effectively implemented. (f) Whether appropriate IT infrastructure is in place to ensure accurate, comprehensive, complete and timely reporting of Operational Risk related items (g) The appropriateness of IT reporting to the management body. <p>In the DORA regulation requirements on ICT-related incident management, classification and reporting are included in Articles 17-23.</p>
25 EC9	<p>Laws, regulations or the supervisor require the board and senior management to understand the risks associated with bank activities performed by service providers and ensure that effective risk management policies and processes are in place to manage these risks. The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor bank activities performed by service providers. The supervisor determines that banks' third-party risk management policies cover:</p> <ul style="list-style-type: none"> (a) procedures for determining whether and how activities can be provided by service providers, and conducting appropriate due diligence for selecting potential service providers; (b) sound structuring of the service providers' provision, including ownership and confidentiality of data, as well as termination rights; (c) managing and monitoring the risks associated with the service provider arrangement, including the financial condition of the service provider; (d) maintaining an effective control environment at the bank over the service provider, which includes a register of outsourced activities, metrics and reporting to facilitate service provider oversight; (e) managing dependencies on arrangements, including (but not limited to) those of service providers, for the delivery of critical operations; (f) maintaining viable contingency planning and developing exit strategies to demonstrate the bank's operational resilience in the event of a failure or disruption at a service provider impacting the provision of critical operations.⁹¹ The bank's business continuity plans should assess the substitutability of the service providers that it uses for critical operations and other viable alternatives that may facilitate operational

⁹¹ In developing their exit strategies, banks should consider both near-term and long-term disorderly and orderly exits, as this could impact exit strategies and assumptions.

	<p>resilience in the event of an outage at a service provider, such as bringing the activity back in-house;</p> <p>(g) execution of comprehensive contracts and/or service level agreements that ensure a clear allocation of responsibilities between the service provider and the bank; and</p> <p>(h) the bank's right to inspect the service provider's books and records and ability to request reporting (e.g. audit reports), and permission for the bank's supervisor to access, directly or via the supervised bank, documentation, data and any other information related to the provision of the activity to the bank.</p>
Description and findings re EC9	<p>The SSM Supervisory Manual requires an assessment of outsourcing. This covers:</p> <ul style="list-style-type: none"> (a) The existence of an outsourcing strategy, and whether it has been appropriately approved; (b) The appropriateness of the outsourcing decision-making process; (c) The existence of relevant clauses: of audit, reversibility plans, security, and Basel Core Principles; (d) The inclusion of the outsourced services in the outsourcer's control framework; (e) The existence of an outsourcing register, encompassing all outsourcing initiatives; (f) The implementation of an appropriate oversight system. <p>For some jurisdictions the ECB is responsible for the assessment and approval of the outsourcing initiatives, in function of the legal requirements at a national level. The ECB publishes an annual horizontal analysis of the latest Outsourcing Register data collection.</p> <p>On-site supervision provides additional assurance on:</p> <ul style="list-style-type: none"> (a) Whether the outsourcing of IT services to external IT service providers is managed adequately in a way that it does not influence the quality of results; (b) Whether contracts in place comply with the minimum risk management and service quality conditions, i.e. audit, security, performance monitoring, BCP, reversibility clauses; (c) Whether appropriate risk assessments have been performed and outsourcing decisions have been appropriately taken; (d) Whether IT reporting includes the reporting of the IT service provider; (e) The adequacy of provider due diligence performed for the outsourcing of critical or important functions; (f) The clarity of responsibilities for monitoring and managing each outsourcing arrangement are set; (g) The service quality and compliance with agreed service level is monitored on an ongoing basis by the institution; (h) The outsourcing service provider's ability to fulfil its contractual agreements is monitored on a regular basis for critical or important outsourcing agreements; (i) Whether the level of internal control of the outsourcing service provider is included in the periodic risk assessment; (j) The adequacy of exit plans and whether adequate competence is retained in the outsourcing institution.

25 EC10	The supervisor determines that senior management has established a change management process ⁹² that is comprehensive, appropriately resourced, adequately divided up between the risk management and control functions, and conducive to the assessment of potential effects on the delivery of critical operations and on their interconnections and interdependencies.
Description and findings re EC10	Supervisors assess change management under the SSM SREP Manual. This includes: <ul style="list-style-type: none"> (a) The ICT Project Management framework (including Governance); (b) ICT Projects for software selection and acquisition (purchased systems); (c) ICT Projects for design and development (in-house). On-site inspection provides additional assurance on: <ul style="list-style-type: none"> (a) risks stemming from: <ul style="list-style-type: none"> i. new products, markets, business lines or new technology, ii. new operational processes, or iii. new outsourcing arrangements are adequately integrated in the operational risk management framework; (b) whether changes of the elements of the IT systems are planned, tested, implemented, documented and monitored in a controlled manner and that the outcome is recorded and evaluated thoroughly; (c) the capacity and performance management processes of the institution's IT operations and whether they are aligned with the requirements of the business and permanently allow the IT infrastructures to cope with the expected load; (d) whether the bank has an appropriate process for identification, classification, evaluation, prioritization and resolution of incidents (operational and security incidents).
Additional criteria	
25 AC1	The supervisor regularly identifies any common points of exposure across banks to operational risk or potential vulnerability (e.g. reliance of many banks on a common service provider, disruption to service providers of payment and settlement activities, exposures to losses from physical risks or from geopolitical events).
Description and findings re AC1	Concentration risk is assessed in the SSM SREP Manual. Supervisors are expected to assess the extent of the overall exposure of the bank to third-party risk outsourcing, in terms of the share of critical contracts. The quality of information available to supervisors is going to improve. Under DORA, all financial entities in its scope will need to have a comprehensive register of their contractual arrangements with ICT third-party service providers available at entity, sub-consolidated and consolidated levels. Such information will feed into the SSM SREP process in 2026 to identify interconnections amongst SIs and ICT third-party service providers and potential (systemic concentrations) in certain providers (as noted in EC 1).

⁹² A bank's operational risk exposure evolves when it initiates change, such as engaging in new activities or developing new products or services; entering into unfamiliar markets or jurisdictions; implementing new business processes or technology systems or modifying existing ones; and/or engaging in businesses that are geographically distant from the head office. Change management should assess the evolution of associated risks across time throughout the full life cycle of a product or service.

	Under DORA, for the area of ICT services, the supervisor, in the form of the Lead Overseer, can issue recommendations addressed to critical third-party providers to prevent the generation of single points of failure or minimize the possible systemic impact in the event of ICT concentration risk (Article 35(1dii) DORA Regulation 2022/2554). In the governance framework, the Lead overseer is one of the ESA (EBA, EIOPA, ESMA), based on the relative importance of an ICT provider for the entities in scope of the supervision of the three institutions. The competent authorities (ECB or for LSIs the respective NCAs) are informed about these investigations and issued recommendations.
25 AC2	The supervisor assesses concentration risk-related arrangements, and potential systemic risks arising from the concentration of services provided by specific service providers to banks within its jurisdiction.
Description and findings re AC2	Under DORA, concentration in the provision of ICT services is assessed under Article 29 and is the responsibility of the Lead Overseer, who can issue recommendations directly addressed to critical third-party providers to prevent the generation of single points of failure or minimize the possible systemic impact in the event of ICT concentration risk (Article 35(1dii) DORA Regulation). Furthermore, the Lead Overseer, via the Oversight Forum, determines systemic concentration risks to specific service providers annually (Article 32(2) DORA).
Assessment of Principle 25	Largely Compliant
Comments	The SSM has made substantial progress in the field of operational risk and resilience since the last BCP Assessment. Since that time, this Principle has been substantially revised. The re-organization of the SSM in 2020 and also the prioritization of Cyber and Operational Resilience has certainly provided an appropriate focus on this important risk. This has been supported by significant legislative change. DORA in particular has provided a robust framework for supervisors with a ground-breaking approach. Indeed the legislation provides a solid foundation for the SSM to improve its compliance with this CP. Of course, this assessment was finalized in the first few weeks of the DORA and there remained substantial implementation challenges – not least resourcing to satisfy a piece of legislation that is very demanding on supervisors. Assessors were shown budget numbers and their iteration as well as the narrative behind the changes made. To be successful, SSM will not only have to resource up to budget (not easy given the shortage of skills and heavy demand for those skills) but also deliver against the budget narrative that supports the resource numbers agreed upon. As such a rating of Largely Compliant is justified.
Principle 26	Internal control and audit. ⁹³ The supervisor determines that banks have adequate internal control frameworks to establish and maintain an effectively controlled and tested operating environment for the conduct of their business, considering 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

⁹³ Reference documents: BCBS, Principles for the effective management and supervision of climate-related financial risks, June 2022; BCBS, Corporate governance principles for banks, July 2015; BCBS, The internal audit function in banks, June 2012; BCBS, Compliance and the compliance function in banks, April 2005; BCBS, Framework for internal control systems in banking organisations, September 1998.

	independent ⁹⁴ internal audit (including those that are outsourced or co-sourced), compliance and other control functions to test adherence to and effectiveness of these controls as well as applicable laws and regulations.
Essential criteria	
26 EC1	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish an effectively controlled and tested operating environment for the conduct of their business, considering their risk profile with a forward-looking view.⁹⁵ These controls are the responsibility of the bank's board and/or senior management and deal with organisational 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, unauthorised trading and computer intrusion). More specifically, these controls address:</p> <ul style="list-style-type: none"> (a) organisational 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, such as but not limited to: 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 internal control and audit functions of banks in the EU is established by the CRD, the CRR and further developed by EBA guidelines, in particular the Guidelines on Internal Governance. Additional national legislation has transposed CRD and EBA guidelines into law.</p> <p>The CRD requires institutions to have robust governance arrangements with well-defined, transparent, and consistent lines of responsibility, effective processes to manage risks and adequate internal control mechanisms. The CRD also lays out specific requirements regarding the risk management function.</p> <p>The CRD lays out general principles on the review process of financial institutions' corporate governance. This includes the segregation of duties and the prevention of conflicts of interest, the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards. The CRD prescribes that staff engaged in control functions are independent of the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of</p>

⁹⁴ 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

⁹⁵ The time horizon for establishing a forward-looking view should appropriately reflect climate-related financial risks and emerging risks as needed.

the business areas they control. The CRR also refers to the requirement of adequate internal control mechanisms in various paragraphs regarding risk identification, measurement, monitoring control, and capital requirement calculation, as well as for prudential consolidation and identifying and managing large exposures.

As required under the CRD, EBA has issued:

- Guidelines on internal governance (EBA/GL/2021/05).
- Guidelines for common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing (EBA/GL/2022/03).
- jointly with ESMA, Guidelines on the assessment of the suitability of members of the management body and key function holders under (EBA/GL/2024/06).
- Guidelines on sound remuneration policies (EBA/GL/2021/04).
- Guidelines on outsourcing arrangements (EBA/GL/2019/02).

Regarding the oversight of control functions, the Guidelines on Internal Governance establish that “internal control functions should regularly submit to the management body written reports on major identified deficiencies. These reports should include, for each new identified major deficiency, the relevant risks involved, an impact assessment, recommendations and corrective measures to be taken. The management body should follow up on the findings of the internal control functions in a timely and effective manner and require adequate remedial actions. A formal follow-up procedure on findings and corrective measures taken should be put in place. Moreover, according to the CRD, institutions that are significant in terms of their size, internal organization and the nature, scope and complexity of their activities should set up at the board level a remuneration committee to oversee the compensation system’s design and operation on behalf of the board of directors. The remuneration committee is expected to 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.

The EBA Guidelines on internal governance also specify the measures credit institutions should have in place to comply with the principles of good governance. Institutions should take into account their size and internal organization, and the nature, scale and complexity of their activities when developing and implementing internal governance arrangements. The compliance status monitoring table published on the EBA website indicates that the ECB complies fully with the guidelines on internal governance when supervising SIs. However, some of the NCAs have indicated they do not intend to comply with these guidelines on some aspects (mostly relating to the structure of committees in management body).

The SSM regularly assesses the internal control and audit function of SIs. The SREP covers the assessment of the internal control function, including internal governance and risk management, risk management function, compliance function and internal audit function in banks. The SSM also conducts regular on-site examinations of SIs in close cooperation with NCAs, focusing on banks’ internal control functions. Such onsite inspections cover risk management (see CP 15), internal audit, and compliance. The SREP assessment of internal governance includes the roles and responsibilities of the relevant people, functions, bodies and committees within an institution and how they cooperate, both in terms of a

	<p>governance framework and in terms of actual behavior. The assessment covers such functions as internal audit, risk management and compliance. The internal governance framework 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 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. Supervisors assess board structure and committees as well.</p> <p>Supervisors also evaluate if the structure of the organization ensures that the internal audit department is not involved in operational organization and that the auditors do not audit activities or functions that they themselves have recently carried out.</p> <p>The ECB, in addition to firm-specific work conducted by JSTs, carries out horizontal benchmarking assessments of internal control functions. An annual data collection exercise on the internal control functions (specifically on their staffing and reporting lines) has been conducted since 2018. These data collections aim to provide JSTs with benchmarking tools to compare institutions, ensure consistency in assessments and supervisory outcomes and identify outliers and potential issues that need a follow-up. Several horizontal thematic reviews have been performed into the different control functions (compliance function, internal audit function).</p> <p>With regards to climate-related financial risks, the ECB has set out supervisory expectations in its 2020 Guide on climate-related and environmental risks, which includes an expectation that banks' compliance and internal audit functions consider the extent to which a bank is equipped to manage climate-related and environmental risks. A deep dive into institutions' climate-related and environmental risk strategies, as well as their governance and risk management frameworks and processes, took place.</p>
26 EC2	<p>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 organisation (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.</p>
Description and findings re EC2	<p>The ECB complies with EBA Guidelines on internal governance, which specify that the internal control functions should have sufficient resources and that internal control functions should have appropriate IT systems and support at their disposal, with access to the internal and external information necessary to meet their responsibilities.</p> <p>As stated in BCP 15 EC1, the internal control function is assessed as part of the SREP in its Element 2 on Internal Governance and Risk Management and through regular on-site examinations.</p>

