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DETAILED ASSESSMENT OF OBSERVANCE—BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision for the euro area was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed in June 2018.

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DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

Prepared By
Monetary and Capital Markets Department

This Detailed Assessment Report was prepared by John Laker, Thomas Curry, Pierpaolo Grippa, and Fabiana Melo in the context of an IMF Financial Sector Assessment Program (FSAP) mission in the euro area during November 2017 and March 2018, led by Daniel Hardy, IMF and overseen by the Monetary and Capital Markets Department, IMF. Further information on the FSAP program can be found at http://www.imf.org/external/np/fsap/fssa.aspx

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Glossary

AMA	Advanced Measurement Approaches
AML	Anti-Money Laundering
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles for Effective Banking Supervision
BIRD	Banks' Integrated Reporting Dictionary
BRRD	Bank Recovery and Resolution Directive - Directive 2014/59/EU of May 15, 2014
CCR	Counterparty Credit Risk
CMT	Crisis Management Team
COI	Centralized Onsite Inspections division
COREP	Common Reporting (in the EU)
CRD	Capital Requirements Directive - Directive 2013/36/EU
CRO	Chief Risk Officer
CRR	Capital Requirements Regulation - Regulation (EU) No 575/2013
CVA	Credit Valuation Adjustment
DA	Delegated Regulation ((EU) 2015/61)
DG	Directorate General
DGSD	European Directive on Deposit Insurance
EBA	European Banking Authority
ECA	European Court of Auditors
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pension Authority
ESCB	European System of Central Banks
ESMA	European Securities and Market Authority
ESRB	European Systemic Risk Board
EU	European Union
EUR	euro
FICOD	Financial Conglomerates Directive
FINREP	Financial Reporting (in the EU)
FSAP	Financial Sector Assessment Program
G-SIB	Global Systemically Important Bank
G-SII	Global Systemically Important Institution
HoM	Head of Mission
ICAAP	Internal Capital Adequacy Assessment Process
IDRA	ITS Data Reporting and Analysis
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Process
IMAS	Information Management System
IMF	International Monetary Fund
IReF	Integrated Reporting Framework

IRB	Internal Ratings-Based
IRRBB	Interest Rate Risk in the Banking Book
ITS	Implementing Technical Standard
JST	Joint Supervisory Team
LCR	Liquidity Coverage Ratio
LEI	Legal Entity Identifier
LSI	Less Significant Institution
MCM	Monetary and Capital Markets Department
MEL	Minimum Engagement Level
MFHC	Mixed Financial Holding Company
MoU	Memorandum of Understanding
NCA	National Competent Authority
NCB	National Central Bank
NDA	National Designated Authority
nGAAP	National Generally Accepted Accounting Principles
NP	National Parliaments
NPE	Nonperforming Exposure
NPL	Nonperforming Loan
NRA	National Resolution Authority
RAF	Risk Appetite Framework
RAS	Risk Assessment System
RCAP	Regulatory Consistency Assessment Program
RTS	Regulatory Technical Standard
SEP	Supervisory Examination Programme
SI	Significant Institution
SRB	Single Resolution Board
SREP	Supervisory Review and Evaluation Process
SRM	Single Resolution Mechanism - Regulation (EU) No 806/2014 of July 15, 2014
SSM	Single Supervisory Mechanism
SSMFR	SSM Framework Regulation - Regulation (EU) No 468/2014 of April 16, 2014
SSMR	SSM Regulation - Council Regulation (EU) No 1024/2013 of October 15, 2013
STE	Short-term Exercises data
TRIM	Targeted Review of Internal Models
WCCA	Written Coordination and Cooperation Arrangement

SUMMARY AND MAIN FINDINGS

1. **The SSM (SSM) has made a solid start.** Set up a little over three years ago, the SSM has developed into a coherent banking supervision mechanism operating across the 19 Euro Area Member States. Banking supervision at the European Central Bank (ECB) is underpinned by a clear mandate and independence from government or industry interference in individual supervisory decisions. Its well-defined supervisory methodology and processes—complemented by committed staff—have laid the foundations for more forward-looking, pre-emptive, and evenhanded supervision. This is a noteworthy achievement for the Euro Area.

2. **The good start nonetheless confronts several important operational challenges.** Decision-making processes are complex and not necessarily conducive to timely supervisory action, although emergency procedures have been successfully tested. Significant gaps remain in the European Union (EU) regulatory framework while the suite of supervisory powers needed for consistent supervision of Euro Area banks is inadequate as it stands to address Brexit and other challenges. Furthermore, the volume, quality, and availability of resources for the supervision of Significant Institutions (SIs) are not fully under the ECB's control. Addressing these constraints, some of which are inherent in the design of the SSM, will shape the SSM's agenda over the immediate period ahead.

3. **The ECB's Supervisory Board has taken several steps to streamline some of the decision-making processes.** Its large membership, and the influence of national interests, can make it difficult to reach an agreed position on complex and time-sensitive issues. This runs the risk of "inaction bias" that needs to be countered in view of the continuing supervisory challenges of dealing with weak banks, and in the long-run interests of the Banking Union. That said, the Supervisory Board and Governing Council have demonstrated they can act expeditiously in emergency situations. In the same vein, the ECB should strive to further improve its internal processes to ensure timely decision-making. The process for how decisions are made and how those decisions are communicated to staff and SIs should be kept under review. Simplification and streamlining of procedures and reporting lines, where work is under way in the ECB, would free up needed resources and ensure the timely communication of supervisory and other information to staff and SIs.

4. **The ECB has also made progress in clarifying its supervisory powers, particularly by harmonizing many supervisory options and discretions in the prudential framework and by assuming the powers available to National Competent Authorities (NCAs) in certain areas.** However, further harmonization is needed, and this requires changes in the legal and regulatory framework. The European Commission has proposed amendments to the Capital Requirements Directive/Regulations (CRD/CRR); if implemented, some of these would remove or mitigate the legal uncertainty around the exercise of the ECB's supervisory powers, but others would constrain supervisory discretion in the setting of prudential capital requirements. The proposed revision provides the opportunity to ensure that the ECB has supervisory powers that apply to all significant forms of banking intermediation in the Euro Area. This is an essential requirement to deal with

Brexit, and to minimize opportunities for regulatory and supervisory arbitrage created by current gaps in the regulatory perimeter. A harmonized approach is also currently lacking in some key risk areas, particularly major acquisitions, transactions with related parties, and country risk.

5. ECB banking supervision must execute many of its tasks according to national laws, which can vary considerably in scope and detail. The inconsistencies hinder efficiency and contribute to a time-consuming supervisory decision-making process. For instance, licensing applications and fit-and-proper reviews must first be conducted by NCAs in compliance with national legislation, before submission and further analysis by the ECB. Supervisory decisions in these and other areas require approval by the ECB's Governing Council, generally on a "no objections" basis. However, a new delegation framework has truncated decisions on fit-and-proper and the significance of institutions at the senior management level. Similarly, the ECB's enforcement and sanctioning powers are largely based on what is available to NCAs under national legislation. Although the ECB has some direct enforcement and sanctioning powers, it mostly needs to act by giving instructions to NCAs to take action. Harmonization and strengthening of the legal framework for enforcement and sanctions should be a priority.

6. The ECB has generally raised the level of supervisory intensity and intrusiveness in respect of SIs. Its supervisory approach is based on a thorough but resource-intensive process of risk assessment, the formal Supervisory Review and Evaluation Process (SREP), onsite inspections, a quality assurance review, and a comprehensive SSM Supervisory Manual. This has helped lay the foundations for a comprehensive and consistent supervisory approach across the Euro Area, but it will be important that, once consistency is more fully embedded, the focus on methods and processes does not discourage supervisors from the pursuit of risk instincts, or from astute supervisory judgments.

7. Heightened supervisory intensity within the SSM has reflected in strengthened risk-based capital and liquidity buffers—although capital and liquidity requirements do not conform fully with the Basel framework—and the winding back of nonperforming loan (NPL) ratios. Nonetheless, NPLs continue to undermine Euro Area bank profitability and remain a challenge to the ECB's determination to resolve legacy issues. The European Commission's recent clarification of the ECB's powers in this area provides the basis for pursuit of more realistic provisioning levels, though these powers should be formalized in EU law.

8. For some SIs, the shift from NCA to ECB supervision has represented a significant change in supervisory approach. Changes have taken place in terms of reporting burden, minimum levels of engagement with supervisors, intrusiveness, and prudential requirements, including capital add-ons from the SREP. For larger SIs, some of which were already under intensive supervision, the supervisory approach has benefitted from a broader SSM perspective and cross-country benchmarking, although concerns have been expressed about slower supervisory response times.

9. The sharing of responsibilities between the ECB and the NCAs, which provide the bulk of supervisory resources to the SSM, is still evolving. Day-to-day supervision is conducted by

Joint Supervisory Teams (JSTs) led by ECB staff with sub-coordinators from NCAs where the parent entity is located (and from NCAs where the bank has significant subsidiaries). The coordination and integration of JSTs staffed by supervisors with very different backgrounds, supervisory cultures, and languages have presented operational and motivational challenges. Levels of cooperation between ECB banking supervision and NCAs have been improving, assisted by a range of staff networks, but remain uneven, and JSTs cannot always be confident about the availability of NCA staff members. Consequently, staff resources in some JSTs have been stretched while the staffing of onsite missions, particularly with cross-border and ECB staff, has faced difficulties. The responsibilities, incentives, and performance assessment of individual NCA staff members of JSTs, who currently serve two masters, need to be better articulated.

10. It is crucial that the SSM banking supervision clearly communicate to SIs its expectations for prudent risk management. Clear expectations provide a consistent basis for supervisory action and, in particular, for supervisory decisions in the SREP. The ECB has made a good start in this direction with the publication of supervisory guides on select topics; the European Banking Authority (EBA) has also published a range of guidelines. The ECB's decision to publish a condensed public version of the SSM Supervisory Manual, setting out its expectations for prudent risk management practices and processes, is welcome. The ECB should also publish its expectations in areas where the EU regulatory framework is silent or provides only general rules. These areas include major acquisitions, loan classification parameters and provisioning, concentration risk, country and transfer risk, related-party risk, and operational risk.

A. Main Findings

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

11. The SSM has established a clear allocation of responsibilities for the supervision of Euro Area credit institutions between the ECB and the NCAs in participating Member States. However, the legal underpinnings of the SSM are complex. The ECB has a broad range of powers provided for in the CRR and the SSM Regulation (SSMR) and can apply the powers set out in CRD IV as transposed into national legislation, but the EU legislation also makes a considerable number of options and discretions available to either the NCAs or the Member States. The ECB has harmonized a range of options and discretions granted to NCAs in the SSM, but harmonization of options granted to Member States would require changes in EU law.

12. The SSM legislative framework, reflecting the uneven coverage of national laws, leaves the ECB facing gaps and asymmetries in its supervisory powers. For example, the ECB does not have supervisory powers that apply to all significant forms of credit intermediation in the Euro Area. In particular, investment firms undertaking "bank like" business in the Euro Area are subject to many of the same regulations as banks, including for capital and liquidity, but are currently supervised nationally even when they are of significant size and very active in cross-border business. The European Commission's proposals for an extensive revision of EU law related to prudential supervision provide an opportunity to remedy this. In addition, Euro Area branches of non-EU or EEA banks are not subject to authorization or supervision by the ECB, nor to CRD IV/CRR (and related EBA standards and guidelines). The regulatory and supervisory framework applicable to such third-country branches needs to be harmonized.

13. The independence of the ECB's banking supervision function is enshrined in law, and the ECB performs its supervisory tasks in an operationally independent manner. Decision-making processes are complex and time-consuming. A substantial volume of routine supervisory decisions requires Governing Council approval. However, a new delegation framework, which truncates decision-making for certain routine decisions at the level of ECB Senior Manager, has considerably shortened timetables, and further delegation of decisions is under discussion.

14. The aggregate resources available to ECB banking supervision to supervise SIs are variable and largely beyond its control. With its Supervisory Examination Programme (SEP), the ECB has a well-structured process for determining and prioritizing its resource needs, but it has only limited control over the levels and allocation of NCA staff dedicated to the supervision of SIs, or over their suitability and performance. Since NCA staff are generally not committed full-time to SI supervision, their availability at any particular point cannot always be assured. The ECB has experienced varying levels of cooperation from NCAs in making up supervisory teams, but collaboration is improving for offsite supervision.

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

15. EU legislation, as transposed into national laws, protects the special status of credit institutions, with the necessary powers residing in most cases with NCAs. The ECB is the licensing authority for credit institutions in the Euro Area, but the NCAs are fully integrated in the authorization process and authorization decisions are taken on the basis of applicable national laws, which are not fully harmonized. The legal framework, though fragmented, and various supporting the EBA, EBA/European Securities and Market Authority (ESMA), and ECB guidance provide a comprehensive basis for supervisory assessments of applications for authorization. As discussed above, the ECB does not have authority to authorize and supervise Euro Area branches of non-EU or EEA banks, or investment firms undertaking "bank like" activities in the Euro Area. These gaps in the regulatory perimeter raise concerns about regulatory and supervisory arbitrage and, in the case of large investment firms, can pose increased financial stability risks. The gaps can only be closed through legislative changes.

16. The SSM legislative framework establishes a clear basis for approving acquisitions or disposals of qualifying holdings in a credit institution by the ECB, the competent authority in this area. As with authorizations, the NCAs are fully integrated in the approval process, which is supported by recent EBA/ESMA/European Insurance and Occupational Pension Authority (EIOPA) joint guidelines and ECB internal rules and detailed procedures. However, there are no specific EU requirements 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, while notification requirements in national law are not consistent.

17. In contrast, EU law does not provide an adequate or consistent supervisory regime for major acquisitions by a credit institution. Some national laws require the approval of acquisitions in third countries by the relevant NCA, and the ECB has confirmed that it is competent to decide on such approvals. However, there are no explicit requirements in EU law on the acquisition of holdings in credit institutions outside the EU, nor are there harmonized assessment criteria at EU level, including whether acquisitions expose the credit institution to undue risks or hinder effective supervision. While the ECB may impose higher capital requirements or even require disinvestment in the case of an unsound acquisition, it cannot require *ex ante* review and approval. The ECB is seeking amendments to EU law that include a clear reference to additional supervisory powers in relation to material acquisitions in third countries.

Methods of Ongoing Supervision (CPs 8–10)

18. The fundamentals of the ECB's methodological framework for supervision are sound. The main elements of the supervision methodology—SREP, risk assessment system (RAS), and SEP—are firmly in place. The methodology has been refined through the experience gained since its initial launch in 2015. This process of continual assessment and improvement should continue as the SREP, RAS, and SEP mature over time. The greater emphasis on quantitative analysis is consistent with the EBA's SREP guidance. The SREP is a forward-looking risk-based assessment of individual banks and banking groups, proportionate to their systemic importance. The ECB's supervisory approach identifies risks within banks and the banking system. The ECB, in conjunction with the Single Resolution Board (SRB) and NRBs, is a key participant in the Euro Area's early intervention and resolution framework.

19. ECB banking supervision uses a mix of offsite analysis and onsite inspections that focus on both horizontal risk themes and vertical assessments of institution-specific risks. The techniques and tools to implement the supervisory approach appear to be appropriately designed, as evidenced by the (confidential) SSM Supervisory Manual and Appendices. The SEPs and onsite inspections also appear to be appropriately calibrated according to institutions' risk profiles, including systemic importance, and the ECB's supervisory resources. Further refinements in methodology and technique should be adopted as the ECB gains additional experience over time.

20. The assessors recommend that ECB banking supervision be more transparent about its supervisory approach and techniques. The ECB's draft guide to onsite inspections and internal model investigations is a good primer for public consumption, and the ECB's practice of publishing guides on important supervisory topics should be continued. In the same vein, a condensed version of the SSM Supervisory Manual was published in March 2018, after the assessors' onsite visit. The published manual removed much of the detail on internal processes and methodologies. Such transparency may help credit institutions comply with the ECB's expectations and assure the public that the SSM operates under well-designed supervisory processes.

21. Supervisory reporting at EU level is not sufficiently granular to adequately support offsite supervision, while "maximum harmonization" does not allow sufficient flexibility and

agility.[1] Not all data needs are covered by reporting under the EBA's implementing technical standards (ITS). The ECB complements the information collected via ITS through Short-term Exercises (STE) data collections and surveys, which cover fundamentally some of the data needs for SREP (e.g., assets and liabilities by repricing date, interest rate risk in the banking book (IRRBB), concentration, liquidity, and operational risk). Timely and accurate data is fundamental to effective supervision. While STE reporting and surveys give the ECB some flexibility in addressing its data needs, the process for amending and augmenting the EU-wide harmonized supervisory reporting based on the ITS is lengthy and cumbersome and should be streamlined and expedited. While focusing mainly on statistical requirements for the moment, the European System of Central Banks (ESCB) initiatives related the Banks' Integrated Reporting Dictionary (BIRD) and the Integrated Reporting Framework (IReF) may contribute to ensuring harmonization of reporting while allowing for more flexibility in its uses.

Corrective and Sanctioning Powers of Supervisors (CP 11)

22. ECB banking supervision adopts a progressive remedial process to address unsafe and unsound practices. The ECB uses the SREP methodology and its SEP to identify unsafe or unsound practices at an early stage. Ongoing supervision identifies issues, and recommends specific corrective actions within defined time periods, informally and in writing. Written communications from the JSTs are "operational acts," which carry significant moral suasion weight even though they are not legally binding. Matters are escalated to the Supervisory Board for a formal decision if an SI does not comply with an operational act. That decision is legally binding and enforceable, as noncompliance constitutes a breach subject to sanctions. Article 16.2 of the SSMR lists a broad range of powers, which the ECB uses, regarding both affirmative obligations and significant consequences to correct deficiencies.

23. The legal framework for enforcement and sanctions, however, is complex and fragmented, and contains substantive and procedural gaps that should be addressed. The complex legal enforcement framework may make it operationally difficult and time-consuming for the ECB to impose formal enforcement actions and sanctions in some countries, in particular where such powers are not available under national laws. The ECB's direct enforcement and sanctions powers are limited. The ECB can make use of the powers available to NCAs, but there is a lack of harmonization in the scope of and approach to the enforcement of sanctions between the ECB and the NCAs. The ECB may impose sanctions only on legal entities; it does not have the power to directly impose sanctions on natural persons. While the ECB has effectively used its authorities under Article 16.2 to effect necessary remedial measures at SIs, express authority to impose non-pecuniary sanctions, such as enforceable administrative "cease and desist" orders with affirmative covenants, would provide an additional supervisory tool that could be used in appropriate circumstances.

[1] *Maximum harmonization* means that "with regard to the scope of application of the Implementing Regulation [on Supervisory Reporting], competent authorities cannot add nor delete data to be reported, nor can they require the reporting of that data in a different format nor in a different (less or more granular breakdown, nor in a combination, other than in accordance with the CRR and with [CRD]," as explained by the EBA.

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

24. ECB banking supervision has an extensive and effective framework for cooperation and collaboration. Within the SSM, the framework is inherent in the various structures and elements of cooperation between ECB banking supervision and the Euro Area NCAs, starting from the Supervisory Board. Outside the SSM, ECB banking supervision has been seeking to build on the highly developed communication channels it inherited from the NCAs under "step in" arrangements. Nevertheless, the ECB's progress in finalizing Memoranda of Understanding (MoUs) with third-country authorities has been slower than expected, although the absence of formal arrangements has not precluded effective working relationships with key authorities. The ECB-led supervisory colleges appear to serve their intended purpose. The assessment of recovery plans, early intervention measures, and the overall planning of supervisory responses of home and host authorities in preparation for and during emergency situations is performed in a coordinated way through the colleges. The SSM's preparations for Brexit from a banking supervision viewpoint have involved heightened interaction with other supervisory authorities.

25. The ECB does not have the authority to review activities of certain affiliates and parent companies that are unsupervised entities, and there are no specific legal requirements authorizing the ECB or NCAs to prohibit shell banks or the continued operation of shell banks. The activities of companies affiliated with parent companies may have an impact on the safety and soundness of the banking group. Where such powers are not provided under national law, this gap may hinder the ECB's ability to assess potential material impact on safety and soundness, and to take appropriate supervisory action. Another layer of complexity is that, while the ECB is lead supervisor for some conglomerates under the Financial Conglomerates Directive (FICOD), mixed financial holding companies are not included in the definition of conglomerates. This may imply a constrained capacity to identify related parties or nonfinancial entities that may impact on the conglomerate, and to include them within the supervisory perimeter. In addition, while the ECB will not authorize shell banks that only serve as a booking office, there is no clear mandate to prohibit shell banks or to limit the use of foreign branches as mere booking offices.

Corporate Governance (CP 14)

26. SIs operate under a corporate governance legal structure that is governed by disparate national law requirements supplemented by EBA guidelines and ECB explanatory guides. The ECB uses its supervisory process to identify weaknesses in management bodies and to recommend and effect changes. The ECB's thematic review of governance and risk appetite provided a horizontal baseline view of industry practice and focused supervision on internal governance, and resulted in recommendations and actions addressed to banks aimed at making supervisory board involvement more robust. The ECB has defined processes for making required fit-and-proper determinations of management body members; however, its dependence on national law for these determinations makes the process very complex, time consuming, and not fully harmonized. The ECB also should be granted greater legal discretion to object to persons whose prior work experience and relationships may have made them not fully independent from management. Internal governance standards for financial conglomerates could be enhanced beyond the general risk considerations outlined in the SSM Supervisory Manual.

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

27. ECB banking supervisors have learned to overcome the hurdles of a fragmented regulatory framework by correctly adopting an extensive interpretation of their role in ensuring the sound management and coverage of risks by banks. However, a more complete and harmonized regulatory framework on risk management would mitigate unnecessary distractions caused by the need to deal with an incomplete and heterogeneous set of rules. It would also facilitate the banks' understanding of supervisory expectations and improve the quality of the supervisory dialogue.

28. Deviations of the EU capital framework from international standards are material, though the ECB has the powers to impose additional requirements. The Basel Committee's Regulatory Consistency Assessment Program (RCAP) assessment found that, in the calculation of risk-weighted assets, some deviations may be significant: these deviations related, for example, to sovereign exposures under the permanent and temporary partial use of the standardized approach, lower risk weights for covered bonds, treatment of participation in insurance, and the counterparty credit risk (CCR) framework. Some of these deficiencies are addressed by banks' internal capital adequacy assessments and supervisory action under the SREP process. The ECB can require banks to hold capital in excess of the minima under Pillar 2. The ECB's Regulation and Guide on National Options and Discretions attempts to harmonize the exercise of some capital-related options and discretions although material deviations exist, for example, in the capital treatment of insurance interests. Overall, deviations cited in the RCAP continue to exist.

29. Supervisory activity on problems assets and provisioning in the SSM has progressed significantly since the recent issue of the ECB's guidance to banks on NPLs. The guidance strengthens the SSM's ability to tackle the long-term issue of extremely high NPL ratios in certain banks. The guidance sets supervisory expectations for how the NPL issue should be addressed by banks in terms of governance, operations, classification (of forbearance and nonperforming status), provisioning, write-off, and collateral valuation. Banks with a high level of NPLs are requested to define an NPL strategy and are subject to *ad hoc* reporting requests. The follow-up and monitoring of banks' NPL reduction plans is intense and it is producing positive results in terms of banks' increased proactivity in addressing their issues.

30. The NPL guidance fills a number of gaps in the EU-wide framework, but its impact is uncertain. Because of its non-binding nature, the guidance cannot override national provisions on the same topics, where these are contained in laws or regulations.[2]

[2] Based on the review of a large (though incomplete) synopsis of national legal frameworks, even if in some jurisdictions there can be more detailed requirements and criteria for the assessment of banks, policies, and processes for identifying and managing problem assets, these do not appear to be in contradiction with the indications provided by the guidance.

31. The European Commission has clarified the ECB's power to require banks to apply specific adjustments (deductions, filters, or similar measures) where the accounting treatment applied by the bank is considered not prudent from a supervisory perspective. An explicit granting of these powers in EU law would represent an even firmer legal basis. The ECB must now make use of this power to foster the convergence of banks' provisions towards more realistic levels, so as to reduce the high levels of legacy NPLs. However, the ECB still lacks explicit power to require banks to classify an exposure as NPL when it does not fully meet all the conditions to be considered defaulted. The ECB should introduce explicit supervisory expectations for NPL provisioning and write-offs.