	<p>An annual data collection exercise on the internal control functions has been conducted since 2018 and several horizontal thematic reviews have been performed on the different control functions.</p> <p>The assessors saw targeted assessments and benchmarking exercises of internal control functions where resources, structure, and the effectiveness of internal controls were reviewed. In addition, examples of SREP provided by the ECB show that these functions were assessed.</p> <p>Leveraging the SREP Manual, the JSTs analyze the risk culture of supervised financial institutions. The accountability of all staff is a key element of a healthy risk culture. Supervisors also ascertain whether the control functions have an adequate status of authority compared to the business lines and how accountability is distributed between control functions and core business areas. Supervisors verify that business lines, the risk management function and the compliance, internal audit and other control functions have clearly segregated responsibilities with regard to monitoring, identifying, managing and mitigating risk. At the same time, the business lines must make risk control and monitoring tasks an integral part of their daily activities. Looking into internal alert procedures, supervisors analyze the volume and patterns of self-reported control or risk problems.</p>
26 EC3	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function 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.</p>
Description and findings re EC3	<p>The EBA Guidelines on internal governance specify that the compliance function should be a permanent and effective independent function (hierarchically and functionally separate and operationally independent from any business activity responsibilities), with a person appointed to be responsible for the compliance function across the entire institution. The compliance function should monitor the institution's adherence to rules resulting from the institution's own policy and those resulting from banking law and its implementing regulations, along with other legal and regulatory provisions applicable to the banking sector (i.e., transparency, anti-money laundering, etc.), as well as litigation and reputational risk related procedures and instructions on an on-going basis (including a comprehensive incident database and analysis).</p> <p>A charter is expected to set out the objectives of the compliance function as well as its responsibilities and competences, guarantees its independence and permanency, and specifies its relations with the other departments and functions. This charter authorizes the compliance function to take the initiative and grant it access to all the information it needs, specifies its reporting lines and gives it the right to contact the management body and the members of the audit committee. The ECB expect that the compliance function has the necessary human (quantitative and qualitative competencies) and technical (access to data) resources to allow it to fulfil its duties effectively and adequately. Furthermore, the function should have the capacity and should also take the initiative and coordinate actions with regard to compliance matters.</p>

	<p>The Compliance function is assessed as part of the SREP in its Element 2 – Module 4 (Compliance function). Based on the SREP results on-site inspections, deep dives, and horizontal reviews can be planned to further analyze the control functions and their adequacy. In 2020 and 2021, a horizontal review of the compliance function was performed, providing benchmarking and guidance to the JSTs.</p> <p>Supervisors assess if the head of the compliance function reports directly to the management body and has the necessary qualifications, experience and hierarchical status to effectively ensure the institution's compliance with laws and regulations and challenge any lack thereof. Supervisors assess, if the work performed by the compliance function is properly documented and included in the internal audit plan and subject to periodic audit reviews. In addition, while performing its duties, it is expected that the internal audit function dedicates sufficient attention to compliance-related issues.</p> <p>The assessors were provided bank-specific assessments of compliance function in on-site inspection reports, SREP assessments and examples of deep dives, which show the thoroughness of the SSM review of the effectiveness of compliance function.</p>
26 EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function (including those that are outsourced or co-sourced) 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 and 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>EBA Guidelines on internal governance require institutions to set up an independent and effective internal audit function, taking into account the proportionality criteria set out in the Guideline, and appoint a person to be responsible for this function across the entire institution. The internal audit function is expected to assess whether the institution's internal control framework is both effective and efficient, verifying the integrity of the processes, ensuring the reliability of the institution's methods and techniques, and the assumptions and sources of information used in its internal models. The internal audit function should assess whether the institution's internal control framework is both effective and efficient. The function has an obligation to keep the management body informed, regularly and on an event-driven basis, about internal audit activities.</p> <p>Pursuant to Directive 2006/43/EU, each public interest entity should have an audit committee. The audit committee should monitor the effectiveness of the institution's internal quality control and risk management systems and, where applicable, its internal audit function. The audit committee should be either a stand-alone committee or a committee of the administrative body or supervisory body of the audited entity. It should be composed of non-executive members of the administrative body and/or members of the supervisory body of the audited entity and/or members appointed by the general meeting of shareholders of the audited entity or, for entities without shareholders, by an equivalent body.</p>

	<p>The internal audit function is assessed as part of the SREP in its Element 2 - Module 5 (Internal Audit function). The status and organization of the internal audit function are regularly assessed by supervisors with regard to independence, impartiality and proficiency. Supervisors assess if the frequency and level of detail of reports on internal audit activity submitted are commensurate with both the size of the institution and the level of risk it incurs. They review the nature and scope of audits in order to ensure that they effectively and comprehensively cover the institution's activities and risks, including outsourced activities.</p> <p>The assessment is also designed to check whether the methodology used by the internal audit is in line with the relevant international and European standards. Special attention must be paid to any new and/or complex activities which the institution may have developed. JSTs often meet with internal auditors to review their progress in implementing audit plans and review their reports and work.</p> <p>In 2022, the internal audit function was subject to a horizontal review, which looked into resources, methodologies, effectiveness, governance, and organization across several SIs.</p> <p>Assessors reviewed multiple on-site inspection reports, SREP assessments, deep dive into internal audit function and internal audit benchmark studies, which show that the effectiveness, structure, resources, quality, planning, and methodologies relating to internal audit functions are assessed in detail within the SSM.</p>
26 EC5	<p>The supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> (a) has sufficient resources and that staff are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence and is accountable to the bank's board or to an audit committee of the board, and its status within the bank ensures that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) may communicate with any member of staff and has full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	<p>EBA Guidelines on internal governance require that the internal audit function should be independent and that resources, in particular its auditing tools and risk analysis methods, are adequate for the institution's size and locations and the nature, scale and complexity of the risks associated with the institution's business model, activities, risk culture and risk appetite.</p> <p>The supervisor assesses the internal audit as part of the SREP -Module 5 (Internal Audit function). Supervisors regularly assess:</p>

	<ul style="list-style-type: none"> • the internal audit function and its position within the financial institution (hierarchical and functional) and check if it enables them to operate autonomously and with authority, • the reporting lines (directly to the institution's management body, possibly through an audit committee), • the effectiveness of the audit function in identifying and raising issues. <p>Supervisors expect that the internal audit function sets up and revises, at least annually, an internal audit plan approved by the management body, covering all the relevant activities and risks of the institution. The audit universe should be comprehensive and cover all the activities and risks of the institution, including new activities and activities which are developed outside of the institution's usual framework (e.g., in terms of their geographical location or legal background). The frequency of audits of those activities and risks should depend on the impact of potential deficiencies on the institution's risk profile and earnings situation. All relevant activities and risks are expected to be covered within a reasonable term, which should never exceed three years. Supervisors also evaluate the support of the management body to ensure the timely and adequate implementation of requested corrective actions in line with the EBA GL on internal governance.</p> <p>Supervisors assess if the internal audit function is provided with the necessary human and technical resources to carry out audits effectively and according to the planned schedule. They assess the level of remuneration and internal status of internal audit staff if it is high enough to attract qualified and sufficiently experienced staff. Institutions are required to offer the auditors appropriate and regular training, either internal or external, covering auditing techniques and best practices as well as the characteristics of the business activities they are auditing.</p> <p>In line with the EBA guidelines on internal governance, the operational tasks of the internal control functions may be outsourced, with the consent of the management bodies of the institutions concerned. In any case, the head of the internal control function concerned, and the management body are still responsible for these activities and for maintaining an internal control function within the institution. The JSTs assess whether a clear, comprehensive and legally contractual agreement exists in which the tasks and responsibilities of the (external) audit expert are clearly set out; the necessary access to documents has been granted under appropriate confidentiality agreements; both, the institution and competent supervisory authorities have access to all the audit expert's documents; the external expert is independent in relation to the institution's own internal auditor(s). Additionally, the Audit Committee and the management body, in its management function, need to receive regular reports on the outsourced activities.</p> <p>In accordance with the EBA guidelines, the internal audit function should have unfettered institution-wide access to all the records, documents, information and buildings of the institution. This should include access to MIS and minutes of all committees and decision-making bodies. Internal audit work should be performed in accordance with an audit plan and a detailed audit program following a risk-based approach. All relevant activities and</p>
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	<p>risks are expected to be covered within a reasonable term, which should never exceed three years.</p> <p>The audit methodology applied by the internal audit department of a financial institution requires to:</p> <ul style="list-style-type: none"> • include an audit charter, which is approved by the management body and specifies the objective and scope of the internal audit function, its place within the organization, its composition, competences and responsibilities, • be compliant (and be regularly updated) with international and European professional standards, • be effectively implemented during audits by the auditing staff, • facilitate that, internal audit policies, methods and procedures should be clearly set down in writing, refer to the standards of the profession and apply to the entire internal audit function within the group. <p>Regarding the assessment of outsourced activities, the EBA guidelines specify that the internal audit function should, following a risk-based approach, independently review and provide objective assurance of the compliance of all activities and units of an institution, including outsourced activities, with the institution's policies and procedures and with regulatory requirements.</p> <p>As stated in EC 4, the assessors reviewed several examples of supervisory reports, including internal audit benchmark studies, which show that the effectiveness, structure, resources, quality, planning, and methodologies relating to internal audit functions are assessed in detail within the SSM.</p>
Assessment of Principle 26	Compliant
Comments	<p>EU laws and guidelines pertaining to internal control and internal audit are generally comprehensive. The SSM regularly assesses the internal control and audit function of SIs. The SREP covers the assessment of the internal control function, including internal governance and risk management, risk management function, compliance function and internal audit function in banks. The SSM also conducts regular on-site examinations of banks' internal control functions, covering risk management, internal audit, and compliance. Several horizontal thematic reviews have been performed, and the annual data collection exercise on the internal control provides JSTs with benchmarking tools to compare institutions.</p> <p>The ECB Guide on climate-related and environmental risks includes an expectation that banks' compliance and internal audit functions consider the extent to which a bank is equipped to manage climate-related and environmental risks. A deep dive into institutions' climate-related and environmental risk strategies, as well as their governance and risk management frameworks and processes, was also conducted.</p>

Principle 27	Financial reporting and external audit. ⁹⁶ 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	
27 EC1	The supervisor ⁹⁷ 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 for ensuring that these are supported by recordkeeping systems to produce adequate and reliable data.
Description and findings re EC1	<p>Article 33 of the Accounting Directive (Directive 2013/34/EU) on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings establishes that the members of the administrative, management and supervisory bodies of an undertaking have collective responsibility for ensuring that the annual and the consolidated financial statements are drawn up and published in accordance with the requirements of this Directive and where applicable in accordance with IFRS. The Directive also requires that members of the administrative, management and supervisory bodies of the undertakings are liable for breach of the duties referred to above. According to CRD Article 88, member states should ensure that the management body defines, oversees and is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interest. Those arrangements should include the principles stating that the management body must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards, and the management body must oversee the process of disclosure and communications.</p> <p>Regulation (EC) No 1606/2002 on the application of international accounting standards, known as IAS Regulation, requires the application of IFRS for consolidated financial statements of an entity only if it has securities that are traded on a regulated EU market. Member states have the option of allowing or requiring IFRS reporting in the annual financial statements of the above companies [stand-alone] or in the financial statements of any other companies [stand-alone and/or consolidated]. This option is exercised by some member states for institutions which do not have securities listed on an exchange market. If member states do not exercise this option, non-publicly traded banks apply nGAAP. Banks that are subject to nGAAP should follow the accounting rules issued by national competent bodies.</p>

⁹⁶ Reference documents: BCBS, Supplemental note to external audits of banks – audit of expected credit loss, December 2020; BCBS, External audits of banks, March 2014; BCBS, Supervisory guidance for assessing banks' financial instrument fair value practices, April 2009.

⁹⁷ In this essential criterion, the supervisor is not necessarily limited to the banking supervisor. 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>EU Directives on transparency and stock exchange listing requirements (2004/109/EC and 2001/34/EC) require that issuers whose securities are listed on a regulated market located or operating in an EU country use IFRS for the preparation of their consolidated accounts and publish their financial statements annually. The financial statements should comprise such consolidated accounts under IFRS as endorsed in the EU and the annual solo financial statements of the parent company drawn up in accordance with the national law of the Member State in which the parent company is incorporated. The parent company on a solo basis may be IFRS or nGAAP, depending on the member state. Not all issuers are required to prepare consolidated accounts. In this case the audited financial statements should comprise the accounts prepared in accordance with the national law of the Member State in which the company is incorporated.</p> <p>Article 24(2) of the CRR empowers the competent authority to require regulatory reporting in accordance with IFRS, also in cases where the national applicable accounting framework requires the use of national GAAP for financial reporting purposes. The ECB has determined not to exercise in a general manner the option set out in Article 24(2) of the CRR. However, it may grant permission for the use of IFRS for regulatory reporting purposes based on the request of an institution on a case-by-case basis.</p> <p>Article 24(4)(h) of the Transparency Directive (Directive 2004/109/EC) requires EU member states to establish a competent authority that should have all the powers necessary for examining 'that information referred to in this Directive is drawn up in accordance with the relevant reporting framework and take appropriate measures in case of discovered infringements' (enforcement of financial information). Coordination of these authorities at the EU level is performed by ESMA. ESMA issued its Guidelines on enforcement of financial information, addressed to these competent authorities. These guidelines detail the extent of enforcement of financial information. The enforcement regime applies to consolidated financial statements and solo financial statements for companies whose securities are traded on a regulated EU market.</p> <p>The ECB does not have a mandate to set standards for public financial statements and external audits. The ECB communicates its supervisory expectations on the implementation of these rules publicly via Dear CEO Letters, blog posts and public reports (e.g., Thematic Review on IFRS 9 provisioning).</p> <p>The ECB has no accounting powers. Recitals to the SSMR state that: "Nothing in this Regulation should be understood as changing the accounting framework applicable pursuant to other acts of Union and national law" and that: "The ECB's request for information to perform its calculation should not force the institutions to apply accounting frameworks differing from those applicable to them pursuant to other acts of Union and national law."</p>
27 EC2	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.
Description and findings re EC2	<p>According to Article 3 of the Accounting Directive, credit institutions are considered public interest entities. Article 34 of the same Directive requires that the financial statements of public-interest entities be audited. Article 26 of the Audit Directive (Directive 2006/43/EC) stipulates that 'statutory auditors and audit firms are to carry out statutory audits in compliance with international auditing standards adopted by the Commission'. member states may apply national auditing standards, procedures or requirements as long as the Commission has not adopted an international auditing standard covering the same subject matter.</p> <p>Article 39 of the Audit Directive also requires, inter alia, that public-interest entities, thus credit institutions, establish an audit committee responsible for (a) monitoring the financial reporting process, (b) monitoring the effectiveness of the company's internal control, internal audit where applicable, and risk management systems, (c) monitoring the statutory audit of the annual and consolidated accounts (d) reviewing and monitoring the independence of the statutory auditor or audit firm, and in particular the appropriateness of the provision of non-audit services to the audited entity.</p> <p>Audit Regulation (Regulation (EU) No 537/2014) specifies additional requirements relating to statutory audit of public-interest entities, including specific rules for the auditors (e.g. independence, limitation of the provision of non-audit services), and specific requirements related to the audit report. It limits the length of the audit engagement (audit rotation).</p>
27 EC3	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.
Description and findings re EC3	<p>In accordance with the Accounting Directive, IAS Regulation and Transparency Directive, institutions may be subject to IFRS or nGAAP, as explained in EC1.</p> <p>Under Article 24(1) of the CRR, the valuation of assets and off-balance sheet items needs to be affected in accordance with the applicable accounting framework, IFRS or nGAAP. As explained in EC1, the competent authority may require regulatory reporting to be done in accordance with IFRS.</p> <p>Implementing Regulation (EU) 2021/451 on supervisory reporting requires financial institutions reporting under IFRS at the consolidated level to fulfil and submit to the competent authorities Financial Reporting (FINREP) templates.</p> <p>ECB Regulation on Reporting Supervisory Financial Information (Regulation (EU) 2015/534) extends FINREP by requiring standardized reporting for all SSM-supervised entities that are subject to capital requirements (i.e., non-waiver institutions). The regulation requires the reported financial information to be based on valuation rules existing under the relevant accounting standards (IFRS or nGAAP).</p>

	<p>For prudential purposes, Article 105 of the CRR requires that credit institutions establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates. Article 105 also requires institutions to perform independent verification and validation and to establish and maintain procedures for considering valuation adjustments. Banks' valuation practices are assessed by the ECB. JSTs may ask for documentation, data, or analyses that substantiate the valuation practices of the bank.</p> <p>Article 34 of the CRR requires institutions to apply the requirements of Article 105 (prudent valuation adjustment) to all assets measured at fair value when calculating the amount of their own funds and to deduct from Common Equity Tier 1 capital the amount of any additional value adjustments necessary. The detailed requirements for prudent valuation adjustment are included in the EBA's 2014 RTS on prudent valuation, which supplements the CRR.</p> <p>In the context of the SREP process, supervisors review the valuation processes followed by supervised institutions and the reconciliation of valuations of assets and off-balance sheet items made under relevant accounting standards and data reported to the supervisor (e.g., COREP). Credit institutions must ensure that data produced for regulatory reporting are reconciled with accounting sources on a regular basis and that data quality and completeness are sufficient. The reconciliation process and quality assurance, which are critical for capital requirements calculations, may be the subject of onsite inspections and "deep dives." CP 10 and CP 18 discuss the role of the ECB in validation of the valuation framework and the powers available to it if valuations of assets are deemed not to be sufficiently prudent.</p> <p>Between 2019-22 the ECB performed an on-site inspection campaign on Valuation Risk, covering both Level 2 and Level 3 fair valued instruments (see CP 22) and the assessors saw evidence of the thoroughness of this work. Independent price verification processes may be discussed by JSTs during periodic meetings with banks, and the assessors were provided with one example. The assessors also saw examples of onsite inspection reports on IFRS 9 provisioning and related processes where findings on model assumptions, qualitative assessment of staging and validation were included.</p>
27 EC4	<p>Laws, regulations or the supervisor set out the scope of external audits of banks and the standards to be followed in performing such audits. These should be aligned with internationally accepted standards and require the use of a risk- and materiality-based approach in planning and performing the external audit.</p>
Description and findings re EC4	<p>The ECB does not have a supervisory power to set the scope of statutory audits. The Audit Regulation establishes the scope of the external audit of public-interest entities according to a risk and materiality-based approach. The Audit Regulation requires that the audit report includes, inter alia, in support of the audit opinion, the following:</p> <ul style="list-style-type: none"> • a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud; • a summary of the auditor's response to those risks; and

	<ul style="list-style-type: none"> • where relevant, key observations arising with respect to those risks.
27 EC5	Supervisory guidelines or local auditing standards determine that audits cover several areas, including but not limited to the loan portfolio, loan loss provisions, non-performing exposures, asset valuations, trading and other securities activities, derivatives, asset securitisations, consolidation of off-balance sheet vehicles and other involvement with such vehicles, and the adequacy of internal controls over financial reporting.
Description and findings re EC5	<p>International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC) cover all the main areas of the financial statements, including the items indicated in this EC. Article 26 of the Audit Directive stipulates that member states should require statutory auditors and audit firms to carry out statutory audits in compliance with international auditing standards adopted by the European Commission. member states may apply national auditing standards, procedures or requirements as long as the European Commission has not adopted an international auditing standard covering the same subject matter.</p> <p>Within the SSM, international audit standards are not used in all the SSM member states. All but three member states have adopted ISAs issued by IFAC. France, Germany, and Portugal are awaiting a formal adoption of ISA by the Commission. Notwithstanding this, the substance of the ISAs has either been transposed into national law (Germany, France) or the ISAs are directly applicable until their adoption by the Commission (Portugal).</p>
27 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 who is not subject to or does not adhere to established professional standards.
Description and findings re EC6	<p>Articles 3 to 5 of the Audit Directive require member states to designate a competent authority responsible for approving statutory auditors and audit firms, subject to the criteria set out in this Directive. Approval of the auditor or audit firm can be withdrawn if these criteria are no longer met. Article 32 of the Audit Directive requires member states to organize an effective system of public oversight for all statutory auditors and audit firms and designate a competent authority responsible for such oversight.</p> <p>Neither the CRR nor the CRD (and EU legislative framework in general) empower the competent supervisory authority to reject the appointment of an external auditor (e.g., through a non-objection procedure, nor do they provide for specific powers vis-à-vis external auditors.</p> <p>National laws in some euro area member states provide for supervisory powers to approve or object to the appointment of external auditors. The ECB, in consultation with the European Commission, has clarified that such where such powers exist, they are to be directly exercised by the ECB for significant credit institutions. This allocation is effective as of January 1, 2017. In some member states, the appointment of an external auditor by a credit institution is subject to the prior approval of the competent supervisory authority (for instance, in Belgium, Luxembourg or Malta) or needs to be notified to the competent authority (for instance, in Austria, Bulgaria, Germany, Italy or France) which may – in some jurisdictions - under certain conditions object to the appointment. Moreover, in some jurisdictions, the competent supervisory authority is empowered to request additional</p>

information from the external auditor, give instructions to the external auditor and to request specific audit reports (for instance, in Austria, Belgium, Germany, Slovenia, and France). Assessors saw examples of these powers being used.

The ECB does not have the power to sanction an external auditor in cases of negligence. The ECB can only exchange information with the authorities in charge of oversight of the auditors, in line with Article 57.1 (c) of CRD. Some national jurisdictions enable supervisors to reject bank auditors by application to court (e.g. Austria).

CRD Article 63(1) requires that member states provide that competent supervisory authorities may require the replacement of the external auditor if that person acts in breach of their obligations (including independence and expertise).

Auditors may be dismissed only where there are proper grounds. Divergence of opinion on accounting treatments or audit procedures is not proper grounds for dismissal. In such a case, the audited entity and the statutory auditor or audit firm are to inform the authority responsible for public oversight of auditors about the dismissal or resignation of the statutory auditor or audit firm during the term of appointment and give an adequate explanation of the reasons.

In the case of a statutory audit of a public-interest entity, such as credit institutions, member states are to ensure that it is permissible to bring a claim before a national court for the dismissal of the statutory auditor(s) or the audit firm(s) where there are proper grounds for so doing.

Article 30 of the Audit Directive grants designated competent authorities the power to take and/or impose at least the following administrative measures and sanctions for breaches of the provisions of the Audit Directive and, where applicable, of the Audit Regulation:

- a notice requiring the natural or legal person responsible for the breach to cease the conduct and to abstain from any repetition of that conduct;
- a public statement that indicates the person responsible and the nature of the breach, published on the website of competent authorities;
- a temporary prohibition of up to three years duration, banning the statutory auditor, the audit firm or the key audit partner from carrying out statutory audits and/or signing audit reports;
- a declaration that the audit report does not meet the requirements of Article 28 of the Audit Directive or, where applicable, Article 10 of the Audit Regulation;
- a temporary prohibition of up to three years duration, banning a member of an audit firm or a member of an administrative or management body of a public-interest entity from exercising functions in audit firms or public-interest entities; and/or
- the imposition of administrative pecuniary sanctions on natural and legal persons.

	member states are also responsible for ensuring the independence of the auditor from the executive members of the administrative body or the managerial body of the audited entity. Additional requirements for public-interest entities are set out in Articles 4–18 of the Audit Regulation.
27 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	<p>As established by Article 17 of the Audit Regulation, the maximum duration of audit engagements for public-interest entities, including credit institutions, is 10 years, or 20 years subject to a tendering process, or 24 years in case of joint audits. Audit engagement can be renewed only after a 4-year period.</p> <p>Key audit partners should cease their participation in the statutory audit by no later than 7 years. Key audit partners can restart their participation in the audit of that public-interest entity after a three-year period.</p> <p>Following clarification of the ECB's supervisory powers under national laws, the ECB has taken an active role in encouraging credit institutions to rotate long-standing auditors in instances in which it can exercise supervisory powers on external auditor appointments (see EC 6 above).</p>
27 EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	The ECB has the right to meet with external auditors to discuss the audit reports without the approval of the banks. Article 12(2) of the Audit Regulation requires the Supervisory Authority to establish an effective dialogue with the external auditors of banks. The EBA guidelines also require that the communication between competent authorities and auditors collectively be as frequent as necessary to ensure timely sharing of information on issues which are relevant to the supervisory tasks and the statutory audit of credit institutions. The ECB has transposed the EBA guidelines in its supervisory practices and has disseminated this guidance to its staff members. Under this legal mandate, the ECB banking supervisors meet regularly with external audit firms collectively to exchange views on current and emerging developments. In addition, there is regular dialogue between the JSTs and group auditors of individual SIs, with the participation of the relevant horizontal functions of ECB banking supervision. Assessors saw meeting agendas with the external auditors on different thematic issues and bank-specific related issues.
27 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 any other matters that they believe are likely to be of material significance to the safety and soundness of the bank. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of the duty of confidentiality.
Description and findings re EC9	Article 12(1) of the Audit Regulation requires auditors or the audit firm carrying out the statutory audit of a public-interest entity to report promptly to prudential supervisors of those public-interest entities (or where so determined by the Member State concerned, to the competent authorities responsible for audit oversight) any information concerning the

	<p>public-interest entity of which the auditor has become aware while carrying out that statutory audit and which may bring about any of the following:</p> <ul style="list-style-type: none"> • a material breach of the laws, regulations or administrative provisions which lay down, where appropriate, the conditions governing authorization or which specifically govern the pursuit of the activities of such public-interest entity; • a material threat or doubt concerning the continuous functioning of the public-interest entity; • a refusal to issue an audit opinion on the financial statements or the issuing of an adverse or qualified opinion. <p>According to Article 63 (1) of the CRD, the auditor should at least have a duty to report promptly to the competent authorities any fact or decision concerning that institution of which that person has become aware while carrying out that task, which is liable to:</p> <ul style="list-style-type: none"> • constitute a material breach of the laws, regulations or administrative provisions which lay down the conditions governing authorization or which specifically govern the pursuit of the activities of institutions; • affect the ongoing functioning of the institution; • lead to refusal to certify the accounts or to the expression of reservations. <p>Furthermore, auditors have at least a duty to report any fact or decision of which that person becomes aware while carrying out its task in an undertaking having close links resulting from a control relationship with the institution within which he is carrying out that task.</p> <p>According to Article 63(2) of the CRD, 'disclosure in good faith' to the competent authorities, by auditors (within the meaning of the Audit Directive), of any fact or decision referred to in CRD, Article 63(1) above, should not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision and should not involve such persons in any liability. Such disclosure should be made simultaneously to the management body of the institution unless there are compelling reasons not to do so.</p> <p>The assessors saw examples of reports from external auditors to supervisors on matters thought to be of material significance.</p>
Additional criterion	
27 AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	The ECB is not legally empowered to access and review the working papers of statutory auditors. However, Article 56 of the CRD allows for the exchange of information, subject to professional secrecy between the supervisor and the auditor. According to the SSM Supervisory Manual the external auditor may be contacted and consulted as needed for the performance of supervisory functions. Besides the exchange of any information that might

	<p>include the contents of working papers, the supervisor has no power to access the external auditors' internal working papers directly.</p> <p>The competent oversight authority of the external auditor can access data related to the audit or any other documents held by external auditors to carry out their tasks. The ECB has not introduced any specific arrangements to access the working papers of auditors through their competent oversight authorities.</p>
Assessment of Principle 27	Largely Compliant
Comments	<p>The ECB has only limited scope under EU law to engage in assessments of the integrity and external audit of financial statements of SIs prepared in accordance with relevant accounting standards. Existing EU legislation does not provide the ECB the power to influence the scope of the external audit or establish the standards for such an audit. Responsibilities under EU laws in this area lie with other competent authorities. The overall EU financial reporting and external audit regime, however, appears robust and ensures broad consistency with this Core Principle.</p> <p>Neither the CRR nor the CRD empower the competent supervisory authority to reject the appointment of an external auditor (e.g., through a non-objection procedure) nor do they provide for specific powers vis-à-vis external auditors. National laws in some euro area member states provide for supervisory powers to approve or object to the appointment of external auditors. However, the ECB has the authority to require banks to replace an external auditor. To foster greater consistency, the ECB should be empowered under EU law to prevent an auditor from being put in office.</p> <p>The ECB has established strong ongoing communication channels with external auditors. Given the reliance on the work of external auditors to help determine asset quality and provisioning, the lack of power to review the external auditors' working papers should be addressed to meet best international practices and extract more value from the work of external auditors.</p>
Principle 28	Disclosure and transparency. ⁹⁸ 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 (including compensation practices). At least for internationally active banks, disclosure requirements are not less stringent than the applicable Basel standards.
Essential criteria	
28 EC1	Laws, regulations or the supervisor require periodic public disclosures ⁹⁹ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the

⁹⁸ Reference documents: BCBS, High-level considerations on proportionality, July 2022; BCBS, Corporate governance principles for banks, July 2015; FSB, Enhancing the risk disclosure of banks, October 2012; BCBS, Enhancing bank transparency, September 1998; [DIS10], [DIS20], [DIS21], [DIS25], [DIS26], [DIS30], [DIS31], [DIS35], [DIS40], [DIS42], [DIS43], [DIS45], [DIS50], [DIS51], [DIS60], [DIS70], [DIS75], [DIS80], [DIS85], [DIS99].