32. Onsite review of problem loans and provisioning relies on a structured methodology that includes detailed indications on credit file reviews, but it suffers from limited resources. The level of onsite attention to problem assets has improved. New statistical procedures that extrapolate results from loan files samples will be employed soon. The limited number of ECB inspectors constrains their direct participation in onsite missions, thus requiring substantial support (and effort) from NCA inspectors. Stretched onsite resources across the SSM could weaken the capacity to maintain pressure on the banks for decisive action on NPLs.

33. Market risk management standards are generally sound and supervisors take an active approach. The larger, more systemic, and risk-oriented banks with a trading bias face greater supervisory intensity and intrusiveness. Market risk has been a focus of supervisors during 2014 and 2015, and a targeted review of banks' internal models is now under way. The activity of JSTs and inspection teams in this area is wide-ranging, covering the different dimensions of market risk. The opaqueness in the valuation of certain products classified as Level 3 and the uncertainties in the classification of Level 2 assets and liabilities—together with the sheer size of these in the balance-sheets of some institutions in the Euro Area —require an intense and frequent supervisory scrutiny.

34. The IRRBB has received a significant amount of supervisory attention during recent years and features as a key priority for SIs. The stress-test exercise on IRRBB conducted on SIs in 2017 has allowed the ECB to gather granular information on banks' exposure to this risk after years of low interest rates. As part of the exercise, the ECB collected also qualitative information for a broader assessment of banks' risk management practices, on which JSTs will follow-up.

35. Concentration risk and country risk should be viewed in a more comprehensive manner, and deserve more supervisory attention. The definition of concentration risk is limited to credit exposures and does not include different types of exposures in a broader sense. Supervisory expectations with respect to concentration risk and country risk management are not clearly communicated to the banks. There is no requirement that all material concentrations be regularly reviewed and reported to the bank's supervisory board. Reporting and monitoring of country risk and concentrations can be improved, and their inclusion in banks' stress tests specifically required.

36. The framework for transactions with related parties is weak. There is no requirement that related-party exposures be monitored and controlled separately and in aggregate. There is no regular reporting of exposures to related parties. Supervision of related-party risk is mostly carried out by external auditors, but their analysis of related-party risk is very limited. While some national laws provide for limits to transactions with related parties, there is no harmonized approach at EU level.

37. Supervisors have stepped up the frequency and intensity of interaction with credit institutions regarding their management of liquidity risk, contingency plans, and funding requirements, though important challenges remain. Supervisors have built up an in-depth understanding of liquidity and funding risks at individual institutions. Funding plans and results of stress testing are reported and evaluated periodically. Guidance for assessing the Internal Liquidity Adequacy Assessment Process (ILAAPs) was implemented in 2016 and helped strengthen the assessment of liquidity risk management as part of the SREP. Supervisors periodically meet with treasury staff and receive monthly monitoring of Liquidity Coverage Ratio (LCR) data. However, the LCR adopted in the EU has a number of elements that are less stringent than the Basel standard, most notably a wider definition of high-quality liquid assets (HQLA). In addition, given the centrality of liquidity risk in bank crises and in the light of recent experience, assumptions on the outflows of different categories of deposits over various time horizons should be revised, both for the banks' own and supervisory stress testing, and the actual availability of supposedly liquid assets should be kept under review, since the information on unencumbered assets currently available to ECB banking supervision might not be sufficient to gauge the residual capacity of a bank to obtain emergency liquidity in a quickly deteriorating environment. Finally, given the sizeable currency transformation operated by certain internationally active banks—some with considerable presence in non-Euro markets—the ECB needs adequately granular and frequent information on their cash flows in material non-Euro currencies and by jurisdiction for JSTs to monitor it on a regular basis; reporting of the maturity ladder broken down by significant currencies has started in March 2018.

38. While operational risk has undergone several enhancements, more attention needs to be paid to monitoring the effective implementation of operational risk management frameworks. The ECB has initiated several reviews on operational risk matters, involving information technology (IT) and cybersecurity risk, and conduct risk, as well as an IT outsourcing questionnaire and a pilot exercise on cyber incidents reporting. Nevertheless, the ECB should take steps to enhance cybersecurity awareness, business continuity, and recovery planning and third-party vendor management in the outsourcing of significant functions. Operational risk is a major risk area under the SSM framework. The onsite examination process for Advanced Measurement Approaches (AMA) model accreditation appeared to be robust. Ongoing monitoring of AMA models has been strengthened by the recent implementation of the reporting for banks' validation functions, and the operational risk benchmarking tool (IDRA).

39. European law and EBA guidelines, particularly the revised *Guidelines on Internal Governance,* provide a comprehensive set of requirements and supervisory expectations for the internal control framework of credit institutions. The revised *Guidelines on Internal Governance* clarify the responsibilities of the supervisory board in relation to the internal control framework, and emphasize the importance of a direct reporting line from the heads of compliance and internal audit to the supervisory function so that concerns and warnings may be raised. The

Guidelines have been reinforced by the ECB's supervisory expectations set out in the June 2016 "SSM supervisory statement on governance and risk appetite" and by the detailed assessment of internal governance undertaken by supervisors as part of the SREP process.

40. ECB banking supervision 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. Responsibilities under EU directives in this area lie with other competent authorities. The overall EU framework, however, appears robust and ensures broad consistency with international standards. The ECB is stepping up its involvement in the external audit process, by assuming any powers granted by national laws to NCAs in relation to the appointment/replacement of external auditors, and through heightened engagement with external auditors, although engagement at the individual and collective level is already active. The ECB is seeking amendments to EU law that include a clear reference to additional supervisory powers regarding external auditors.

INTRODUCTION AND METHODOLOGY[3]

A. Introduction

41. 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 Financial Sector Assessment Program (FSAP) mission undertaken by the International Monetary Fund (IMF) during November 2017 and February 2018, 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 represent an analysis of the state of the banking sector or the crisis management framework, which are addressed in other parts of the FSAP.

42. 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 19 Euro Area Member States. 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 is limited to the direct supervision by the ECB of SIs. It is important to note, however, that to the extent regulations and practices are harmonized across SSM members, the assessment of the supervisory environment for SIs may provide a useful picture of regulation and supervision of the Less Significant Institutions (LSIs) indirectly supervised by the ECB.

[3] The assessment team comprised John Laker (former Chairman of the Australian Prudential Regulatory Authority), Thomas Curry (former United States comptroller of the Currency), and Pierpaolo Grippa (IMF). Fabiana Melo (IMF) coordinated the assessment work and drafting of this report.

43. **This is the first detailed assessment of the BCP conducted for the Euro Area.** Since the establishment of the SSM, one detailed assessment of Germany was conducted in 2016 and, while several SSM member countries have undergone FSAP exercises, no other detailed assessment has been conducted. Nevertheless, this assessment leverages on the work and material provided to the teams that covered banking regulation and supervision during these FSAPs. Information and Methodology Used for Assessment

44. **The ECB requested to be assessed according to the Revised BCP Methodology issued by the Basel Committee of Banking Supervision in September 2012.** The current assessment was thus performed on a revised content and methodological basis compared with previous BCP assessments carried out in several SSM member countries. Hence, such assessments cannot be directly compared to the current assessment. The revised BCP have a heightened focus on corporate governance and risk management practices in supervised institutions and their assessment by the supervisory authority, raising the bar in measuring the effectiveness of the supervisory framework (see Box 1 for more information on the 2012 Revised Core Principles).

45. **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.

46. **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.

47. **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, including extensive provision of documentation and access, at a time when staff was burdened by many initiatives related to European and global regulatory changes, and was still adapting to the new Euro Area supervisory framework.

48. **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 operation of the banks being supervised.

49. 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 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.

50. 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. This made the assessment of Core Principle 29 impracticable, and it has therefore been excluded from this report. In addition, while several regulatory aspects of the CPs have been harmonized in the Euro Area, different national legal frameworks apply in many cases. In such cases, the ECB must apply national legislation. 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 19 Euro Area Member States; rather, it uses the national information as a source for a more general assessment of regulatory adequacy and supervisory effectiveness.

51. 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 (for instance, the regulatory framework is agreed but has not yet been fully implemented). 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 2012 Revised Core Principles

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

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

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

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

INSTITUTIONAL AND MARKET STRUCTURE—OVERVIEW[4]

52. 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 (CCPs), and Euro Area institutions are also heavy users of CCPs located elsewhere. Banks are the most important single source of financing for households, nonfinancial corporates

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

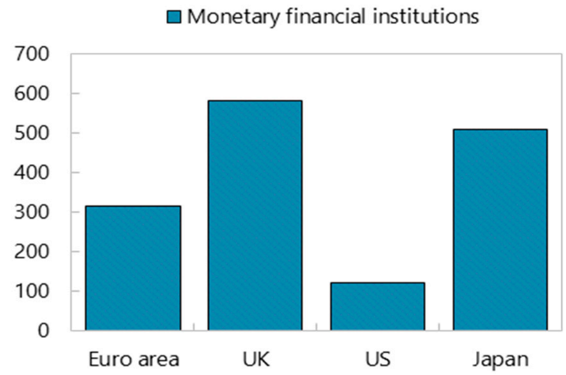
(NFCs), and the public sector. Since the global financial crisis, nonbanks, and financial markets are playing a greater role, particularly in funding larger NFCs.

53. Within the SSM, banks (technically, "credit institutions") are categorized as Sis or LSIs. The ECB directly supervises the SIs. These currently comprise 118 banking groups (with around 1,000 banks), including 8 global systemically important banks (G-SIBs), which cover more than 80 percent of Euro Area banking assets. The NCAs directly supervise the LSIs (around 3,100 in number), but under the general oversight of the ECB to promote a more consistent supervisory approach across the SSM. The SSM is one of 3 pillars intended to sustain European banking union; the other 2 pillars are an SRM for banks covered by the SSM, which became effective from January 1, 2015, and harmonized arrangements for national deposit insurance schemes, which are still under development.

Figure 1. Euro Area: Financial System Overview

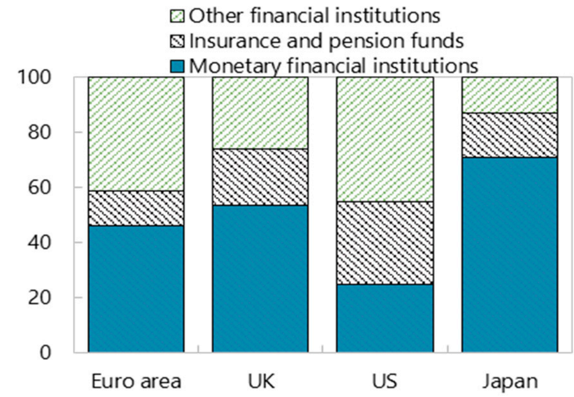
The Euro Area banking system is large…

Structure of the Financial System
(in percent of GDP)



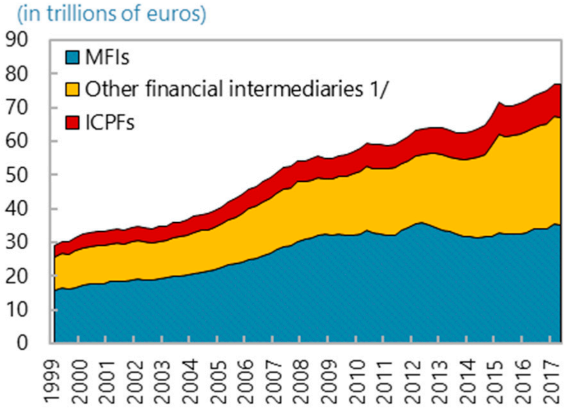
…also relative to the financial system…

Structure of the Financial System
(Share of total assets of the financial sector)



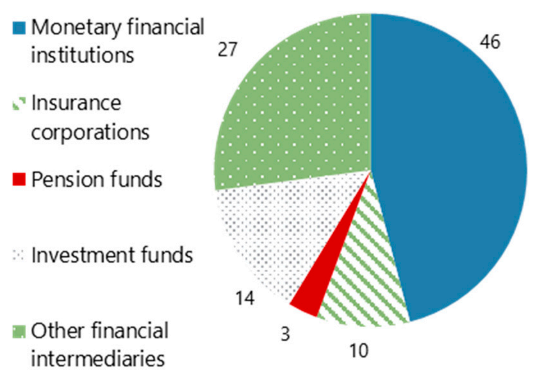
… but the nonbank financial sector is growing.

Total Assets of the Euro Area Financial Sectors
(in trillions of euros)



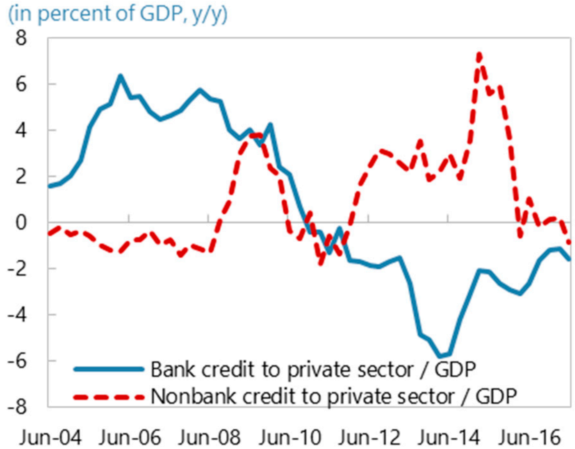
Nonbanks are diverse, and include a large "other" sector.

Share of Total Sssets of the Financial Sector (2017Q2)
(in percent)



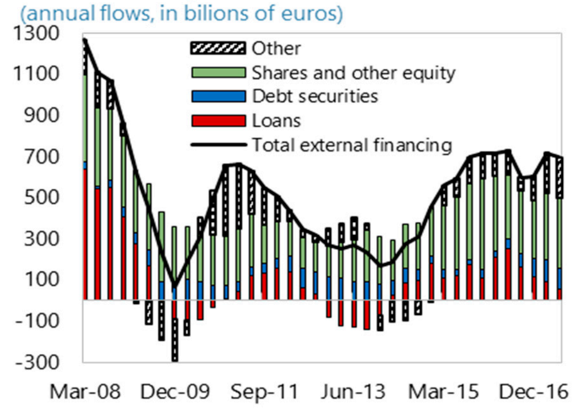
Since 2009, nonbanks are playing a greater role…

Private Sector Credit Growth: Bank and Nonbank
(in percent of GDP, y/y)



…particularly in funding nonfinancial firms.

Sources of external financing provided to the nonfinancial corporate sector
(annual flows, in bilions of euros)



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

[1] OFIs comprise investment funds, money market funds, financial vehicle corporations, and a sizeable OFI residual.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION[5]

54. The Euro Area is enjoying a robust cyclical recovery with solid job growth, combined with low inflation and low wage growth. At the time of the FSAP the area had seen18 consecutive quarters of expansion and growth accelerated to an estimated 2.5 percent in 2017. All Member States are expanding together, with the lowest cross-country dispersion in growth rates since the launch of the euro in 1999. Domestic demand remains the main driver, supported by a pick-up of net exports amid the global trade recovery. Solid job creation has steadily driven down the unemployment rate—to 8.9 percent in September 2017, its lowest reading since early 2009. In spite of a small uptick in inflation, to 1.4 percent year-on-year in October, core inflation has remained sticky, suggesting no sustained convergence of inflation toward the ECB's medium-term price stability objective yet. Low core inflation partly reflects slow wage growth, which has remained below 2 percent for the last five years, albeit with wide differences across countries. Many net external debtor countries have regained much of their lost competitiveness in recent years through price, wage, and employment adjustments, with current account deficits becoming surpluses.

55. In the Euro Area, macroprudential policy is a shared competency between the national authorities and the ECB. 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 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.

56. NDAs in each EU member state monitor financial stability risks arising from the entire financial system, and important powers were given to the ECB to counter potential inaction bias in Euro Area member states. The NDA is expected to have control over the necessary macroprudential instruments for achieving its objective. NDAs have not been set up fully in all countries, however. The ECB can apply higher requirements for capital buffers and more stringent measures than those applied by national authorities (topping-up power), but cannot set lower requirements than those set nationally. So far, the ECB has not exercised its topping-up power. The Governing Council is the ultimate decision-maker for macroprudential policy in the ECB. The Council decides on macroprudential measures based on a proposal by the Supervisory Board, taking into account the input of the ECB's Financial Stability Council and the Macroprudential Coordination group.

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

57. 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 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.

58. International Financial Reporting Standards (IFRS) are required for publicly traded companies.[6] 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.

59. The EU adopted new rules regarding auditing standards in 2014.[7] An amending directive (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. At national level, additional audit requirements may exist. Based on an EBA survey across Member States in EU in 2015, the scope of the audit varies across Member States.

60. The EU supervisory framework significantly changed in 2011, with the set-up of European supervisory agencies (ESAs). On January 1, 2011, the EBA was created, along with ESMA and EIOPA. Their creation aimed at enhancing the mechanisms to coordinate cross-border supervision, facilitate cooperation between supervisors, promote convergence of supervisory practices, and monitor implementation of the Single Rule Book. The ESAs are regulatory agencies of the Commission accountable to the European Parliament and the Council of the European Union. They have legal personality as well as administrative and financial autonomy. In this context, the ECB is obliged to cooperate with and support the work of the ESAs. This also includes the implementation of ESA guidelines and recommendations.

61. The European Commission adopted an action plan to promote a Capital Markets Union (CMU) in 2015.[8] The objective of the CMU project is to create a true single market for capital within the member states, so as to enhance investment, better channel savings, make the financial system

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[6] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/financial-reporting_en.

[7] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/auditing-companies-financial-statements_en.

[8] European Commission, Action Plan on Building a Capital Markets Union, COM (2015) 468, September 30, 2015.

more stable, deepen financial integration and increase competition. A review of implementation of the action plan in mid-2017 indicated that significant progress toward its targets had been made.[9] Among the measures that have been adopted are revised prospectus guidelines, steps to revitalize securitization, proposed rules for preventive restructuring procedures, and agreement in principle to establish a venture capital fund in partnership with the private sector.

62. Despite the progress that has been achieved, capital markets in Europe continue to be highly fragmented.[10] National legal frameworks continue to differ in ways that affect the unification of capital markets, and a number of issues impeding free movement of capital have not been resolved. Prospective borrowers in different countries face divergent national legislation and practices governing the issuance, listing, and trading of securities, and rules can vary significantly depending on the point of origination of a new transaction. Domestic contractual requirements vary markedly among countries, as do rules on potential conflicts of interest, credit guidelines, and ongoing provision of company information.[11] Partly as a result, the investor side of the market is marked by a high degree of domestic bias, particularly within the insurance and pensions sectors, which continue to be supervised largely on an individual national basis

63. On a European level the Banking Recovery and Resolution Directive (2014/59/EU, BRRD) was enacted. It establishes a common European framework for the recovery and resolution of failing banks and as such aims to implement the Financial Stability Board key attributes of effective resolution regimes into EU Law. Regulation (EU) No 806/2014 establishes uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism (SRM) and a Single Resolution Fund (SRF). Regulation (EU) 2015/81 of December 19, 2014 specifies uniform conditions of application of Regulation (EU) No 806/2014 of the European Parliament and of the Council with regard to ex ante contributions to the SRF (EU) 2015/81. In addition to the BRRD, the reform of the deposit guarantee schemes directive (2014/49/EU, recast DGSD) was enacted in 2014.

64. Bank resolution within the Banking Union falls under the scope of the SRM. Under the SRM Regulation, a new agency, the SRB, has been established and vested with direct responsibility for resolution planning and resolution decision-making for all SIs directly supervised by the ECB, all cross-border banks established in the Euro Area, and any other LSI where resolution requires the use of the SRF. The SRM centralizes decision-making for resolution actions and relies on joint SRB/ National Resolution Authorities (NRA) teams (internal resolution teams or "IRTs") for resolution planning for SIs and cross-border banks. However, resolution implementation—even for institutions that fall within the purview of the SRB—is primarily the responsibility of the NRAs. The NRA is also responsible for resolution planning, resolution decision-making and implementation with respect to

[9] European Commission, Mid-Term Review of the Capital Markets Union Action Plan, COM (2017) 292, 8 June 2017.

[10] Xafa, Miranda, European Capital Markets Union Post Brexit, Centre for International Governance Innovation, CIGI Papers No. 140, August 2017.

[11] Valiante, Diego, Europe's Untapped Capital Market: Rethinking Financial Integration after the Crisis, Final Report of the European Capital Markets Expert Group, Centre for European Policy Studies Paperback, Rowman & Littlefield International, London, 2016, pp. 187 ff.

LSIs not covered by the SRB. With respect to both SIs and LSIs, the SRB maintains back-up authority to intervene and directly implement a resolution if necessary to ensure high resolution standards or to ensure that resolution objectives are being met.

65. The SRM Regulation establishes an SRF. The SRF is owned and administered by the SRB, and is funded by regular ex ante and, potentially, extraordinary ex post contributions by banks. The fund will be built up to an initially estimated target amount of EUR 55 billion over eight years (1 percent of covered deposits of all banks within the member states participating in the SRM). The fund consists of national compartments, which can be used to fund resolution measures with respect to banks in the contributing jurisdiction. The contributions will be progressively mutualized over a period of eight years. The mutualized compartments are available to fund resolution measures in any SRM jurisdiction. The SRF may fund the losses, costs or other expenses associated with resolution measures only to the extent necessary to ensure the effective application of the resolution tools.

66. The DGSD harmonized deposit insurance coverage across the EU. The DGSD also extended coverage to deposits of large nonfinancial companies, introduced faster pay-outs and ex-ante funding arrangements, while maintaining the same level of protection of deposits at EUR 100,000. The DGDS requires that, by July 3, 2024, each DGS shall reach a target level of at least 0.8 percent of the amount of covered deposits. The EC announced in 2015 a proposal to implement a European Deposit Insurance Scheme for Banking Union members by 2024. Under this proposal, national DGS would be gradually mutualized over time and in three stages. In the first, so-called reinsurance stage, the scheme would provide support (financed by contributions from the national DGS) to a national DGS that has first exhausted its national fund. This would then move after three years to a co-insurance scheme, in which the contribution to the scheme would progressively increase over time, until full mutualization was reached in 2024.

DETAILED ASSESSMENT

A. Supervisory Powers, Responsibilities, and Functions

Principle 1	**Responsibilities, objectives, and powers.** An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.[12] A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws, and undertake timely corrective actions to address safety and soundness concerns.[13]
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision[14] are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	The ECB, in cooperation with NCAs, is responsible for the supervision of credit institutions established in the participating EU Member States.[15] Together, the ECB and the NCAs form the SSM, which became operational on November 4, 2014. The ECB is responsible for the effective and consistent functioning of the SSM. The objectives and responsibilities of ECB banking supervision and NCAs are defined in the SSMR.[16] This Regulation is supplemented by the SSM Framework Regulation (SSMFR),[17] which provides the framework for organizing the practical arrangements for cooperation within the SSM. The respective tasks of the ECB and of the NCAs, which depend on whether a credit institution is considered "significant" or not, are listed in Articles 4 and 6 of the SSMR and further detailed in the SSMFR. In brief, banks are SIs or LSIs on the basis of defined criteria

[12] In this document, "banking group" includes the holding company; the bank; and its offices, subsidiaries, affiliates, and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example nonbank (including nonfinancial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

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

[14] Such authority is called "the supervisor" throughout this paper, except where the longer form "the banking supervisor" has been necessary for clarification.

[15] The participating Member States are the Member States whose currency is the euro or a Member State whose currency is not the euro but which has established close cooperation with the ECB.

[16] Council Regulation (EU) No 1024/2013 of October 15, 2013 conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions.