⁹⁹ In 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.

	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>There are two different types of disclosures that impact credit institutions in relation to providing transparent information on the financial condition and performance of the entity: (i) those required in the financial statements of the entity and (ii) those required under Pillar 3 of the Basel Framework, as transposed into the CRR. Financial disclosures are expected to appear in the financial statements and notes. As regards Pillar 3 disclosures, institutions are required under the CRR to disclose, at least on an annual basis, qualitative and quantitative information on their own funds, capital adequacy, the risks they have incurred and their risk management procedures. The last RCAP in 2014 found the Pillar 3 regime in the EU compliant. The EBA ITS 2021/637 provides further specifications such as harmonized disclosure templates and tables as well as mapping with supervisory reporting, which facilitates comparability between institutions in specific disclosure areas.</p> <p>The SSM, in its supervisory expectations relating to risk management and disclosures of climate-related and environmental risks, requires institutions to publish meaningful information and key metrics on climate-related and environmental risks that they deem to be material.</p> <p>To ensure the reliability of the information, the CRR requires that the management body or senior management should adopt formal policies to comply with the disclosure requirements and put in place and maintain internal processes, systems and controls to verify that the institutions' disclosures are appropriate and in compliance with the requirements.</p> <p>Disclosure is governed by the principle of materiality defined by the institutions themselves and is not applicable to legally protected or confidential information. These concepts are further defined in the EBA Guidelines on materiality, proprietary and confidentiality and disclosure frequency.</p> <p>In the case of banking groups, disclosure requirements are generally applicable at the top consolidated level, with a limited scope of requirements being applicable to large subsidiaries. Amendments to CRR made in 2019 removed the requirement on disclosures at a solo level for all subsidiaries.</p> <p>Financial statements based on IFRS are not mandatory for all banks. Entities that do not apply IFRS for their consolidated or solo financial statements apply nGAAP.</p>
28 EC2	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 (including information that will help in understanding a bank's risk exposures during a financial reporting period), aggregate exposures to related parties, transactions with related parties, accounting policies, business models, management, governance (including major share ownership and voting rights) and compensation practices. The scope and content of the information provided and the level of disaggregation and detail are commensurate with the risk profile and systemic importance

	of the bank. At least for internationally active banks, disclosure requirements are not less stringent than the applicable Basel standards.
Description and findings re EC2	<p>Part Eight of the CRR requires banks to disclose information regarding their risk profile and prudential standards. They are also required to disclose their risk management objectives and policies, their governance arrangements, their risk exposures under different aspects (including ESG risk) and their remuneration policy. These disclosures partially replicate disclosures in financial statements. Related party transactions are disclosed under accounting disclosures and Pillar 3 disclosures (OVA template). The FINREP report on related party transactions reflect the related parties' accounting definition under IAS 24, which is not as comprehensive as the definition under CP 20 but closer to the Basel definition than the much narrower CRD definition used for Pillar 3 disclosure. For example, parties that can exert significant influence on board members or senior management of a bank are considered related parties under CP 20 but not under IAS 24. Similarly, an entity which is a major shareholder of a bank would be considered related party under CP 20 but not under IAS 24 unless (i) the shareholder has significant influence or (ii) the shareholder and the bank belong to the same group. Moreover, all direct and related interests of a natural person (who is itself a related party) are included under CP 20, while IAS 24 only considers the entities controlled, jointly controlled or significantly influenced by an individual meeting the definition of related party, or the entities (or parent entities) in which the individual meeting the definition of related party is a member of the key management personnel. As regards financial disclosures, 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 in the annual reports, either in the financial statements or the management commentaries.</p> <p>The EBA has developed standardized templates and tables to foster consistency and comparability across institutions. These templates and tables are based on the applicable prudential standards in the EU, which may deviate from the Basel standards (see CP 16).</p> <p>Article 431 of the CRR requires that institutions should also have policies in place to verify that their disclosures convey their risk profile comprehensively to market participants. Where institutions find that the disclosures required under CRR do not convey the risk profile comprehensively to market participants, they should publicly disclose information in addition to the information required to be disclosed. CRR Article 432 allows the application of a materiality principle and institutions are allowed to omit one or more of the disclosures where the information provided by those disclosures is not regarded as material. The principles of materiality and confidentiality are further detailed in the EBA Guidelines (EBA/GL/2014/14).</p> <p>Disclosures in the financial statements are more often provided using end-of-period values. As regards Pillar 3 disclosures, changes have been introduced since the 2018 FSAP. According to Article 447 of the CRR, institutions should disclose in relation to their liquidity coverage the average or averages of their liquidity coverage ratio based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period, the average or averages, of total liquid assets, after applying the relevant haircuts based on end-of-the-month observations over the preceding 12 months for each</p>

	quarter of the relevant disclosure period, and the averages of their liquidity outflows, inflows and net liquidity outflows based on end-of-the-month observations over the preceding 12 months for each quarter of the relevant disclosure period. Under the Basel Framework, LCR data should, however, be disclosed as simple averages of daily observations over the previous quarter.
28 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 and accordingly, for Pillar 3 disclosure, the scope of consolidation is the prudential scope of consolidation set out in the CRR. The CRR requires large subsidiaries to disclose some information on an individual basis or a sub-consolidated basis, as applicable.</p> <p>According to the CRR, institutions must disclose an outline of the differences between the accounting and regulatory scopes of consolidation and of the legal entities included within the regulatory scope of consolidation where it differs from the accounting scope of consolidation. The outline of the legal entities included within the regulatory scope of consolidation shall describe the method of regulatory consolidation where it is different from the accounting consolidation method, whether those entities are fully or proportionally consolidated and whether the holdings in those legal entities are deducted from own funds. Institutions should also disclose the circumstances for applying the derogation from the application of prudential requirements on an individual basis and the application of the individual consolidation method. 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 non-controlled institutions as well as unconsolidated structured entities.</p> <p>Disclosures to be provided in the financial statements follow an accounting scope of consolidation.</p>
28 EC4	The supervisor or another authority effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	The Pillar 3 assessment framework follows a risk-based approach based on the proportionality principle. Banks' Pillar 3 disclosures are assessed annually with a thematic focus that is aligned with supervisory priorities. This assessment conducted by JSTs is complemented by ad hoc reviews of further risk areas of concern at the level of supervisory teams or horizontal functions. One example of such reviews is the recent ad hoc review of ESG risk disclosures. The results of the annual reconciliation exercise are published on the ECB Banking Supervision website. The SSM assesses the compliance of banks' climate disclosures with the provisions stemming both from the Pillar 3 disclosures and the ECB Guide on climate-related and environmental risk disclosures.
28 EC5	The supervisor or other relevant authorities regularly publish 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).
Description and findings re EC5	Both the ECB and the EBA disclose banking system statistics. EBA disclosures include all EU banking systems, while ECB disclosures cover the SSM area.

	<p>The ECB, on its web page, discloses quarterly market data which covers aggregate banking statistics for both SIs and LSIs. LSI-related aggregate disclosures started in May 2023. The disclosed information include: general statistics, balance sheet composition and profitability, capital adequacy and leverage, asset quality, funding, liquidity and data quality.</p> <p>The EC has expanded information disclosure over the years. Lastly, in 2022 new indicators on loans and advances subject to impairment review (stages) were added, together with the net stable funding ratio and the non-performing loans ratio, excluding cash balances at central banks and other demand deposits. In 2023, the content of the quarterly aggregate banking statistics was further expanded with new indicators on the net interest margin, an additional breakdown of the net stable funding ratio and a breakdown of debt securities by counterparty. On the dashboard disclosed by the ECB, users can filter and visualize data for aggregate SIs or LSIs, country and business models depending on the choice for selected indicators.</p> <p>Published data are based on data reported under the ITS on Supervisory Reporting supplemented with financial information based on the FINREP framework. The scope of the publication comprises the SIs and LSIs in the SSM-participating member states at their highest level of consolidation. This choice is made in order to avoid double counting when aggregating the data. Moreover, the list of SIs considered in the statistics for each reference period only includes banks reporting FINREP together with COREP at that point in time. Accordingly, the list of banks used for the various reference periods may differ as the list of SIs changes and as banks start to report under FINREP obligations. Usually, the change is restricted to a small number of institutions.</p> <p>In addition to the statistics dashboard, the ECB publishes aggregate statistical data on the supervised entities within the framework of complying with its supervisory disclosure obligations according to Article 143 CRD. Based on the CRD Article, the 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> <p>Part 1: Consolidated data per Competent Authority; Part 2: Data on credit risk; Part 3: Data on market risk; Part 4: Data on operational Risk; Part 5: Data on supervisory measures and administrative penalties; and Part 6: Data on waivers.</p> <p>The publication takes place in July for the data of the preceding calendar year and is updated on an annual basis. The ECB disclosures of information are accessible online: on the banking supervision website at https://www.bankingsupervision.europa.eu/banking/statistics/html/index.en.html and in the</p>
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	<p>ECB Data portal for interactive visualizations and effective data retrieval at https://data.ecb.europa.eu/main-figures/supervisory-banking-data.</p> <p>In addition to the ECB disclosures, the EBA publishes relevant supervisory information for risk analysis. The publications cover risk monitoring tools (indicators, dashboards), the outcome of EU-wide stress tests, and an annual transparency exercise to complement banks' own Pillar 3 disclosures.</p>
Assessment of Principle 28	Compliant
Comments	<p>The EU has introduced a comprehensive disclosure framework to promote transparency, both through qualitative and quantitative disclosure requirements. The quarterly, semi-annual and annual disclosures by SIs allow market participants to assess key information on capital adequacy, risk exposures, risk management processes and financial performance. The EBA and ECB publish a wide range of information and data on the banking system. The ECB is monitoring SIs' actual practice, through both sample testing and thematic reviews.</p> <p>While SIs are required to disclose related party exposures as part of the Pillar 3 disclosures, the definition of related parties is narrower than that of CP 20, which is reflected in the grading of CP 20.</p> <p>Some changes have been introduced in the CRR to require banks to disclose data which is not end of period data. The disclosure requirements for the LCR are, however, not fully aligned with the Pillar 3 Basel standards.</p>
Principle 29	Abuse of financial services. ¹⁰⁰ The supervisor determines that banks have adequate policies and processes, including robust and risk-based ¹⁰¹ customer due diligence (CDD) rules and effective compliance functions to promote high ethical and professional standards in the financial sector and prevent the bank from being used intentionally or unintentionally for criminal activities. ¹⁰²
Essential criteria	
29 EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of compliance with the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	The CRD lays out the requirement from credit institutions to have in place a clear and robust control framework to ensure sound and effective risk management. This is, in turn, an

¹⁰⁰ Reference documents: FATF Recommendations (February 2012, as amended in November 2023); BCBS, Sound management of risks related to money laundering and financing of terrorism, July 2020; FATF, Guidance on risk-based supervision, March 2021; FATF, Guidance on correspondent banking services, October 2016; FATF, Risk-based approach guidance for the banking sector, October 2014; BCBS, Shell banks and booking offices, January 2003

¹⁰¹ Adopting a risk-based approach will enable competent authorities and banks to ensure that measures to prevent or mitigate money laundering and terrorist and proliferation financing are commensurate with the identified risks

¹⁰² The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and terrorist and proliferation financing. Thus, in the context of this principle, "the supervisor" might refer to such other authorities, particularly in essential criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria set out in this principle.