[17] Regulation (EU) No 468/2014 of the ECB of April 16, 2014 establishing the framework for cooperation within the SSM between the ECB and NCAs.

	in Article 6 of the SSMR, mainly: their size, their importance for the economy of the Union or a specific Member State, and the importance of their cross-border activities.[18] Significant banks or banking groups are under the direct supervision of the ECB. In accordance with Article 6 of the SSMR, NCAs are responsible for assisting the ECB, under the conditions set out in the SSMFR, with the preparation and implementation of any acts relating to the range of tasks conferred on the ECB in Article 4 of the SSMR. Less significant banks or banking groups are under the direct supervision of the NCAs. For these LSIs, the ECB has an oversight responsibility to ensure that the supervisory activities of the NCAs are of the highest quality and that supervisory requirements on all credit institutions covered by the SSM are consistent.[19] In this context, when necessary to ensure consistent application of high supervisory standards, 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 credit institutions, including in the case where financial assistance has been requested or received indirectly from the European Financial Stability Facility (EFSF) or the European Stability Mechanism (ESM). This prerogative has not been exercised to date. The SSMR and the SSMFR are published in the Official Journal of the EU and are available on the ECB Website. In addition, at the establishment of the SSM, the ECB published its *Guide to banking supervision*, which aims to explain to the public how the SSM functions and to give guidance on the SSM's supervisory practices. In carrying out its prudential tasks, the ECB has at its disposal: • the tools and powers provided for in the SSMR; and • the tools and powers mentioned in EU supervisory law, in particular: the CRR[20] dealing with prudential requirements for credit institutions; the CRD IV[21] on access to the activity of credit institutions and the prudential supervision of credit

[18] The ECB directly supervises 118 banking groups in 19 Member States, which include 1,108 banks representing EUR 21,400 billion of aggregated assets.

[19] The NCAs, under the general oversight of the ECB, supervise more than 3,100 banks, which represent EUR 4,900 billion of aggregated assets.

[20] Regulation (EU) No 575/2013 of the European Parliament and of the Council of June 26, 2013 on prudential requirements for credit institutions and investment firms, amending Regulation (EU) No 648/2012).

[21] Directive 2013/36 of the European Parliament and of the Council of June 26, 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

	institutions; the Single Resolution Mechanism Regulation (SRMR)[22] establishing uniform rules and a uniform procedure for the resolution of credit institutions; the BRRD[23] establishing the framework for the recovery and resolution of credit institutions; and the FICOD[24] on supplementary supervision of financial conglomerates. In November 2016, the European Commission published proposals for an extensive revision of the above-mentioned legislation related to prudential supervision. The proposal contains amendments to the CRR and CRD IV, the SRMR, and the BRRD. The ECB published a detailed opinion on this proposal in November 2017 (CON/2017/46). Where the relevant EU law is composed of directives, the ECB is able to apply the tools and exercise the powers mentioned in national laws that have transposed these directives. The ECB also exercises directly powers granted to NCAs by national laws provided that these powers fall under the tasks conferred on the ECB in Article 4 of the SSMR and underpin the ECB's supervisory functions under EU law.[25] This understanding of the ECB's powers is shared by the European Commission.[26] Where the relevant EU 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 IV, which predated the

[22] Regulation (EU) No 806/2014 of the European Parliament and of the Council of July 15, 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of the SRM and an SRF and amending Regulation (EU) No 1093/2010.

[23] Directive 2014/59/EU of the European Parliament and of the Council of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council.

[24] Directive 2002/87/EC of the European Parliament and of the Council of December 16, 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate and amending Council Directives 73/239/EEC, 79/267/EEC, 92/49/EEC, 92/96/EEC, 93/6/EEC and 93/22/EEC, and Directives 98/78/EC and 2000/12/EC of the European Parliament and of the Council.

[25] The Supervisory Board agreed 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 nonbanks 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 with the exclusion of the approval requirements for the issuance of covered bonds and strategic decisions. The Supervisory Board agreed that the NCAs are responsible to: authorize third-country branches, approve mergers from a competition law or macroprudential perspective, supervise external auditors, impose or enforce conditions attached by regulation to banking activities, such as product rules and impose penalties to absorb the economic advantage gained from the breach of prudential requirements, which primarily serve competition law purposes.

[26] Report from the Commission to the European Parliament and the Council on the SSM pursuant to Regulation (EU) No 1024/2013, COM (2017), p. 12 and accompanying Commission Staff working document (SWD(2017) 336 final, p. 26–27). The report is available here: https://ec.europa.eu/info/sites/info/files/171011-ssm-review-report_en.pdf.

	establishment of the SSM, provide options and discretions for Member States (around 30) and to NCAs (around 130) in relation to the prudential supervision of credit institutions. In 2015, the ECB decided to harmonize the application of options and discretions granted to NCAs for the supervision of SIs. The objective was to strengthen the overall robustness of the supervisory framework and the comparability of prudential requirements across credit institutions, so as to reduce regulatory complexity and compliance costs and the potential for regulatory arbitrage. A harmonized policy was introduced by means of a published Regulation, which entered into force on October 1, 2016, and a consolidated Guide.[27] In April 2017, the ECB introduced a recommendation and a guideline addressed to NCAs to harmonize around 60 options and discretions available to NCAs in EU law for the supervision of LSIs. However, harmonization of options and discretions provided to Member States under the CRR and CRD IV would require amendments to EU legislation. On the basis of the SSMR, the ECB may adopt guidelines and recommendations, and take decisions subject to and in compliance with EU law. Moreover, to the extent necessary to carry out the tasks conferred upon it by the SSMR, the ECB may adopt regulations and may 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 (Article 9(1) of the SSMR). In the case of supervision of LSIs, the ECB may issue regulations, guidelines[28] or general instructions to NCAs in accordance with Article 6(5)(a) of the SSMR. The ECB is subject to technical standards developed by the EBA and adopted by the Commission, and also to the EBA's European Supervisory Handbook. The EBA also issues guidelines and recommendations aimed at establishing consistent, efficient, and effective supervisory practices, which are subject to a "comply-or-explain" procedure on the part of competent authorities.
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	Article 1 of the SSMR clearly states the objectives of ECB banking supervision: "This Regulation confers on the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory

[27] Available at the ECB's website: Regulation (EU) 2016/445 on the exercise of options and discretions available in Union law; ECB Guide on options and discretions available in Union law consolidated version of November 2016.

[28] An example of such a legal act addressed to NCAs is the Guideline of the ECB of September 3, 2015 on communication of supervisory plans for less significant entities and less significant groups by the NCAs to the ECB (ECB/2015/NP20).

	arbitrage." That is, the primary objective of ECB banking supervision is to promote the safety and soundness of banks and the stability of the financial system. Article 25 of the SSMR further specifies that, when carrying out its supervisory tasks, the ECB shall pursue only the objectives set by the SSMR. The same provision also establishes a framework to separate the supervisory function of the ECB from its monetary policy function. The purpose of the separation principle is to ensure that each function is exercised in accordance with its respective objectives, therefore avoiding conflicts between these objectives, but without duplication of work for shared services. The separation principle covers, among other things, the separation of objectives, decision-making processes, and tasks, including organizational and procedural separation at the level of the Governing Council. In order to ensure full separation of objectives, decisions taken by the ECB in the area of banking supervision are prepared by an independent Supervisory Board before being submitted to the Governing Council for final adoption. Adoption is mainly under a "non-objection procedure," according to which the Governing Council is deemed to have adopted the decision unless it objects within a specific timeframe.[29] Moreover, the ECB's Rules of Procedure were amended to regulate organizational and procedural aspects related to the Supervisory Board and its interaction with the Governing Council. This included the rule that the Governing Council's deliberations on supervisory matters are to be kept strictly apart from those on other issues, with separate agendas and meetings. Additionally, as required under Article 25(5) of the SSMR, a Mediation Panel[30] has been established to resolve any differences of views expressed by the NCAs of participating Member States regarding an objection of the Governing Council to a draft decision by the Supervisory Board. The SSMR requires the ECB to adopt and publish any necessary internal rules to ensure 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. On September 17, 2014, the ECB adopted a Decision on the implementation of separation between the monetary policy and supervision functions of the ECB.[31]
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to

[29] The time period for the Governing Council to object is no more than 10 working days.

[30] Regulation (EU) No 673/2014 of the ECB of June 2, 2014 concerning the establishment of a Mediation Panel and its Rules of Procedure (ECB/2014/26).

[31] Decision of the ECB of September 17, 2014 on the implementation of separation between the monetary policy and supervision functions of the ECB (ECB/2014/39).

	increase the prudential requirements for individual banks and banking groups based on their risk profile[32] and systemic importance.[33]
Description and findings re EC3	The ECB has a range of powers provided for in the relevant regulations—the CRR and SSMR—and can apply the powers set out in CRD IV, as transposed into national legislation. The CRR and CRD IV provide the legislative basis for banking supervision in the EU. Minimum regulatory capital requirements are determined by Article 92 of the CRR. Credit institutions must at all times satisfy the following own funds requirements: (a) a Common Equity Tier 1 (CET1) capital ratio of 4.5 percent; (b) a Tier 1 capital ratio of 6.0 percent; and (c) a total capital ratio of 8.0 percent. Credit institutions are also required to maintain a capital conservation buffer of CET1 capital calculated in accordance with Article 129 of CRD IV. From January 1, 2016 onwards, a systemic risk buffer of CET1 capital has applied to banks that are identified as globally systemically important institutions (G-SII buffer) or as other systemic institutions (O-SII buffer, up to 2.0 percent of the total risk exposure). In addition, ECB banking supervision may increase capital requirements for individual banks and banking groups based on their risk profile and systemic importance. The determination of these requirements is based on the SSM SREP, referred to in Article 97 of the CRD IV and further specified in the respective EBA Guidelines.[34] The SREP, which is described in detail in CP 8, ensures a common methodology and decision-making process for the ongoing assessment of credit institutions' risks, their governance arrangements and their capital and liquidity situation. The SSM SREP evaluates: • risks to which the institutions are or might be exposed; • 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.

[32] In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

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

[34] EBA, Guidelines on common procedures and methodologies for the SREP, EBA/GL/2014/3 of December 19, 2014, available at the website of EBA. It is noted, as a preliminary observation, that the Commission proposal referred to above may unduly limit the supervisors' necessary flexibility to act in this respect.

	ECB banking supervision assesses, at least annually, whether an additional capital requirement, on an individual or on a consolidated basis, is necessary to capture risks to which an institution is or might be exposed, taking into account the following: • the quantitative and qualitative aspects of an institution's assessment process; • an institution's arrangements, processes, and mechanisms; • the outcome of the review and evaluation carried out; and • the assessment of systemic risk. Starting in the 2016 SREP process, capital requirements based on the individual risk profile of a credit institution have two parts: Pillar 2 requirements and Pillar 2 guidance. Pillar 2 requirements are binding and breaches can have direct legal consequences for banks. Pillar 2 guidance is not directly binding and a failure to meet that guidance does not automatically trigger legal action. Nonetheless, the ECB expects credit institutions to meet Pillar 2 guidance; where an institution's capital has fallen, or is expected to fall, below the level of that guidance, the institution is to immediately notify ECB banking supervision and explain the reasons for non-compliance. In addition to its powers to determine prudential capital and liquidity requirements for each bank or banking group, the ECB has a broad set of supervisory and investigatory powers that it can use to carry out its tasks, including oversight of the functioning of the system and of the supervision of LSIs by NCAs. These powers include, in particular, the supervisory powers listed in Article 16 of the SSMR. If a bank does not meet the requirements of relevant EU law, is likely to breach these requirements within 12 months, or if, based on the SREP, ECB banking supervision determines that the arrangements, strategies, processes, and mechanisms implemented by the credit institution and the own funds and liquidity held by it do not ensure sound management and coverage of its risks, the ECB has, inter alia, the following powers: • to require the reinforcement of the arrangements, processes, mechanisms, and strategies; • to require institutions to present a plan to restore compliance with supervisory requirements and set a deadline for its implementation, including improvements to that plan regarding scope and deadline; • to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements; • to restrict or limit the business, operations, or network of institutions or to request the divestment of activities that pose excessive risks to the soundness of an institution; • to require the reduction of the risk inherent in the activities, products, and systems of institutions;