	<p>integral focus of the ECB's supervision in general, though it does not lay any specific focus on criminal activities. In general, according to the SSMFR, when the ECB has reasons to suspect that a criminal offence may have been committed, it should request the relevant NCA to refer the matter to the national criminal authorities.</p> <p>As regards AML/CFT, the SSMR specifically excludes the supervision of AML/CFT from the ambit of the ECB. This responsibility is assigned to the national AML/CFT competent authorities, who are responsible for the supervision of obliged entities' compliance with AML Directive 2015/849. These could either be standalone or integrated with the NCAs responsible for prudential supervision.</p> <p>Given that ML/TF and other criminal activities may have serious prudential implications for banks, the ECB incorporates a 'vigilant approach' and shares information gleaned by it in the course of its prudential supervision with the relevant agencies. The ECB's approach has evolved in recent years. CRD 5 introduced new AML/CFT-related requirements for prudential supervisors regarding authorization and withdrawal procedures and SREP, and the obligation to cooperate with AML/CFT supervisors and Financial Intelligence Units (FIUs) and notify EBA under certain conditions. The EBA SREP Guidelines have incorporated the relevant prudential risk areas impacted by AML/CFT (and other abuses of the financial system) to be assessed by prudential supervisors in relation to business model, internal governance, operational risks, credit risk and liquidity risk. Those Guidelines are implemented by the ECB in its supervisory methodology. Further, the EBA Guidelines on AML/CFT Cooperation have elaborated on the responsibilities of the prudential supervisors, AML/CFT authorities and FIUs to share information necessary for each other's mandated tasks to be carried out. [1]</p> <p>The ECB has also issued a draft guide on Governance and Risk Culture in 2024 (currently under consultation), which further clarifies supervisory expectations on the prudential implications of abuse of financial services (including AML/CFT, tax offences, sanctions violations or other criminal offences).</p> <p>[1] Guidelines on cooperation and information exchange between prudential supervisors, AML/CFT supervisors and financial intelligence units under Directive 2013/36/EU.</p>
29 EC2	<p>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 monitoring, detection and prevention of criminal activity, and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>As part of its supervision, the ECB ensures that banks have set up the relevant policies, processes and controls from a governance perspective addressing all risks they are or might be exposed to, which also includes the prudential implications of criminal activities.</p> <p>In line with the EBA Guidelines on Internal Governance, a bank's management body is responsible for setting, approving and overseeing a corporate culture and values which foster responsible and ethical behavior, including a code of conduct or similar instrument. The assessment of the bank's policies and processes that promote high ethical and professional standards is performed on an ongoing basis. JSTs also assess that the bank's</p>

	<p>control framework is equipped to identify, measure, monitor and mitigate all financial and non-financial risks. This also includes reporting and escalation to the management body in cases of breaches of regulation or major breaches in the bank's risk appetite framework.</p> <p>Several horizontal supervisory assessments have been carried out to assess the adequacy of banks' governance, control and culture in promoting high ethical and professional standards and to prevent the bank from being used intentionally or unintentionally for criminal activities. These include tax fraud schemes, for which the ECB set up a task force to understand the prudential implications of those cases, which led to recommendations being issued to banks. Other assessments have included one on banks' risk culture, which covered the implementation of a code of conduct and one on the mis-selling of loans denominated in Swiss francs in a non-participating Member State.</p> <p>An assessment was also made of banks' control frameworks to adapt to the sanctions in the context of the Russia's war in Ukraine, following which guidance was issued to JSTs to assess the governance and control implications of the evolving sanction situation as part of the SREP. This guidance was also shared with the EBA as input for the recently published EBA Guidelines on restrictive measures, clarifying the role of the prudential supervisor on sanctions.</p> <p>A few deep-dives or on-site inspections have also been performed following a risk-based approach to assess the bank control frameworks to address specific situations where the bank may be exposed to criminal activities, fraud or ML/TF risks.</p> <p>Assessors were shown anonymized reports of the above-mentioned assessments.</p> <p>Finally, as part of the vigilant approach approved by the Supervisory Board, the ECB has developed prudential warning signals pointing out potential ML/TF risks to be reflected in the SREP. They relate to all the relevant prudential risks impacted by AML/CFT matters, e.g. governance and risk management, business model, operational risk, credit risk and liquidity risk.</p>
29 EC3	<p>In addition to reporting to the financial intelligence unit or other designated authorities, banks report suspicious activities and incidents of fraud to the banking supervisor if such activities/incidents are material to the safety, soundness or reputation of the bank.¹⁰³</p>
Description and findings re EC3	<p>Banks are required to file suspicious transaction reports to the FIUs of the member states in which they are established.</p> <p>While there is no legal requirement for SIs to report suspicious activities or incidents of fraud to the prudential supervisor, the ECB expects to be made aware of (material) incidents affecting the banks soundness in the course of ongoing supervision, in which it has regular meetings with board members and key function holders, as well as access to various</p>

¹⁰³ In accordance with international standards, banks are to report suspicious activities involving cases of potential money laundering, terrorist financing and proliferation financing to the relevant national centre, which is established either as an independent governmental authority or as a department within an existing authority or authorities that serves as a financial intelligence unit.

	documents, including minutes of management meetings. The internal SSM Operational Guidance also covers how JSTs should review incidents such as internal fraud, external fraud, transaction fraud and conduct risk. The assessors saw anonymized examples where the bank had, of its own volition, immediately communicated to the JST such incidents.
29 EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authorities of such transactions. In addition, the supervisor directly or indirectly shares information related to suspected or actual criminal activities with relevant authorities, in a timely manner.
Description and findings re EC4	<p>Information sharing between the prudential supervisors, AML/CFT supervisors and the FIUs is governed by the EBA guidelines on AML/CFT cooperation between them. These guidelines lay out the circumstances and situations in which such information sharing must take place. They require prudential supervisors to request from AML/CFT authorities information relevant to the SREP process, which also includes emerging ML/TF risks and potential and actual breaches of AML/CFT laws and to report to the AML/CFT authorities information relevant to inherent and sectoral ML/TF risks; the relevant outcome of the SREP process; and information on breaches and sanctions, among others. Where the ECB becomes aware of potential suspected illegal activities, for example, during an onsite inspection or offsite supervisory activities or via a breach report from a whistleblower reporting alleged fraud schemes, the information is shared with the relevant AML/CFT supervisor who is asked to onward share the information with relevant authorities. The CRD and the Guidelines also envisage prudential supervisors sharing information with the FIU, relevant to their respective tasks. The FIU and the ECB have set-up common folders to facilitate this exchange, although this channel does not reflect frequent receipt of information from the FIUs.</p> <p>Moreover, according to the SSMFR, when the ECB has reasons to suspect that a criminal offence may have been committed, it should request the relevant NCA to refer the matter to the national criminal authorities. The ECB has in place a process under which such requests to NCA are made initially at a technical level in a timely manner and subsequently in a formal manner by letter approved by the Chair or Vice-Chair of the Supervisory Board. The assessors saw anonymized examples of such letters.</p>
29 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 include appropriate steps to identify, assess, monitor, manage and mitigate the risks of money laundering, terrorist financing and proliferation financing with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management programme, 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 (or will be terminated) based on identified risks; (b) an ongoing customer identification, verification and due diligence programme, which encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that CDD information is updated and relevant;

	<p>(c) policies and processes to monitor transactions on an ongoing basis and identify unusual or potentially suspicious transactions as well as those individuals or entities subject to the United Nations sanctions related to terrorism and proliferation financing;</p> <p>(d) enhanced due diligence on high-risk accounts (e.g. escalation to the bank's senior management of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);</p> <p>(e) enhanced due diligence on politically exposed persons (including their family members and close associates) encompassing, among other things, escalation to the bank's senior management of decisions on entering into business relationships with these persons; and</p> <p>(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.</p>
Description and findings re EC5	<p>The ECB does not review the implementation of the CDD policies of the supervised entities from an AML perspective nor does it determine that banks are undertaking the enhanced diligence of the high-risk accounts, politically exposed persons, etc., on an ongoing basis. These tasks are expected to be covered by the national AML/CFT competent authorities.</p> <p>However, in the course of its assessment of the robustness of the bank's internal control framework as part of the SREP on (i) governance and risk management and (ii) operational risk, the ECB may come across deficiencies in the implementation of CDD policies and processes. In such a case, as evidenced in the material reviewed by the assessors, it does follow up on the prudential implications and informs the AML/CFT competent authorities. JSTs are guided by the SREP Manual on operational risks (Module on 'Conduct/Client, Product and Business Practices Risk, Internal Fraud Risk') and their assessment could involve a review of policies and processes on topics such as boarding/account opening, off-boarding/account closing, account/product management, client permissions/disclaimers missing, unapproved access given to accounts, and incorrect client records.</p>
29 EC6	<p>The supervisor determines that banks have specific policies and processes regarding correspondent banking and other similar relationships, in addition to normal due diligence. Such policies and processes include:</p> <p>(a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, their reputation, how they are supervised and whether they have been subject to money laundering, terrorism financing or proliferation financing investigations or regulatory actions;</p> <p>(b) prohibitions on establishing or continuing correspondent banking relationships with those banks that do not have adequate controls to manage the risk of criminal activities, that are not effectively supervised by the relevant authorities, or that are considered to be shell banks; and</p> <p>(c) senior management approval for entering into new correspondent banking relationships.</p>

Description and findings re EC6	<p>The ECB does not assess correspondent banking activities from an AML/CFT perspective. However, it may do so from a prudential perspective, especially where such activities may hamper its compliance with a prudential requirement.</p> <p>The core principle, however, requires prudential supervisors to play a more active role in determining that banks have policies and processes to ensure that the correspondents are effectively supervised by the relevant authorities and are not shell banks and that senior management approval is obtained for opening new correspondent accounts. The ECB could integrate these aspects in their prudential supervision to complement the role already envisaged in the EBA Guidelines on SREP for competent authorities in their ongoing supervision in the context of credit risk, reputation risk and liquidity risk.</p>
29 EC7	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering, terrorism financing and proliferation financing.
Description and findings re EC7	<p>The ECB does not assess the effectiveness of the AML/CFT controls regarding ML/TF and proliferation financing, which lies in the remit of the national AML/CFT competent authorities. From a prudential perspective, ECB supervision aims to ensure that banks have a robust governance and internal control framework consistent with the EBA guidelines on Governance, as detailed in CP 14. However, under the EBA guidelines on AML/CFT cooperation, it is expected to request information from the AML/CFT authorities related to material weaknesses in the supervised institution's AML/CFT governance, systems and controls framework as relevant to the SREP process. If it does receive any information from AML authorities or other sources (including its prudential warning signals), then the JST is expected to make a critical assessment of prudential concerns and reflect them in the relevant SREP elements, including Internal Governance and Risk Management. Depending on the severity of the concern, the prudential response could vary from downgrading the score to remedial measures</p>
29 EC8	The supervisor has adequate powers to take action against a bank that does not comply with relevant laws and regulations regarding criminal activities.
Description and findings re EC8	<p>The ECB does not have any competence or powers to address criminal activities, and the SSMFR lays out its role in this regard <i>"where, in carrying out its tasks under the SSM Regulation, the ECB has reason to suspect that a criminal offence may have been committed, it shall request the relevant NCA to refer the matter to the appropriate authorities for investigation and possible criminal prosecution, in accordance with national law."</i></p> <p>However, in keeping with its prudential mandate, it can and does use the supervisory powers accorded to it by the SSMR to address the deficiencies in risk management or breaches in regulatory requirements in the SIs that may have led to, or arise from, the abuse of financial services including ML/TF. If a bank does not comply with AML/CFT relevant laws and serious breaches have been established by the AML/CFT supervisor, the ECB can withdraw the authorization of the bank in line with Article 18(f) CRD, if this measure is assessed as proportionate by the ECB. The EBA Guidelines on AML/CFT Cooperation lay out that the information shared by the AML/CFT Competent authorities on measures and sanctions should be such that it allows for prudential implications to be determined by the prudential supervisors. Accordingly, for instance, supervisory measures have been issued to require banks to strengthen their control framework and risk culture regarding compliance and</p>

	fraud risks and implement de-risking strategies regarding risky businesses or exposure to risky entities. There have also been a few cases of reassessment of board members and a license withdrawal triggered by deficiencies in AML/CFT matters.
29 EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) effective policies and processes to designate a compliance officer at the bank's management level to manage the financial crimes compliance programme, and a dedicated officer to whom potential abuses of the bank's financial services (including suspicious transactions) are reported; (c) a compliance function with adequate powers, reporting independence, staff and other resources; (d) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff or when entering into an agency or outsourcing relationship; (e) ongoing training programmes for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities; and (f) policies and processes to report criminal activities by staff to competent authorities.
Description and findings re EC9	<p>a. In line with the EBA's guidelines on internal governance, the ECB expects banks to have a robust and fully independent internal audit function in place. The internal audit function must be responsible for drawing up, implementing and monitoring the bank's audit cycle and audit plan. It should follow up on any relevant audit findings and escalate these to the management body in its supervisory function where needed. Internal audit, along with risk management, compliance and risk culture are assessed during the SREP. Internal audit reports are reviewed as part of ongoing supervision. An annual governance data collection exercise is used by JSTs as one input in their assessment, which covers mainly information on:</p> <ul style="list-style-type: none"> - Reporting lines and independence of the bank's control functions - Staffing of the internal control functions <p>Over the past years, the ECB has performed several on-site inspections, deep dives and horizontal analysis of banks' internal audit functions. In particular, in 2022, a horizontal benchmarking of the internal audit function in SIs looked into their resources, methodologies, effectiveness, governance and organization. Its findings have been incorporated into the draft ECB Guide on Governance and Risk Culture. However, the banks' practices and their supervision do not focus on AML/CFT but on internal and external audits in general.</p> <p>b & c. The expectations from the compliance function are laid out in the EBA Guidelines on Internal Governance. Institutions should establish a permanent and effective compliance function to manage compliance risk and should appoint a person to be responsible for this function across the entire institution. Proportionality allows the function to be combined</p>