	• to require institutions to limit variable remuneration as a percentage of net revenues when it is inconsistent with the maintenance of a sound capital base; • to require institutions to use net profits to strengthen own funds; • to restrict or prohibit distributions to shareholders, members, or holders of Additional Tier 1 instruments where the prohibition does not constitute an event of default of the institution; or • to impose additional or more frequent reporting requirements, including reporting on capital and liquidity positions. In practice, such qualitative measures are generally adopted as an outcome of the SREP process, in addition to specific capital or liquidity requirements. In addition, the ECB is able to take early intervention measures under Article 27 of the BRRD, which are discussed in EC 6 below. The ECB's assessment of whether an early intervention measure is needed and proportionate forms a structural part of the yearly SREP cycle.
EC4	Banking laws, regulations, and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.
Description and findings re EC4	As noted in EC 3 above, the CRR and CRD IV provide the legislative basis for banking supervision in the EU. This legislation was adopted in 2013 following public consultation. In November 2016, the Commission released for public consultation a set of proposals to amend, *inter alia*, the CRR and CRD. Article 32 of the SSMR provides that the Commission publish, every three years, a report on the application of the SSMR, accompanied by proposals for potential review. This ensures that the regulatory framework for European banking supervision is regularly updated. The first such EC report, to which the ECB actively contributed, was published in October 2017. The overall conclusion of the report was that the application of the SSMR appeared to work well in practice, with no major changes needed to the legal framework at this stage. The report also concluded that the supervisory pillar of the Banking Union has been successfully established, functions well and has proven its effectiveness. The report is also discussed in EC 3 of CP 2. As noted in EC 2 above, the ECB is subject to technical standards developed by the EBA and adopted by the Commission, and also to the EBA's European Supervisory Handbook. EBA technical standards and guidelines are subject to formal public consultation. To meet its aspirations to be a best practice supervisory agency, particularly in terms of instruments and practices, the ECB contributes to the development of draft regulatory technical standards (RTS) or ITS by the EBA. The ECB is also entitled to draw the attention of the EBA to a potential need to submit to the Commission draft standards amending existing

	RTS or ITS. The ECB has defined and will continue defining supervisory approaches in policy stances and supervisory expectations to ensure a consistent application of supervisory law and a level playing field.[35] Additionally, as noted in EC1 above, the ECB may adopt regulations to the extent necessary to organize or specify the arrangements for carrying out its tasks. Before adopting a regulation, the ECB must conduct open public consultations and analyze the potential related costs and benefits, unless such consultations and analyses are disproportionate in relation to the scope and impact of the regulations concerned or in relation to the particular urgency of the matter. In that case, the ECB must justify that urgency. To date, the ECB has adopted the following regulations after public consultations: • ECB Regulation on reporting of supervisory financial information; • ECB Regulation on supervisory fees; • ECB SSMFR; and • ECB Regulation on the exercise of options and discretions for SIs. While public consultation is only legally required for ECB regulations, the ECB has also conducted a number of public consultations on supervisory approaches, so as to inform the public about the proposed adoption of a new supervisory stance and to benefit from comments. Consultations have covered: • ECB Guide on options and discretions available in Union law; • ECB Guide on the approach to the recognition of institutional protection schemes for prudential purposes; • ECB Guidance on NPLs; • ECB Guidance on leveraged transactions; • Addendum to ECB Guidance on leveraged transactions; • ECB Guide to fit-and-proper supervision; • ECB Guide concerning the assessment of license applications; • ECB Guide concerning the assessments of fintech credit institution license applications; • ECB Guide to onsite inspections and internal model investigations; • ECB Guide on materiality assessment;

[35] For instance: Public guidance on the review of the qualification of capital instruments as Additional Tier 1 and Tier 2 instruments, June 6, 2016; Public guidance on the recognition of significant credit risk transfer, March 24, 2016, available at the website of the ECB banking supervision www.bankingsupervision.europa.eu

	• Guideline on the options and discretions available in Union law by NCAs in relation to LSIs (ECB/2017/9); and • Recommendation on common specifications for the exercise of some options and discretions available in Union law by NCAs in relation to LSIs (ECB/2017/10).
EC5	The supervisor has the power to: (a) have full access to banks' and banking groups' Boards, management, staff, and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) supervise the activities of foreign banks incorporated in its jurisdiction.
Description and findings re EC5	*With respect to criterion EC 5 (a):* In accordance with Article 10 of the SSMR, the ECB may require credit institutions; financial and mixed financial holding companies; and mixed-activity holding companies, established in the Euro Area, to provide all information necessary in order to carry out its supervisory tasks. The ECB may also request information from persons belonging to these entities or from third parties to whom those entities have outsourced functions or activities. In addition, pursuant to Article 11 of the SSMR, the ECB may conduct investigations of any of these entities, persons or third parties, when those are established or located in the Euro Area. To that end, the ECB is empowered to: • require the submission of documents; • examine the books and records of the persons referred to in Article 10 and take copies or extracts from such books and records; • obtain written or oral explanations from any person referred to in Article 10 or their representatives or staff; and • interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation. The ECB may also conduct all necessary onsite inspections according to Article 12 of the SSMR and may, for that purpose, enter any business premises and land of the legal persons subject to an investigation. *With respect to criterion EC 5 (b):* Article 4(1)(g) of the SSMR empowers the ECB to carry out supervision on a consolidated basis over credit institutions' parents established in the Euro Area, including over financial holding companies and mixed financial holding companies. It 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 parents of a significant credit institution are established outside the Euro Area but in the EU/EEA, the ECB participates in

	supervision on a consolidated basis, including in colleges of supervisors, with the relevant NCAs as observers. Within the SSM, the ECB is the competent authority for participation in EU or international supervisory colleges for significant banking groups. The ECB may conclude MoUs with non-SSM NCAs in order to describe, in general terms, how they will cooperate with one another in the performance of their supervisory tasks (Article 3 of the SSMR). The conclusion of such a memorandum is specifically required by the SSMR with the NCA of each non-participating Member State that is home to at least one G-SII. To date, however, no MoUs or close cooperation agreements have been concluded with non-SSM NCAs (see CP 3). In addition, pursuant to Article 8 of the SSMR, the ECB may also develop contacts and enter into administrative arrangements with supervisory authorities of third countries (i.e., countries outside the EU), subject to appropriate coordination with the EBA. Under "step in" arrangements, the ECB took the place of NCAs in cooperation arrangements with other authorities entered into prior to November 4, 2014 that cover at least in part the supervisory tasks transferred to the ECB (Article 152 of the SSMFR). *With respect to ECB 5 (c):* The ECB has direct supervisory competence in respect of credit institutions, financial holding companies, and 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. For less significant branches of EU/EEA parents, the host authority is the respective NCA (Article 14 of the SSMFR). If a non-participating Member State establishes a college as the home authority, an onsite inspection of branches is possible under Article 159 of CRD IV. In accordance with Article 18 of the SSMFR, the ECB is the coordinator of financial conglomerates for SIs and the NCA the coordinator of financial conglomerates for LSIs. Similarly, foreign banks establishing a subsidiary in the Euro Area are authorized by the ECB and directly supervised by the ECB when classified significant. However, foreign banks establishing a branch or providing cross-border services in the EU are directly supervised by the relevant NCAs (Recital 28 of the SSMR) and regulated by national laws and regulations. Such branches are neither subject to CRD/CRR (and related EBA RTS/ITS and guidelines), nor to consolidated supervision at the EU level.
EC6	When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to: (a) take (and/or require a bank to take) timely corrective action; (b) impose a range of sanctions; (c) revoke the bank's license; and

	(d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.
Description and findings re EC6	Also see CP 11. The ECB has a broad range of measures it may take (and/or require a bank to take) to ensure timely corrective actions.[36] Those measures include a wide range of supervisory powers as well as administrative measures and administrative penalties. In line with Article 102 of CRD IV for supervisory measures and Articles 27–29 of the BRRD for early intervention,[37] 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 (e.g., when the institution does not meet relevant regulatory requirements or when the ECB has evidence that the institution is likely to breach these requirements). The assessment whether an institution infringes or is likely to infringe requirements is based on the outcome of the SREP. Any corrective measures should be the most appropriate for the particular weaknesses identified and proportionate to the particular circumstances. Additional supervisory measures available to the ECB under Article 16(2) of the SSMR include requiring institutions to hold additional own funds, to reinforce governance arrangements and procedures, and 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; requesting the divestment of activities that pose excessive risks to the soundness of an institution; or requiring institutions to limit variable remuneration. The available early intervention measures described in Article 27 (1) of the BRRD include: requiring the management body of the institution to implement one or more of its recovery measures, to draw up and implement an action plan to overcome problems, or to convene a meeting of shareholders of the institution and require certain decisions to be considered for adoption by the shareholders; requiring one or more members of the management body or senior management to be removed or replaced; requiring the management body of the institution to draw up a plan for negotiation on restructuring of debt with some or all of its creditors according to the recovery plan, where applicable; requiring changes to the institution's business strategy or its legal or operational structures; and acquiring, all the information necessary in order to update the resolution plan and prepare for the possible resolution of the institution and for valuation of its assets and liabilities in accordance with

[36] With regard to crisis management, reference is made to the following provisions: Articles 27, 36, 38(8), 41(1), 47(4), 56–58, 63(1)(m), 71(7), 81(3), 83(4), and 90(1) of the BRRD; Articles 97 and 102 of CRD IV; Articles 3(4), 9, and 16(2) of the SSMR and Article 18(1) of the SRM Regulation. The crisis management framework of the SSM covers a number of phases ranging from preparatory activities in the ongoing supervision of SIs to assessment of the failing or likely to fail criteria and involvement in decisions on their resolution. However, during the resolution process, the main decision-makers are the resolution authorities: i.e., the SRB for SIs and cross-border LSIs and the NRAs for all other LSIs. In addition, some supervisory action by the ECB or the NCA, respectively, may be necessary as a consequence of resolution, such as the authorization of a bridge institution or the assessment of the acquisition of a qualifying holding.

[37] Directive 2014/59/EU of the European Parliament and of the Council of May 15, 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

	Article 36 of the BRRD. Under Articles 28 and 29 of the BRRD, the ECB can under specific conditions also remove the senior management or management body of the institution and appoint a temporary administrator. In addition, where a supervised entity, intentionally or negligently, breaches a requirement, the ECB may impose sanctions (see CP 11). The ECB also has the powers to withdraw the authorization of a credit institution (see EC1 of CP 5). In the case of the resolution of SIs and other cross-border banks, 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 or groups 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 SRB and the Commission without delay. Under certain conditions, the determination that an entity is failing or likely to fail can also be made by the SRB. Where such a determination is made by either the ECB or the SRB, other external stakeholders have to be informed as well, e.g., the relevant deposit guarantee scheme(s), the competent ministries, the European Systemic Risk Board (ESRB) and the designated national macroprudential authority. Moreover, to support any resolution action(s), the ECB provides advice to the SRB and relevant NRA in the resolution stage and on necessary follow-up actions, e.g., authorization of a bridge bank and withdrawal of the license of the 'old' institution, where appropriate. Once an SI or group is in resolution and under the control of the SRB, the general obligation on the ECB to provide the resolution authority on request with all the information relevant for the exercise of its tasks continues to apply.[38] In addition, the BRRD envisages certain tasks to be performed by the banking supervisor, e.g., assessing 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. Where a bridge institution is set up by the resolution authority, it may submit a request to the banking supervisor for a temporary exemption of the conditions for authorization.[39] In these cases, the relevant NCA would receive the request for authorization, but the ECB would grant authorization and it could become the competent banking supervisor for the bridge bank if it were an SI. The resolution authority will publish on its website and also request that the institution under resolution, the EBA and the ECB publish on their websites a copy of the resolution order or instrument or a summary note,

[38] Article 3(4) of the SSMR and Article 90(1) of the BRRD; MoU between the SRB and the ECB in respect of cooperation and information exchange is available on the website of ECB banking supervision.