	<p>with the head of the Risk Management Function or another senior person, provided there is no conflict of interest between the functions combined. The compliance function and its head should be independent of the business lines and internal units it controls and have sufficient authority, stature and resources. Staff within the compliance function should have sufficient knowledge, skills and experience in compliance and relevant procedures, and access to regular training. The management body, in performing its supervisory function, should oversee the implementation of a well-documented compliance policy, which should be communicated to all staff. Institutions should set up a process to regularly assess changes in the laws and regulations applicable to their activities.</p> <p>The Guidelines do not stipulate a separate function or officer for financial crimes, though national laws may provide for one. In any case, compliance is expected to take appropriate action against internal or external behavior that could facilitate or enable fraud, ML/TF or other financial crimes and breaches of discipline. A prudential warning signal that the JSTs are meant to take into account in their ongoing supervision is whether the compliance function and/or the equivalent function in charge of AML/CFT compliance has significant deficiencies in covering ML/TF risk, including the absence of a charter to cover such risks.</p> <p>The annual governance data collection includes some questions on the governance and staffing of the AML/CFT and compliance function, which are shared with the JSTs to support the SREP assessment. A horizontal analysis of the compliance function was also undertaken to assess the reporting lines, operations, staffing and tooling. The identified concerns and deficiencies were followed up with banks.</p> <p>d. There are no explicit expectations regarding screening processes to be implemented when hiring staff, which is a Financial Action Task Force (FATF) Recommendation, but the EBA Guidelines on Outsourcing Arrangements do stipulate the due diligence to be undertaken before entering into such agreements. Institutions should ensure that the service provider has the business reputation, appropriate and sufficient abilities, expertise, capacity, resources, organizational structure and, if applicable, the required regulatory authorization(s) or registration(s) to perform the critical or important function in a reliable and professional manner. Further, it should act in a manner consistent with their values and code of conduct and act in an ethical and socially responsible manner.</p> <p>e. The EBA Guidelines on Internal Governance require institutions to develop a risk culture and ensure staff awareness of the code of conduct through staff training. Staff in internal audit, compliance and risk management are expected to receive regular training. Further, JSTs should review how the supervised entity pays attention to preconditions to prevent internal fraud. Factors to be considered include the risk culture, adequate employee management and supervision, employing sufficient experienced personnel, the prevention of overstretching personnel, adequate training (including ethical training), carrying out background verifications before onboarding new employees, job rotation, and adequate remuneration.</p> <p>f. The CRD (Article 71) enshrines the “appropriate protection for employees of institutions who report breaches committed within the institution against retaliation, discrimination or</p>
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	other types of unfair treatment at a minimum”, and the EBA Guidelines expect banks to have in place an alert mechanism or whistleblowing system for all staff to report incidents and breaches. The SSM Supervisory Manual requests JSTs to assess whether the supervised entity has a dedicated internal fraud investigation function and a whistleblowing mechanism.
29 EC10	The supervisor determines that banks have and follow clear policies and processes for staff to report any issues related to the abuse of the banks’ financial services to local management and/or the relevant dedicated officer. The supervisor also determines that banks have and utilise adequate management information systems to provide the banks’ boards, management and dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	<p>Although not focused exclusively on reporting financial abuse, as stated in EC9, the ECB expects banks to have in place an alert mechanism or whistleblowing system for all staff to report incidents and breaches in terms of the CRD and the EBA Guidelines on Internal Governance. The draft ECB Guide on Governance and Risk Culture further links the whistleblowing mechanism to the soundness of a bank’s risk culture.</p> <p>The SSM Supervisory Manual requests JSTs to assess banks’ compliance with obligations on whistleblowing systems in place. This includes the relevant policies and procedures, the whistleblowing channels in place, their use in practice, and management’s involvement. A stock take conducted in 2019 found that all banks have some speak-up mechanisms in place, which vary in terms of degree of formalization and usage and are sometimes completed by other ‘speaking-up’ tools.</p> <p>In case the ECB has come across examples of whistleblowing cases that may point to ML/TF risks, it has shared the relevant information with the competent AML/CFT authority.</p> <p>Again, while not focused exclusively on risks arising from criminal activities, ECB supervision has been covering the adequacy of MIS as part of the SSM supervisory priority on RDARR capabilities. It has published a guide on effective data aggregation and reporting, which describes the practices which are necessary from the perspective of RDARR to ensure effective processes are in place to identify, manage, monitor, and report the financial and non-financial risks banks are or might be exposed to which also allows managers to be informed and react on a timely basis.</p>
29 EC11	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.
Description and findings re EC11	<p>The CRD (Article 71) calls for appropriate protection for employees of institutions who report breaches (see also EC 9 and EC10). “member states shall ensure that competent authorities establish effective and reliable mechanisms to encourage reporting of potential or actual breaches” and that the mechanisms should include “appropriate protection for employees of institutions who report breaches committed within the institution against retaliation, discrimination or other types of unfair treatment at a minimum.”</p> <p>In keeping with EBA Guidelines on Internal Governance, JSTs are required to assess whether institutions have in place appropriate procedures for their employees to report breaches through a specific, independent, and autonomous channel and “<i>whether there are (i) appropriate whistleblowing procedures in place which can be used by employees without any</i></p>

	<p><i>reprisal, (ii) rules on the treatment of whistle-blowers clearly articulated and followed in practice."</i></p> <p>In addition, the ECB has developed its own breach reporting (i.e. "whistleblowing") mechanism that allows anyone who, in good faith, has reason to suspect that a breach of relevant EU law has been committed by a supervised entity or a competent authority to report it to the ECB. The report is treated as a protected report, and the identity of a person who has submitted a protected report is not revealed without first obtaining the person's explicit consent unless its disclosure is required by a court order in the context of further investigations or subsequent judicial proceedings.</p> <p>Further, in order to comply with their legal obligations, the ECB and the other NCAs have established a "whistleblowing mechanism" within the SSM, where all the information contained in the reports is treated in line with the confidentiality regime. This mechanism also includes a platform which provides a safe harbor for whistleblowers who can alert the ECB to potential breaches without the need to reveal their identities. The assessors saw an anonymized complaint received from a whistleblower against a bank's issuance of credit cards in fictitious names which was shared with relevant agencies and also followed up by the ECB.</p>
29 EC12	<p>The supervisor, directly or indirectly, cooperates with relevant domestic and foreign financial sector authorities or exchanges information with them regarding suspected or actual criminal activities present in banks, where this information is for supervisory purposes.</p>
Description and findings re EC12	<p>The ECB exchanges information on a regular basis with national AML/CFT competent authorities in the EEA. This structured exchange is based on the multilateral agreement signed between the ECB and the respective AML/CFT authorities (the AML Agreement), which now has 51 signatories and has led to a significant improvement in information sharing. In addition, the ECB currently participates as an active observer in 64 AML/CFT Colleges, which allows JSTs to share and receive information within the College. Further, supervisory colleges also allow for engagement with AML/CFT representatives as the lead AML/CFT supervisor and other host AML/CFT supervisors may also be invited by the consolidating supervisor to attend these colleges.</p> <p>The ECB and the AML/CFT competent authorities exchange information that is relevant for the completion of their respective tasks either on their own initiative or upon request. The information shared by AML/CFT competent authorities, on an annual basis, concerns, in particular, the ML/TF risk assessment performed by AML/CFT competent authorities, information related to AML/CFT sanctions and information related to subsidiaries that are perceived as high-risk from a ML/TF perspective. The ECB inter alia shares, on an annual basis, relevant excerpts of SREP decisions, and ad-hoc on-site inspection reports, authorization & fit and proper decisions and breach reports. The assessors viewed some of these exchanges. The revised SSM Operational Guidance 3 Annex on AML/CFT in On-Site Inspections approved by the SSM Supervisory Board in August 2024 includes provision for the organization of joint meetings between AML Supervisors and on-site inspections when simultaneously on-site, but these have not taken place at the time of the assessment. The ECB also contributes to the EU's Central Database (EuReCA) for material CFT and AML weaknesses (i.e. breaches, potential breaches and ineffective applications), including related</p>

	<p>measures. The ECB has made 48 submissions related to 14 entities and is one of main contributors among prudential supervisors.</p> <p>The ECB also contributes to policy discussions on governance and AML/CFT via its participation in the work performed at the EBA and is part of the EBA subgroups dealing with the EBA Guidelines on governance and risk management (including fit and proper aspects). It is also an observer at the EBA AML/CFT Standing Committee (AMLSC), which publishes an annual opinion on the level of ML/TF risks in which the ECB provides its input as a prudential supervisor.</p> <p>The EBA Guidelines on AML/CFT Cooperation also ask that AML/CFT and prudential supervisors consider undertaking coordinated work, including mutual participation in thematic reviews, as well as on-site and off-site inspections. However, assessors have not come across any such instances.</p> <p>The coordination across multiple agencies is expected to be streamlined with the establishment of the new AML Authority (AMLA). The ECB and AMLA are working on a MOU that will set out the practical modalities for cooperation and for exchanging information for the performance of their respective tasks under Union law.</p>
29 EC13	<p>Unless another authority is responsible, the supervisor has in-house resources with specialist expertise for addressing criminal activities detected in banks. In this case, the supervisor regularly provides information on the risks of money laundering, terrorism financing and proliferation financing to the banks.</p>
Description and findings re EC13	<p>AML/CFT competence lies with national AML/CFT competent authorities and hence this expertise lies with them. Still, the ECB has the needed expertise on governance, controls, and compliance, which underpins its part of the work related to criminal abuse of the financial system. In addition, NCAs also include many experts on governance and risk management and also may include experts on AML/CFT matters for integrated authorities.</p> <p>The ECB has established the AML Coordination Office (AMLCO), which serves as the center of expertise on AML/CFT-related issues within the SSM. An important task of AMLCO is the coordination of the SSM AML/CFT NCA Network. The Network, consisting of experts from all NCAs and ECB, supports a consistent SSM-wide approach in integrating ML/TF risk in prudential supervision, promotes information exchange and cooperation among the relevant ECB business areas and NCAs, and facilitates the participation and contribution of NCAs in the relevant projects and initiatives. It provides support to the JSTs, including conducting training and workshops, <u>d</u>eveloping benchmarks and peer comparisons for Compliance and AML/CFT, undertaking <u>t</u>hematic analysis on prudential root causes, and contributing to assessment methodology, tools and related supervisory policies.</p> <p>The ECB engages in a regular dialogue with the industry on governance, risk culture and compliance matters and holds periodic conferences on these topics. Prudential implications of AML/CFT and other non-financial risks may be discussed in the bilateral discussions with bank board members and key function holders by the JSTs. Expectations on governance and risk culture have been communicated via the draft guide, and published FAQs have been used to convey expectations in the context of sanctions following the Russian war against</p>

	Ukraine. The public has also been kept informed of the work on prudential matters related to AML/CFT and criminal abuse of the financial system through reports, speeches and blogs.
29 EC14	The supervisor determines that banks have in place group-wide programmes to address money laundering, terrorist financing and proliferation financing, including policies and procedures for sharing information within the group for these purposes.
Description and findings re EC14	<p>Assessing the existence of programs to address money laundering, terrorist financing, and proliferation financing is within the purview of the AML/CFT competent authorities and not the ECB. The requirement for institutions to have in place policies, controls and procedures to mitigate and manage effectively the risks of ML/TF is set out in the AML Directive (EU) 2015/849.</p> <p>The ECB, for its part, assesses compliance and controls in general as part of the SREP Element governance and risk management, particularly Module 1 on 'organizational structure' where the JST analysis focuses on the "coordination between parent group and other entities and reporting lines and the proper implementation of policies". The effective implementation of compliance policies and processes across the group is also assessed as part of the module on the compliance function. This also follows from the EBA Guidelines on Governance and the ECB draft guide on Governance and Risk Culture, which expects banks to have in place a central risk management function that facilitates a group-wide holistic view across financial and non-financial risks.</p> <p>A few on-site inspections and JST deep-dives have focused on this topic (especially in relation to the oversight by the parent company of smaller local entities where the potential risk of abuses of financial services is higher). In 2022, a stocktake on the central steering of cooperatives in the SSM was undertaken, looking at the steering powers of the central body and integration of the control functions; however there were no findings from this with relevance for AML/CFT.</p>
Assessment of Principle 29	Largely Compliant
Comments	<p>Many requirements of this CP do not apply in full to the ECB as it has no mandate to undertake AML/CFT Supervision, which responsibility lies with national AML/CFT competent authorities. Ergo, it exercises great caution in ensuring that it is not viewed as encroaching on the territory of AML/CFT Supervisors. However, the EU framework has increasingly envisaged an enhanced role for prudential supervisors in cooperation and information exchange with AML/CFT authorities and addressing prudential implications of ML/TF risk, and the ECB, too, has been strengthening its toolkit in supervising the prudential implications of ML/TF. In keeping with its prudential mandate, it has been developing its supervisory expectations and practices via a 'vigilant approach' to ensure that it covers them appropriately in its ongoing supervision. Accordingly, it has implemented the relevant EBA Guidelines and also developed its own guidance for supervisory assessment of ML/TF risks in SREP, including prudential warning signals, which incorporate its experience from horizontal assessments.</p> <p>ECB supervision also covers risks emanating from other types of criminal abuse of the financial system, including internal, external and transactional fraud, and covers these in the</p>

context of its supervision of internal controls as well as operational risks. However, there is no requirement for banks to report suspicious activities and incidents of fraud to the banking supervisor if such activities/incidents are material to the safety, soundness or reputation of the bank, and the ECB has to rely on the effectiveness of its ongoing supervision to become aware of such incidents. It would help to lay out supervisory expectations in this regard. Also, while the AML/CFT authorities are responsible for the supervision of correspondent banking accounts from the AML/CFT perspective, the ECB should also play a greater role in monitoring the policies and processes for the selection, access to, and conduct of these accounts from the perspective of reputation and operational risk.

The cooperation and information exchange between ECB and AML/CFT authorities has improved since the signing of the multilateral exchange agreement between them, and it regularly shares information with them when it comes across ML/TF-related issues in its supervision. Many tools are employed for this information and experience sharing including AML/CFT Agreements, AML/CFT Colleges and the EuReCA database. The multiple actors and forums increase the complexity of the prudential – AML/CFT interaction, and the new AML/CFT authority (AMLA) is expected to ensure more effective cooperation and information exchange between all relevant AML/CFT authorities and the relevant non-AML/CFT financial supervisory authorities. The ECB has also noted continuing heterogeneity in the inputs received from the different AML authorities in the member states, who also use different methodologies for assessing and scoring the associated risks. The reporting also varies in regularity and intensity. AMLA could help in enhancing the harmonization of ML/TF risk assessments and other AML/CFT supervisory tasks performed by these authorities. However, given that the direct supervision of AMLA will be limited to a few entities, some complexity in the system will remain. The ECB has advocated for the future AMLA database to be a central data hub designed to facilitate the sharing of information among all the authorities involved, including prudential supervisors, while minimizing the reporting burden of the existing unintegrated multiple channels. This view is shared by the assessors. There are also issues of potential overlap that need to be ironed out. In line with AMLA Regulation the new AML authority has the ability to propose to the authority that granted the authorization to withdraw or suspend the authorization of an AMLA supervised institution. However, at national level AML/CFT supervisors for institutions under their direct supervision can withdraw/ suspend the authorization under Article 56 (2)(f) of the AMLD VI, while the ultimate authority for all credit institutions should remain with the prudential supervisor even though the decision may be driven by reported ML/TF deficiencies. Devising a cooperative process that takes into account the views of the AML/CFT authorities in the decision of the ECB to withdraw the license will help address the potential overlap

Overall, in a relatively short period of time the ECB has developed a sound supervisory approach to incorporating the prudential implications of information on AML/CFT deficiencies received by it in its own supervision. Given the heterogeneity in the information in periodicity and intensity received by it is encouraged to take a more proactive approach and incorporate these more systematically into its own supervisory work program including by deep dives and joint work with AML authorities.