[39] Article 41(1) of the BRRD.

	and in particular the effects on retail customers and the terms and period of suspension or restriction.[40]
EC7	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	In the case of SIs, ECB banking supervision is performed both on a solo and on a consolidated basis. In the same vein, the assessment of the significance of banks and banking groups is done at the highest level of consolidation in the Euro Area. In relation to significant credit institutions or groups, the ECB carries out supervision, on a consolidated basis, of the parents of credit institutions established in one of the participating Member States, including over financial holding companies and mixed financial holding companies (Article 4(1)(g) of the SSMR). The ECB chairs supervisory colleges of groups of SIs with head office in a participating Member State and takes part in supervisory colleges for SIs with headquarters outside the Euro Area. The NCAs have the right to participate in such colleges as observer. Similarly, the ECB has the power to require credit institutions as well as financial holding companies and mixed financial holding companies in the Euro Area to take necessary measures. For such entities, the ECB may also use the powers conferred to the supervisor by the national law transposing Union law, or request the NCA to make use of its purely national powers. Where a significant credit institution or group has insurance or investment activities outside the banking perimeter, the ECB consults with the relevant national authority in terms of the EU's FICOD.
Assessment of Principle 1	Largely Compliant
Comments	The SSM has established a clear allocation of responsibilities for the supervision of Euro Area credit institutions between the ECB and the NCAs in participating Member States. However, the legal underpinnings of the SSM are complex. The supervisory function has been "force fitted" over a complicated interplay of EU and national laws that had not envisaged a unified approach. Differences in national laws have been a challenge to achieving a consistent application of prudential rules and promotion of a level playing field among Euro Area banks. The ECB has a broad range of powers provided for in the CRR and the SSMR and can apply the powers set out in CRD IV as transposed into national legislation. However, the EU legislation also makes available a considerable number of options and discretions to either the NCAs or the Member States that allow modification of some of the provisions. As the

[40] Article 83(4) of the BRRD.

	competent authority, the ECB can exercise and harmonize the options and discretions granted to NCAs in the SSM, and it has made strong progress in this direction. The ECB has also publicly clarified that it is competent to directly exercise several "clusters" of supervisory powers granted to NCAs, when these powers are clearly used for prudential purposes and fall within the ECB's supervisory tasks. Where the exercise of options and discretions is attributed to Member States, the ECB must apply national legislation and it cannot harmonize these types of options and discretions. Furthermore, national powers differ quite considerably, and need to be assessed on a case-by-case basis by applying a two-pronged test to establish whether the ECB can exercise these powers directly. Harmonization in these areas would require amendments to EU legislation, which should be pursued as a matter of priority. Though the ECB has a broad range of powers, the SSM legislative framework—reflecting the uneven coverage of national laws—leaves the ECB facing gaps and asymmetries in its supervisory powers. The ECB does not have supervisory powers that apply to all significant forms of credit intermediation in the Euro Area. In particular, investment firms undertaking "bank like" business in the Euro Area are subject to many of the same regulations as banks, including for capital and liquidity, but are currently supervised nationally even when they are of significant size and very active in cross-border business. In addition, Euro Area branches of non-EU or EEA banks, unlike their subsidiaries, are neither subject to CRD IV/CRR (and related EBA standards and guidelines), nor to consolidated supervision at the EU level;[41] they are regulated by national laws and regulations, which vary significantly, and are supervised directly by local NCAs. This issue is discussed in detail in CP 5. The Commission's proposals for an extensive revision of EU law related to prudential supervision provide an opportunity for harmonization and clarification of the ECB's supervisory powers. In its opinion of November 2017 on these proposals, the ECB noted that large and complex "bank like" investment firms, particularly those with cross-border operations, can pose financial stability risks as well as an increased risk of spill-over effects on other banks. It has also proposed that EU law should include a clear reference to additional supervisory powers in a number of areas, to avoid legal uncertainty and to ensure a level playing field with regard to supervisory powers across the Banking Union. These areas mainly relate to acquisitions in third countries (see CP 7), mergers, asset transfers, and other strategic decisions, the amendment of credit institutions' statutes and their shareholders' agreements on the exercise of voting rights, the provision of credit to related parties, the outsourcing of activities by credit institutions, supervisory powers regarding external auditors, and additional powers related to the authorization of credit institutions.

[41] Subsidiaries of non-EU groups, which operate under a Member State authorization (or of the ECB, if significant), can be subject to sub-consolidated supervision in cases where they control other institutions in the EU.

	The Largely Compliant rating for CP 1 acknowledges the gaps and asymmetries in the ECB's supervisory powers, which are material in some specific areas, but also recognizes the clear responsibilities and objectives of the ECB within the SSM, and the broad range of powers available to it under legislation, and being employed, to ensure effective supervision of Euro Area banks and to promote the safety and soundness of the Banking Union.
Principle 2	**Independence, accountability, resourcing, and legal protection for supervisors.** The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
Essential criteria	
EC1	The operational independence, accountability, and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	Article 130 of the Treaty on the Functioning of the EU and the SSMR require that the ECB act independently. The ECB's independence encompasses functional, institutional, personal and financial independence,[42] and extends to its supervisory tasks. The same requirement for independence applies to the NCAs. Article 19 of the SSMR provides that: "When carrying out the tasks conferred on it by this Regulation, the ECB and the NCA 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." ECB banking supervision is also subject to high standards of democratic accountability to ensure confidence and transparency in the conduct of this function. As a European institution, the ECB is primarily accountable to the European Parliament and the European Council, in line with Article 20 of the SSMR. The practical arrangements for this accountability are described in the Interinstitutional Agreement with the European Parliament and in the MoU with the European Council (see EC 3 below). Moreover, the ECB submits its annual report on banking supervision to national parliaments (NPs) and these may address their considered observations to the ECB (Article 21 of the SSMR).
EC2	The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out

[42] The concept of central bank independence is described in the biannual ECB convergence report, p. 20.

	the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.
Description and findings re EC2	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 (this is the case for Austria, Estonia, Finland, Germany, Latvia, Luxembourg, and Malta). The process for the appointment of the Chair and Vice-Chair of the Supervisory Board, as well as of the four ECB representatives, is described in Article 26 of the SSMR, the ECB Rules of Procedure and Decision ECB ECB/2014/4 of February 6, 2014 on the appointment of representatives of the ECB to the Supervisory Board. The Chair is chosen on the basis of an open selection procedure, 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 shall specify and make public the criteria for the selection of the Chair and describe arrangements that ensure a proper involvement of the European Parliament and Council in the procedures. The Vice-Chair is chosen from among the members of the Executive Board of the ECB, who are in turn appointed by the European Council, acting by a qualified majority, from among persons of recognized standing and professional experience in monetary or banking matters, on a recommendation from the Council, after it has consulted the European Parliament and the Governing Council of the ECB. 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 Parliamentary Committee. Following approval of the Parliament, the Council adopts an implementing decision appointing them. The four ECB representatives are appointed by the Governing Council, on a proposal from the Executive Board, from among persons of recognized standing and experience in banking and financial matters. The term of office of the Chair, the Vice-Chair, and the four ECB representatives is five years, non-renewable. The Council may, following a proposal of the ECB that has been approved by the European Parliament, adopt a decision to remove the Chair from office, if he/she no longer fulfills the conditions required for the performance of his/her duties or has been guilty of serious misconduct. If the Vice-Chair, being at the same time a member of the Executive Board, no longer fulfills the conditions required for the performance of his/her duties or has been guilty of serious misconduct, the Court of Justice of the EU may, on application by the Governing Council or the Executive Board, compulsorily retire him/her from his/her function as member of the

	Executive Board. In such a case, the Council may, following a proposal by the ECB that has been approved by the European Parliament, adopt an implementing decision to remove him/her as well from the office of Vice-Chair. If an ECB representative no longer fulfills the conditions required for the performance of his/her duties, or if he/she has been guilty of serious misconduct, the Governing Council may, on application of the Executive Board and after having heard him or her, decide to remove him/her from office.
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.[43]
Description and findings re EC3	The objectives of ECB banking supervision are clearly stated in Article 1 of the SSMR. This Regulation confers on the ECB "… specific tasks concerning policies relating to the prudential supervision of credit institutions, with a view to contributing to the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State, with full regard and duty of care for the unity and integrity of the internal market based on equal treatment of credit institutions with a view to preventing regulatory arbitrage." As noted in EC1 above, the ECB is accountable, mainly to the European Parliament and the Council and, to some extent, to NPs of the participating Member States. The main tool for accountability is the record of proceedings of each meeting of the Supervisory Board, which the ECB provides to the European Parliament, and the published ECB Annual Report on supervisory activities. This Report, which is also communicated to the Commission, the Eurogroup (an informal body of Ministers of the Euro Area Member States), and the NPs in the Euro Area, describes the implementation of the ECB's supervisory tasks as well as the expected evolution of the structure and amount of supervisory fees. In practice, the Report is also an important element of communication about the priorities for supervision in the SSM for the coming year. The Chair of the Supervisory Board participates in public hearings in the European Parliament or in the Eurogroup, an informal body of Ministers of the Euro Area Member States. The ECB also replies in writing to questions posed by Members of the European Parliament, which are published on the ECB's website. The ECB has a duty to cooperate in any investigations by the European Parliament, while the operational efficiency of the management of the ECB in exercising its supervisory tasks may be examined by the European Court of Auditors (ECA) (Article 20 of the SSMR). The first such review by the ECA was published in November 2016.

[43] Please refer to Principle 1, Essential Criterion 1.

	In addition to this accountability to European institutions, the SSMR (Article 21) caters for a number of possible interactions and reporting requirements from ECB banking supervision to NPs. Members of NPs can ask the ECB written questions in respect of its tasks and the Chair or a Member of the Supervisory Board may be invited for an exchange of views in NPs regarding SIs in the respective Member State. Whether the exchanges of views are public or confidential depends on the institutional framework of each NP. Several such exchanges of views have taken place so far. This framework is without prejudice to the NCAs' accountability to their NPs for their supervision of LSIs, for their residual tasks in the supervision of SIs (e.g., consumer protection, anti-money laundering (AML), counter-terrorism financing, third-country branches supervision), and for issues not related to supervision (e.g., budgets or human resources issues). Moreover, in order to enhance efficiency, the Commission will publish every three years a report on the application of the SSMR, with a special emphasis on monitoring the potential impact on the smooth functioning of the internal market. This report is to evaluate specific aspects of supervision listed in Article 32 of the SSMR, such as: the impact of ECB's supervisory activities on the interest of the Union as a whole and on the coherence and integrity of the internal market in financial services; the division of tasks between the ECB and the NCAs within the SSM; the effectiveness of independence and accountability arrangements; the appropriateness of governance arrangements, including the composition of, and voting arrangements in, the Supervisory Board and its relation with the Governing Council. The Commission seeks the ECB's views on specific issues for this review of Union legislation. The Commission's first report under this mandate, which was focused on the legislative, institutional and procedural framework of the SSM, was issued in October 2017.[44] The report assessed, inter alia, that the accountability arrangements applicable to the ECB are effective overall. In particular, the various processes and procedures in place for ensuring accountability towards political bodies such as the European Parliament, the Council, the Eurogroup, and NPs are frequently used in practice.
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	The internal governance rules of the ECB and its banking supervision function are laid down, in particular, in the SSMR, the SSMFR, the ECB Rules of Procedure, and the Rules of Procedure of the Supervisory Board. The internal (communication) processes are specified

[44] Report from the Commission to the European Parliament and the Council on the SSM pursuant to Regulation (EU) No 1024/2013, COM (2017), p. 12 and accompanying Commission Staff working document (SWD(2017) 336 final, p. 26–27). The report is available at: https://ec.europa.eu/info/sites/info/files/171011-ssm-review-report_en.pdf.

	further in the SSM Supervisory Manual. In addition, there is a general obligation to exchange information within the SSM, as introduced by Article 21 of the SSMFR. The decision-making processes in ECB banking supervision depend on whether supervisory actions are "operational acts" or are legally binding on supervised credit institutions. Operational acts are taken outside formal decision-making procedures, do not have a specific legal form and reflect the majority of the day-to day supervisory interaction with institutions (e.g., non-binding requests, statements, informal communication on supervisory expectations). Operational acts are decided by supervisors, without the involvement of the Supervisory Board and the Governing Council. However, all legally binding acts, including all supervisory decisions, need to be submitted to the Supervisory Board for approval, which then submits the draft decision to the Governing Council for adoption, under a non-objection procedure. Consequently, both bodies are confronted with a very high number of supervisory decisions to be adopted (around 2,000 decisions a year, including many routine decisions), and the process has a considerable impact on the complexity and duration of decision-making even for straightforward decisions. This becomes particularly challenging if supervisory decisions need to be taken within defined legal deadlines. In response, the Governing Council has introduced a delegation framework that allows certain supervisory decisions, which involve limited discretion, to be delegated to nominated ECB managers. Implementing such delegation required two steps: firstly, a general framework setting out the institutional requirements for the delegation of decision-making powers: and, secondly, a specific framework for the types of supervisory decisions that are subject to delegation, setting out the relevant criteria for the exercise of delegation. The first types of delegated decisions, from June 2017, were "fit-and-proper" decisions, which represent the large majority of the ECB supervisory decisions, as well as decisions amending the significance of supervised entities or groups. The volume of routine decisions going to the Supervisory Board has fallen considerably as a result. The ECB is currently considering extending the delegation framework to other types of routine decisions, such as own funds decisions, for which there is critical mass and clear assessment criteria that allow limited discretion. The timelines for decision-making reflect the procedural steps laid down in the legal framework. These timelines must be reasonable (i) to ensure a proper interaction between the ECB and NCAs; (ii) to allow the Supervisory Board and the Governing Council to properly review draft decisions and to take reasoned decisions; and (iii) to respect the rights of the addressees of decisions. The ECB has endeavored to streamline the decision-making process by written procedures for routine decisions and by standardizing and simplifying the documentation to be submitted to the decision-making bodies.