SUMMARY OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	The ECB has a broad set of powers derived from Union law and the national laws of the NCAs, supplemented by the technical standards and guidelines of the ESAs and its own supervisory guidance and expectations. Still, the ECB has to contend with an inconsistent suite of powers which are not harmonized in all respects across the member states on account of the differences in transposition of Union directives. The 2018 FSAP had also pointed to some gaps in these powers vis-à-vis international standards. Several of these will be addressed by recent EU legislative initiatives which remained to be transposed and implemented in national legislative frameworks at the time of the BCP assessment.
2. Independence, accountability, resourcing and legal protection for supervisors	LC	The governance arrangements of the SSM help to insulate against industry and government interference and will be further strengthened by the legislative changes which impose term limits on the heads of agencies in member states. The connection with an independent central bank further strengthens this independence but has implications for the budgetary autonomy demanded by the BCP. The access to staff from NCAs for a large part of the work is an added advantage but the inability of the NCAs to meet their staffing commitments can affect

Core Principle	Grade	Comments
		the planned deployment of supervisory resources.
3. Cooperation and collaboration	C	The ECB has been growing an extensive network of cooperation and information sharing arrangements with both European and foreign supervisory authorities that works well.
4. Permissible activities	C	Following up on the recommendations from the 2018 FSAP, investment firms have now been brought into the supervisory ambit of the ECB. CRD 6 has also introduced a more harmonized regime for the prudential regulation of Third Country Branches as well as several safeguards, but their supervision remains with the NCAs who retain the discretion to require large branches to subsidiarize. There still could be situations in which such branches are comparable to SIs but are not supervised by the ECB. The entry of new actors and bank-like products offers an opportunity to harmonize banking-related definitions and powers.
5. Licensing criteria	LC	<p>The licensing criteria are clearly articulated in EU legal framework and supervisory guidance for licensing is well developed. The ECB and NCAs cooperate effectively in the licensing process.</p> <p>There is no requirement in the EU framework that the host supervisor obtains a non-objection from the home supervisor. In some cases, the ECB faces challenges in assessing whether the third country authority applies global consolidated supervision.</p>

Core Principle	Grade	Comments
		<p>The ECB does not have authority to authorize and supervise euro area branches of non-EU or EEA banks. These branches are currently regulated by national laws and regulations and supervised directly by local NCAs. CRD 6 harmonizes the regulation and improves supervision of third-country branches on several key areas. In the case of third country branches with systemic importance, the process under CRD 6 to require the establishment of subsidiaries (which would then fall into the SSM's remit) is led by NCAs, without any possibility for the ECB to influence the outcome. Regulatory and supervisory arbitrage opportunities for non-EU banks may remain.</p>
6. Transfer of significant ownership	LC	<p>The SSM has a rigorous process to assess transfer of qualifying holdings.</p> <p>EU legislation does not require the notification of supervisors of any material information that may negatively affect the suitability of a major shareholder or a party that has a controlling interest.</p> <p>The requirement for annually informing the competent authority about shareholders and qualifying holdings is limited to institutions traded on a regulated market and does not cover all institutions.</p> <p>EU legislation does not require reversal or modification of transfers when it takes place without necessary notification to, or approval from the supervisor, or where the approval of</p>

Core Principle	Grade	Comments
		the change in ownership was based on false information.
7. Major acquisitions	MNC	CRD 6 has introduced a harmonized regime for the prudential regulation of the acquisition of material holdings by a credit institution in other financial and non-financial institutions, addressing a key recommendation from the earlier FSAP. However, until CRD 6 is transposed into national legislative frameworks by January 2026, the assessment of the acquisition of a material holding can only be conducted if a specific power exists under national law, which is not the case in all member states. Moreover, provisions in existing national legislations are not as comprehensive as the requirements under this CP.
8. Supervisory approach	LC	The SSM applies a highly intensive supervisory approach and has not strayed far from delivering against the mandate it was given at its creation to raise the quality of supervision across the Eurozone and to level the playing field. The cost of the existing supervisory approach is that it is resource-intensive and can be burdensome and challenging to be agile. The stickiness of the SREP scores (over time) and limited differentiation (amongst institutions) were noted.
9. Supervisory techniques and tools	C	The SSM is a highly sophisticated regulator with a comprehensive and fully articulated supervisory approach, supported by excellent risk analysis, and a strong skill set in all aspects of supervision. SREP letters are often lengthy and very legalistic. The assessors also received feedback that

Core Principle	Grade	Comments
		Pillar 2 requirements and what banks needed to do to reduce them were not always clear. The comprehensive and intensive supervisory approach also generates a large number of findings and, consequently, a challenge to follow up and ensure effective remediation. New priorities may reduce the focus on other areas of supervision in an environment of budget stabilization.
10. Supervisory reporting	LC	The EU has a well-developed common supervisory reporting system which ensures maximum harmonization. The process to revise and enhance the common reporting at the EU level is lengthy. While the ECB has the power to collect ad-hoc data as needed for supervisory purposes, this approach faces some limitations, including less standardization which may lead to a generally lower quality. FINREP data collection on transactions with related parties is not sufficiently granular and the scope is too restricted.
11. Corrective and sanctioning powers of supervisors	LC	The framework is asymmetrical, resulting in potentially inconsistent supervisory approaches to sanctions in the SSM. There continue to be limitations in the corrective and sanctioning powers available to the ECB in Union law and powers available in national laws to take corrective actions for certain situations are not fully harmonized as member states may go beyond the minimum level of harmonization set by CRD. CRD 6 will enhance the enforcement powers of the competent authorities and reduce though not eliminate the asymmetry to

Core Principle	Grade	Comments
		the legal framework. Notwithstanding these shortcomings, the ECB has made a big effort to streamline the enforcement and sanctions processes for taking corrective and enforcement actions and imposing penalties. An escalation framework has been introduced to expedite the internal processes and decision making and to facilitate the full and timely use of its tools by supervisors. This is gradually being internalized and is poised to have a positive impact on timely redress.
12. Consolidated supervision	LC	The ECB undertakes intensive supervision on both standalone and consolidated basis. The EU legislation does not provide an adequate framework for the supervision of mixed activity groups. Competent authorities lack an appropriate mandate for group-wide and cross-border activities in the case of mixed-activity groups. In the case of ownership in banks by corporates, no authority exists to conduct fit and proper reviews on an ongoing basis of senior management of such corporate parents.
13. Home-host relationships	C	The ECB participates effectively in different types of groupings and colleges as home and host supervisor and has formal and informal cooperation and information sharing arrangements that help facilitate its supervisory tasks. The agenda of college meetings and industry feedback suggest that the colleges are working well though the opportunity to undertake joint work remains untapped and receiving data and information

Core Principle	Grade	Comments
		from some peer jurisdictions under the MoUs remains work in progress. Although there is still no explicit legal authority to prohibit shell banks as mentioned in 2018, CRD 6 introduces provisions that will limit the use of third country branches as booking offices. There is however no information that could confirm whether all legacy shell banks had discontinued their operations.
14. Corporate governance	C	The ECB has significantly strengthened its supervision of corporate governance of banks. It continues to feature in the top supervisory priorities of the SSM and more guidance has been issued for both banks and for supervisors on what is expected. Supervision is both comprehensive and intrusive, going into depth and great detail. It is also a major element of the formal sanctioning proceedings and the penalties imposed. While the fit and proper process has been delegated, it still absorbs a lot of supervisory resources and the lack of EU harmonization still remains an issue as governance practices, supervisory responsibilities, and powers available in national laws vary across member states. CRD 6 will help in this regard, including by bringing key function holders into the scope of supervisory assessments of suitability, and strengthening the primary responsibility of banks in appointing suitable candidates,
15. Risk management process	C	The SSM provides substantial coverage of risk management based on CRD/CRR and additional EBA

Core Principle	Grade	Comments
		guidelines. The SSM has been very active in publishing its own guides to supplement the Level 1 and 3 framework and conducts an intensive approach. The SSM has made significant progress in assessing risks that could materialize over longer time horizons (including risks related to digitalization, climate-related financial risks and emerging risks). Both climate and digitalization are SSM priorities and have been the subject of targeted reviews and enhanced supervision.
16. Capital adequacy	MNC	<p>Deviations with international standards persist from past RCAP reviews and new ones are introduced in CRR 3. The impact of the EU specific adjustments on capital requirements is material.</p> <p>The ECB is facing resourcing constraints in internal model validation.</p> <p>The CRR allows banks, subject to supervisory approval, to apply IRB to sovereign exposures while continue using in the same exposure class the standardized approach for sovereign exposures towards EU member states; this possibility may facilitate cherry picking.</p> <p>There is no harmonized EU methodology for the calibration of O-SII buffers, which may result in unwarranted heterogeneity across the euro area. The use of the ECB's top-up powers is not a substitute for a harmonized calibration methodology</p>
17. Credit risk	LC	CRD, CRR and EBA Guidelines provide a good base for banks' credit risk management requirements, but not all

Core Principle	Grade	Comments
		those envisaged by this CP. Since the last assessment there have been some improvements to the supervision of credit risk. The introduction of loan-by-loan information on banks' credit exposures to all legal entities (including SMEs) in the euro area (AnaCredit database) has been a major improvement. The security-by-security database (Security Holding Statistics) provides a comprehensive picture of all legal entities' indebtedness in the euro area. These data can lend themselves to beneficial and powerful uses for supervisory purposes, such as monitoring banks' progress in reducing NPLs and granting loan forbearance and the availability of early warning signals on the indebtedness of specific borrowers and groups of connected borrowers.
18. Problem assets, provisions, and reserves	LC	Supervision continues to progress in the area of NPLs, resulting in a much-reduced level of NPLs in banks. While the policy framework has also improved, much remains soft law. The ability to use P2R provides a fallback option to ensure appropriate prudential treatment of problem loans (albeit where provisions are inadequate for NPLs based on a uniform provisioning calendar) and further supports supervisors' efforts to use moral suasion on classification and provisioning levels.
19. Concentration risk and large exposure limits	LC	The large exposures framework of EU is largely compliant with the Basel Framework. While the various forms of concentration risks (e.g., credit concentration, market concentration, funding concentration, etc.) are

Core Principle	Grade	Comments
		<p>addressed in the EBA SREP Guidelines, there is no supervisory guidance providing detailed expectations on the management of all forms of concentration risks. There is no requirement or supervisory guidance that specifying that all material concentrations be regularly reviewed and reported to the bank's supervisory board.</p> <p>The ECB does not consider in a systematic fashion sovereign risk concentrations when setting Pillar 2 requirements.</p>
20. Transactions with related parties	MNC	<p>As pointed out in 2018, the EU framework for related party transactions is neither comprehensive nor consistent. The definitions employed are not aligned with the Basel standard and there are no limits or thresholds triggering supervisory notification or approval prescribed in EU law or harmonized across member states. There has also not been any horizontal or thematic review so far that could help develop benchmarks for materiality or for supervisory expectations to be more formalized.</p>
21. Country and transfer risks	LC	<p>Although there is no harmonized framework for country risk at the EU level, there have been several developments in developing the SREP supervisory methodology and tools for assessment of these risks which go a long way in serving the intent of this principle. The EBA SREP Guidelines now address these risks in a more harmonized way and include these risks under the credit risk as a sub-category.</p>

Core Principle	Grade	Comments
		No supervisory expectations for the industry have been issued. Evidence was not provided that the applicable SSM supervisory guidance on oversight of provisions against country risk and transfer risk is implemented.
22. Market risk	C	There is a fully articulated and distinct framework within the EU for Market Risk. Given the business models of SIs, market risk is inevitably the smaller of the three principal risk types (the others being credit and operational), but since the UK's departure from the EU, the risk is growing.
23. Interest rate risk in the banking book	C	There is a fully articulated and distinct framework within the EU for IRRBB. Given the business models of the SSM banks, IRRBB can be significant, and it does receive appropriate attention from the supervisors – assisted by the fact that it has been a priority since 2022. The EU framework has been able to keep pace with developments in international standards thanks to updates in the EBA Guidelines but also sensible use of stress tests.
24. Liquidity risk	LC	The SSM delivers a thorough assessment and mitigation of liquidity risk and has progressed substantially from the position found in the 2018 report. The SSM responded well to the 2023 liquidity problems in some banks – including a sensible and well managed move to weekly reporting. However, gaps remain with international standards.
25. Operational risk	LC	The SSM has made substantial progress in the field of operational risk and resilience since the last BCP

Core Principle	Grade	Comments
		Assessment. The prioritization of Cyber and Operational Resilience has certainly provided an appropriate focus on this important risk. This has been supported by significant legislative change. DORA in particular has provided a robust framework for supervisors with a ground-breaking approach. There remain substantial implementation challenges – not least resourcing to satisfy a piece of legislation that is very demanding on supervisors.
26. Internal control and audit	C	The EU framework provides a comprehensive approach to internal control and audit. There is a strong emphasis and attention on internal control, compliance and audit throughout supervisory processes.
27. Financial reporting and external audit	LC	<p>Although the ECB has only limited scope under EU law to engage in assessments of the integrity and external audit of financial statements of SIs, the overall EU financial reporting and external audit regime appears robust.</p> <p>EU laws do not empower the ECB to reject the appointment of external auditors and access external auditors' working papers.</p>
28. Disclosure and transparency	C	The EU has introduced a comprehensive framework to promote transparency both through qualitative and quantitative disclosure requirements. The definition of related parties used for disclosure purpose is not as comprehensive as in CP 20. LCR is disclosed based on end of month averages instead of end of period

Core Principle	Grade	Comments
		values, which is not fully aligned with the Basel Pillar 3 standards.
29. Abuse of financial services	LC	<p>The ECB mandate specifically excludes AML/CFT supervision and hence its focus in this area is to supervise the prudential implications of AML/CFT weaknesses identified by AML/CFT authorities or those it might come across otherwise. It has been strengthening its supervisory training, and toolkits for this purpose.</p> <p>The cooperation and information exchange between ECB and AML/CFT authorities has improved though considerable heterogeneity has been noted in the information received by it from others. The multiple actors and forums increase the complexity of the prudential – AML/CFT interaction and the new AML/CFT authority (AMLA) is expected to ensure more effective cooperation and information exchange. ECB supervision also covers risks emanating from other types of criminal abuse of the financial system, including internal, external and transactional fraud, and covers these in the context of its supervision of internal controls as well as operational risks. However, there are areas of potential overlap with AML authorities such as the policies and processes related to correspondent banking, CDD and recruitment that should also be systematically incorporated by the ECB so that these do not fall through the cracks.</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	<ul style="list-style-type: none"> The EU should promote further regulatory harmonization consistent with international standards, by reducing the ECB's reliance on national legislative frameworks in the exercise of its supervisory tasks and introducing more detailed common EU-wide standards limiting the differences in implementation at national level.
Principle 2	<ul style="list-style-type: none"> To ensure alignment of prudential supervisory staffing for SI supervision to current and expected future workload, NCAs should endeavor to meet their staffing commitments to the SSM and, on its part, the ECB should ensure that the banking supervision business lines are consulted at an early stage in the budgetary process. As half of supervisory decisions are still taken by the Supervisory Board, the SSM should delegate more decision making to staff. Member states should address any impediments to the independence of supervisors brought out in country FSAPs not least so that these are not carried through to the Supervisory Board. The ECB should formalize the assurances that (i) ECB staff will be supported in case of lawsuits filed for their work in official capacity even outside of member states, and (ii) consultants and other service providers used in the supervisory process will also be similarly protected from such lawsuits.
Principle 3	<ul style="list-style-type: none"> The ECB should use the capabilities provided in the MoUs to promote more joint inspections with non-SSM supervisors.
Principle 4	<ul style="list-style-type: none"> The EU should work to have common EU-wide legal definitions of key terms relating to the core activities of credit institutions (such as deposits, other repayable funds, granting of credit etc.). The EU should also consider developing an EU-wide framework allowing competent authorities to prohibit deposit-taking by unlicensed institutions to reduce the potential for regulatory arbitrage.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 5	<ul style="list-style-type: none"> • In the case of third country banks establishing a subsidiary in the euro area, the ECB as host supervisor should obtain a non-objection from the home supervisor and assess consistently whether third country authorities apply global consolidated supervision. • The ECB should have a greater say in the subsidiarization decision of large or systematically important third country branches conducting banking activities in the euro area. • Where the ECB does not have access to relevant information through supervisory colleges or supervisory fora, regular exchanges of information should be established between the ECB and NCAs where third country branches are operating. • The EU authorities should conduct on a regular basis a mapping of banking-related activities conducted by third country groups through branches, investments firms and/or cross-border provisions of financial services.
Principle 6	<ul style="list-style-type: none"> • Institutions should be required to notify the ECB 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. • The ECB should be empowered to reverse the change in significant ownership when this change that has taken place without the necessary notification to, or approval from, the ECB, or when it was based on false information. • In addition to listed banks, the ECB should obtain (e.g., through periodic reporting) the names and holdings of all significant shareholders of institutions that are not traded on a regulated market, or those that exert controlling influence on such entities.
Principle 7	<ul style="list-style-type: none"> • In issuing the technical standards for the acquisition of material holdings, the EBA should ensure that the coverage of holdings is broad enough to incorporate material investments, as envisaged in the Basel standard.
Principle 8	<ul style="list-style-type: none"> • The ECB should continue to streamline and simplify its supervisory processes to ensure effective resource use and improve supervisors' agility. • The ECB should expedite the review of the SREP methodology to augment the discriminatory power of the SREP scores (between institutions) and their sensitivity to idiosyncratic risk factors (over time).

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 9	<ul style="list-style-type: none"> • The SSM should ensure that new priorities do not crowd out core areas of supervision. • The SSM should continue improving communication to banks to set the agenda for the banks' governing body and ensure that recommendations and measures are always focused, specific, measurable, achievable and realistic and with a timeframe. • The SSM is encouraged to increase transparency around the main drivers of the decision to determine Pillar 2 requirements. • The SSM should ensure a timely and assertive application of supervisory measures, and escalation, when deficiencies are identified in banks and findings are not remediated in due time. • The ECB should continue to improve its planning processes so that it encompasses a more realistic assessment of the supply of resources as well as the priorities for which they will be utilized.
Principle 10	<ul style="list-style-type: none"> • The EBA and ECB are encouraged to expedite the implementation of an integrated reporting system that strikes a better balance between the harmonization of reporting requirements and flexibility in responding to evolving data needs.
Principle 11	<ul style="list-style-type: none"> • EU should continue harmonizing the legal framework for enforcement and sanctions including for direct enforcement measures and sanctions on individuals. • As mentioned in the 2018 FSAP, the ECB should also be given express authority to directly impose the full range of non-pecuniary sanctions. • The EU should align the conditions for adopting early intervention measures in the BRRD with those for introducing supervisory measures and ensure that the ECB can always intervene even if an infringement or likely infringement of prudential requirements has not yet materialized.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 12	<ul style="list-style-type: none"> • The ECB and other financial regulators in the euro area should intensify their cooperation through joint initiatives, such as joint onsite inspections. • In the case of mixed-activity groups, the EU authorities should regularly monitor the evolution of the range of activities conducted to ensure that supervisors are adequately informed regarding all direct and indirect financial activities conducted by such groups. There should also be an ongoing assessment of whether the mandate and supervisory powers of financial supervisors should be expanded. • The ECB should be empowered to conduct fit and proper reviews of senior management of banks' nonfinancial parent companies.
Principle 13	<ul style="list-style-type: none"> • ECB should finalize MoUs with supervisory authorities of all G-SIBs. • ECB should undertake more joint work with non-EU supervisors. • The ECB should work with peer jurisdictions to ensure smooth two-way sharing of data as envisaged in their MoUs. • EU should expressly prohibit the establishment of shell banks.
Principle 14	<ul style="list-style-type: none"> • The SSM should consider further risk-based delegation of fit and proper decisions.
Principle 15	<ul style="list-style-type: none"> • Internal pricing, performance measurement and new product approval by the bank's board should be subject to requirements included in EU legislation. • The SSM should make use of stress testing scenarios for a wider range of risks than current practice.
Principle 16	<ul style="list-style-type: none"> • The EU authorities should review capital requirements for EU internationally active banks and ensure that they are aligned with the Basel standards. • The EBA and ECB should regularly monitor, quantify and disclose the impact of deviations on banks' capital. • Where institutions have not deployed IRB for all material exposures within an asset class, the ECB should verify that the application of the standardized approach is not made with a view of engaging in regulatory arbitrage • The ECB should consider implementing a more proactive review of internal models and increasing resources devoted to the review of institutions' internal models used for regulatory purpose. • The EBA and ECB should harmonize the methodology for the calibration of O-SII buffers.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 17	<ul style="list-style-type: none"> The EU legislation should be amended to include specific EU-wide requirement that a bank's board or senior management approve credit risk exposures exceeding a particular threshold.
Principle 18	<ul style="list-style-type: none"> The ECB should be given the ability to impose P2R add-ons in all instances where accounting provisioning levels are considered inadequate from a prudential perspective. The ECB should be given the ability to require valuation, classification, and provisioning be conducted on an individual item basis, at least for significant exposures. The SSM should set an appropriate threshold for identifying significant exposures and regularly review the threshold's level.
Principle 19	<ul style="list-style-type: none"> The EBA should issue a guidance on the management of all forms of concentration risks and specifying that all material concentrations should be regularly reviewed and reported to the bank's board. The ECB should consider more systematically high sovereign risk concentration when setting Pillar 2 capital add-ons.
Principle 20	<ul style="list-style-type: none"> EU should develop a harmonized framework for related party transactions that comprehensively covers all elements of the Basel definition, and which lays down materiality, limits and supervisory reporting requirements. The ECB should develop a common approach to the supervision of related party risk for SIs in the SSM.
Principle 21	<ul style="list-style-type: none"> The ECB should issue supervisory expectations on the management of country and transfer risk. The ECB should implement its internal operational guidance regarding supervisory oversight of provisions against country risk and transfer risk.
Principle 24	<ul style="list-style-type: none"> The ECB and EBA should carry out and disclose a regular analysis of the impact of the deviations from Basel in the LCR and NSFR. The ECB should prioritize the remediation of contingency funding issues and certainly before banks are due to resubmit their recovery plans. Further work including a simulated event would be beneficial in preparing the SSM for sudden changes in depositor behavior (e.g., social media sourced mobilization of depositors). The ECB should continue to develop its approach to intraday liquidity and in particular consider their policy towards collateral in an intraday context.

Recommended Actions to Improve Compliance with the Basel Core Principles and the Effectiveness of Regulatory and Supervisory Frameworks	
Reference Principle	Recommended Action
Principle 25	<ul style="list-style-type: none"> The ECB should ensure the effectiveness of crisis procedures in situations where several institutions are impacted simultaneously—for example, in an operational resilience or cyber situation.
Principle 27	<ul style="list-style-type: none"> The ECB should be granted the direct power to reject the appointment of external auditors. The ECB should be empowered to access external auditors' working papers, where necessary.
Principle 28	<ul style="list-style-type: none"> Disclosures on transactions with related parties should be based on the definition provided in CP 20. Aggregated data on the activities of third country branches in the euro area should be disclosed periodically to complement available data already disclosed by the EBA on the number of branches and assets of branches per member state.
Principle 29	<ul style="list-style-type: none"> Banks should be required to promptly report to their prudential supervisor material suspicious or criminal activities and incidents of fraud which can be material for the safety, soundness and reputation of the bank. The ECB should incorporate more systematically the monitoring of policies and processes for the selection, access to and conduct of correspondent banking accounts in their prudential supervision. The ECB should, where appropriate, undertake more deep dives and thematic reviews on prudential areas identified with AML/CFT risks including through joint work with AML authorities as envisaged in the EBA Guidelines on Cooperation. The EU should devise a cooperative process that will enable AML concerns to be taken into account for license withdrawal decisions while leaving the ECB as the ultimate authority for the exercise of the decision.

B. Authorities' Response to the Assessment

European Commission

The European Commission welcomes the IMF's comprehensive assessment of the Euro Area's observance of compliance with the Basel Core Principles for effective banking supervision. The European Commission appreciates the effort made by the IMF to produce this thorough assessment, and largely agrees with its findings, with notable exceptions.

The European Commission's main point of disagreement is the IMF's team assessment of the Basel Core Principle 7 on the powers of bank supervisors in case of bank mergers. The assessment concludes that the EU framework is in this area "materially non-compliant", as supervisors might not be notified, or lack sufficient powers to evaluate, all the potential transactions involving banks. The European Commission considers this issue to have already been addressed by Directive (EU) 2024/1619 (CRD6), published in the European Union Official Journal on 19 June 2024 and in application in the Union since 9 July 2024. While member states yet need to transpose the new CRD6 provisions concerning bank mergers into their national laws by 11 January 2026, the CRD6 is already legally in force at the EU level. The transposition obligation stems from this legal status, as is the case for any Directive under EU law.

In addition to the above, the European Commission would like to highlight a number of other key policy areas where it does not fully agree with the assessment.

First, the assessment notes that licensing procedures are not harmonized in the Union. This is factually incorrect, as the granting and the withdrawal of banking licenses are regulated under the CRD and, in the context of the Banking Union, are tasks entirely attributed to the ECB-SSM (so called "common procedure"). This procedure applies uniformly across member states, ensuring a consistent supervisory approach, which ultimately contributes to the integrity of the internal market for banking services.

Second, with regard to Basel Core Principle 16, the European Commission welcomes the IMF's acknowledgement that the application of the Basel standards to all banks strengthens banks' resilience and financial stability. The European Commission notes that the standards are also applicable on all levels of consolidation. In addition, the EU has a strong Pillar 2 framework, and makes active use of macroprudential measures, which go beyond Basel standards. The Commission is of the opinion that the above should also be given more weight in the assessment of capital adequacy.

European Central Bank

The ECB welcomes the IMF's detailed assessment of observance of the Basel Core Principles for Effective Banking Supervision in the euro area.

The ECB takes note of the IMF's overall positive assessment of the quality of banking supervision in the SSM and the transparency of its supervisory approach. The ECB also takes note of the IMF's acknowledgment of the significant progress which has been achieved since the previous euro area FSAP in 2018. The ECB is pleased that the assessment highlights the supervisory work which is being done as regards operational resilience, business model sustainability, risk management, governance, crisis management and climate-related financial risks and nature-related risks (as a category of emerging risks under the Basel Core Principles), amongst others. When it comes to these areas, the bar was significantly raised in the 2024 review of the Basel Core Principles. In addition, the IMF acknowledges the ECB's work to articulate specific requirements for banks to address geopolitical risks as another important risk driver.

The ECB values the identification of some areas for improvement which will help it continue to foster state of the art supervision. The recommendations and findings regarding the ECB's supervisory processes and methods are generally welcome, and echo initiatives that are already underway – namely when it comes to the ECB's SREP reform (including the multi-year approach), the delegation framework for decision making, the increasing use of the escalation ladder, the tiered approach to findings and measures, the risk tolerance framework and the recent changes to the P2R methodology.

The ECB regrets the IMF's decision not to consider, when performing its assessment, the regulatory improvements introduced by the EU legislation which implemented the final Basel III standards (in particular, the CRD6). As a result, certain issues identified in the report are in fact already fully addressed under existing EU law – for example on CP7 (major acquisitions).

The ECB concurs with the IMF's assessment that the SSM is a successful example of supranational banking supervision and has to navigate a complex legal framework. The ECB agrees with the IMF's recommendation to promote further regulatory harmonization consistent with international standards, by reducing the ECB's reliance on national legislative frameworks and options and discretions in the exercise of its supervisory tasks, and introducing more common EU-wide standards where relevant in both prudential and non-prudential areas. This would make the regulatory framework more coherent and less fragmented, and help achieve the goal of simplification and scaling up effectively the European single market in financial services. In this regard, the ECB welcomes the IMF's call for avoiding regulatory dilution while acknowledging the ECB's strong commitment to upholding international standards and the resilience of the EU banking system.

The ECB thanks the IMF for producing this thorough and high-quality assessment and for the valuable recommendations included therein.