	In addition, if need be, the timeframe can be reduced substantially using fast-track procedures such as shortening the time limits for approval or taking decisions at teleconferences. For instance, in emergency situations such as a crisis, decisions are more likely to be approved by the Supervisory Board in a teleconference, which may include the Governing Council or be held back-to-back with a Governing Council teleconference where the decision is adopted. These fast-track procedures allow the ECB to take decisions within a day, when necessary. In 2014, the Supervisory Board adopted a Code of Conduct to provide a general framework of high ethical standards that the members and other participants in Supervisory Board meetings are to observe. The Code establishes specific procedures to deal, among other things, with potential conflicts of interest, private financial transactions, and cooling-off periods. In substance, the Code of Conduct 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 are subject to any applicable national procedural rules. At the same time, the Code requires Supervisory Board members to disclose in writing any situation that could cause or could be perceived as causing a conflict of interest (these members will not participate in any deliberation or vote in relation to that situation). A high-level Ethics Committee has been established to support and advise Supervisory Board members in the application of ethics rules.
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	The ECB's Ethics Framework, which applies to all ECB staff, was revised in 2014. The revised Framework strengthens, in particular, the rules on avoiding conflicts of interest, as well as the rules governing gifts and hospitality, private financial transactions, professional secrecy, and cooling-off periods. It also establishes a Compliance and Governance Office, which advises all ECB staff and monitors compliance. In order to strengthen its impartiality and reputation, ECB banking supervision adopted a broad concept of conflicts of interests, and ethics rules have been laid down in order to avoid conflicts of interests during the recruitment phase and during ECB employment. In addition, restrictions have been established to avoid conflicts of interest arising from subsequent employment activities. To avoid the inappropriate use of information obtained through work, strict rules have been laid down regarding private financial transactions. Members of staff are also prohibited, even after their duties have ceased, from making unauthorized disclosure of any information that they have received in the performance of their duties, unless that

	information has already been made public. Disciplinary measures may be adopted in case of breach of professional duties, intentionally or by negligence.
EC6	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: (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate onsite work, effective cross-border cooperation, and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).
Description and findings re EC6	The SSMR provides that the ECB must be able to devote adequate resources to carry out its supervisory tasks effectively. It further requires that these resources be financed via a supervisory fee borne by the entities subject to the ECB's supervision. The Supervisory Board does not exercise control over the ECB's supervisory budget. 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 function, based on 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 NCBs of the Eurosystem and the ECB. The BUCOM evaluates the ECB's reports on budget planning and monitoring and reports directly to the Governing Council. Hence, resources for ECB banking supervision are allocated within broader organizational priorities of the ECB. The annual budget covers all operating expenses, including those related to support functions. Since the establishment of the SSM, ECB banking supervision has been able to augment its original staffing allocation based on an improved understanding of the banks it was supervising, the desired level of supervisory intensity, and the resources needed for a number of key tasks. In September 2015, the Governing Council, which is the decision-making body for headcount decisions, agreed to augment the SSM-related headcount, to be implemented over the following two years; this increase significantly strengthened the JSTs as well as selected horizontal and oversight functions.

	In its 2016 review of the SSM, the ECA noted indications that staffing levels in ECB banking supervision at that time were insufficient, and recommended in particular that the ECB substantially increase the presence of its own staff in onsite inspections. The ECB accepted this recommendation. JSTs may request that an ECB staff member be appointed to lead an onsite inspection team, and have done so in the case of critical supervisory issues, to compensate for skills shortages or to ensure an independent pair of eyes. However, resource constraints have meant that ECB staff have led only around 10 percent of inspections, many fewer than the ECB would have preferred. More recently, the Governing Council has approved additional headcount for ECB banking supervision to prepare for the consequences of Brexit; increases will take place over 2018 and 2019. Other factors that will bear on future ECB headcount include the identification of synergies and opportunities to streamline work processes, and new supervisory tasks, e.g., in the context of crisis management and cooperation with the SRB. As envisaged under the SSM arrangements, a significant share of supervisory resources comes from the NCAs. The average composition of JSTs is around 25 percent ECB staff and 75 percent NCA staff, but this average masks considerable variation in the ratio across the different clusters of credit institutions; for some of the smaller and less complex SIs, the ratio is closer to 50/50. The average composition of onsite inspection teams is less than 10 percent ECB staff and more than 90 percent NCA staff, though inspection teams in some member states often comprise only NCA staff. NCA staff assigned to JSTs and to onsite inspections are determined and funded by each NCA, and remain part of the NCA's personnel and organizational structure, including performance assessments and remuneration. As a consequence, the ECB does not have control over the levels, suitability, and performance of staff dedicated to the supervision of SIs (see EC 7 below). The ECB's salary and benefit structure (applying to all ECB staff) has so far proven sufficiently attractive to hire and retain supervisory staff. The level of qualifications and experience is taken into account when determining the entry salary. ECB banking supervision has the ability to commission external consultants. Such consultants are subject to the same professional secrecy requirements as ECB staff members when they provide services related to the discharge of supervisory duties. In order to successfully pass on knowledge and develop skills, and to support the promotion of a common SSM culture, a dedicated training curriculum for the SSM has been developed that complements general training available at the ECB and training available locally at NCAs. SSM training activities are centrally coordinated and are open to all SSM staff. The Steering Group for Supervision Training has devised an SSM training curriculum that is currently being rolled out.
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into

	account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	ECB banking supervision benefits from the assistance of the NCAs and consequently from the skills and competences available at national level. Under the SSMR, the NCAs have a duty to cooperate in good faith, but the number of NCA staff to be made available to the ECB for JSTs and onsite work is not set out in any formal agreement. NCAs have some discretion in allocating the supervisory resources committed to JSTs. The commitment of NCA headcount is determined in the context of ECB banking supervision's annual supervisory planning process (see EC 8 below). However, assignment to the ECB does not imply that individual NCA staff must work full-time on ECB supervisory tasks. NCAs commit only that their staff will be available 80 percent of the time (90 percent for some NCAs); staff may be taken "offline" by their NCA to work on LSI supervision or other matters in response to domestic priorities. As a consequence, the availability of NCA staff at any particular point cannot always be assured; in some JSTs, NCA staff may contribute as little as 25 percent of their time. Moreover, smaller NCAs facing their own staffing constraints can find it difficult to honor commitments. Commitments made by the NCAs are regularly monitored through surveys and discussed bilaterally and multilaterally. The Supervisory Board also receives a regular report on NCA headcount in the supervision of SIs (actual vs. committed). Drawing on experience gained so far, ECB banking supervision is seeking to optimize staff allocation based on supervisory needs and priorities. This process includes quantitative as well as qualitative analysis in order to balance the demand of headcount and required skills with the available workforce and expertise in the SSM. Three years after the establishment of the SSM, a program of rotation of JST Coordinators and supervisors has now commenced, as a means of broadening experience and perspectives, and avoiding regulatory capture. In its 2016 review of the SSM, the ECA recommended that the ECB amend the SSMFR to formalize commitments by NCAs and ensure that all NCAs participate fully and proportionately in the supervision of SIs. In its response, the ECB did not rule out the possible need for amendment to the SSMFR, but indicated a preference at this point for continued collaboration with NCAs to ensure that JSTs are always sufficiently staffed.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	The level of supervisory engagement with SIs is governed by a detailed SEP for each SI that aims to ensure that interactions are risk-based and proportionate. The responsibility for defining the SEP lies with ECB banking supervision, with the respective NCA contributing. SEPs are approved by the Supervisory Board.

	Individual SEPs build upon the ECB's annual Supervisory Priorities, the SSM Supervisory Principles and the SSM Supervisory Manual. The Supervisory Priorities are identified through a strategic planning exercise and take into account the macroprudential information at the ECB's disposal. The SEPs define the main supervisory activities that will be carried out to monitor risks and address weaknesses of each SI, and are assessed and reviewed twice a year. SEPs set out the detailed activities that go beyond the defined minimum engagement levels (MELs), taking into account the specific risk profile of each institution. They form a solid core examination program that ensures appropriate intensity and frequency of supervisory work, and that system-wide risks are taken into account. Assessors saw a number of examples of SEPs. Two complementary consolidated SEPs have been developed in parallel to the individual SEPs. The first refers to the on-going supervision activities to be carried out by the JSTs and the second contains the onsite inspections and internal model investigations. Under the first consolidated SEP, each SI is classified in each risk category according to a level of engagement (Intense, Enhanced, Standard, or Basic) that depends on the risk score and the SI's size and complexity. For each risk category, a set of core activities and respective frequency is proposed as the basis of the on-going supervision program. This constitutes the MEL for each SI. The MEL forms the basis for operational supervisory work and, as a general rule, must be performed by each JST. JSTs will then either comply with this requirement or explain any deviations. The execution of planned activities is monitored through the year and, if necessary, the SEP may be reviewed in response to possible emerging risks and their outcomes. The review may also address emerging resource constraints so as to make best use of available resources and to avoid bottlenecks. Conflicting plans or resource constraints may be tackled by reprioritizing, moving, or cancelling certain activities or by requesting the allocation of additional resources. Under the second consolidated SEP, in which JSTs and NCAs are also strongly involved, each JST submits a list of requests for onsite inspections and internal model investigations for the year, classifying each request according to its priority (also taking into account the supervisory priorities) and urgency. Horizontal functions in ECB banking supervision review the supervisory needs, also taking into account the resources available both in the ECB and in the NCAs. The activities are planned following a risk-based and proportionate approach. Moreover, in order to foster harmonization, disseminate best practices and reinforce the sense of unity, ECB banking supervision has recourse to staff from other NCAs in the SSM. For European cross-border institutions, the supervisory planning process contains the relevant procedures according to CRD IV (e.g., colleges of supervisors, joint risk assessment, joint decisions).

EC9	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.
Description and findings re EC9	In accordance with Article 39 of the Statute of the European System of Central Banks, "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." In terms of Articles 11 and 22 of Protocol (No 7) on the privileges and immunities of 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." The ECB is, however, liable for its actions and is subject to judicial control by the Court of Justice of the EU, 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. The ECB is required to make good any damage caused by it or by its staff in the performance of their duties, provided that their conduct infringes laws conferring rights on third parties, is sufficiently serious and there is a causal link between this unlawful conduct and the damage caused. This is without prejudice to the liability of NCAs to make good any damage caused by them or by their staff in the performance of their duties in accordance with national legislation (Recital 61 of the SSMR). NCA staff participating in internal bodies of the ECB, such as the Supervisory Board or JSTs, enjoy functional immunity in the EU according to Article 10 of 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."
Assessment of Principle 2	Largely Compliant
Comments	The independence of the ECB's banking supervision function is enshrined in law, and the ECB performs its supervisory tasks in an operationally independent manner. In principle, the fact that all legally binding supervisory decisions sent to individual institutions need to be submitted to the Supervisory Board, where all NCAs are represented, and then to the Governing Council for approval, provides further protection from "regulatory capture" and the promotion of special interests. In practice, the dominance of national representatives, with natural domestic allegiances, on the Supervisory Board may make it more challenging to achieve outcomes that give priority to the interests of the Banking Union. On some issues, the presence of strong national interests may work against timely policy responses.

	Decision-making processes in ECB banking supervision are complex and time-consuming. A substantial volume of supervisory decisions requiring Governing Council approval are routine decisions that, in many other supervisory agencies, would be made at the operational level. In many respects, this complexity is due to constraints resulting from EU law and cannot be easily remedied. Nonetheless, the Supervisory Board has taken important steps to streamline decision-making processes and reduce the burden they impose on the Board and the Governing Council, freeing up members of these two bodies (and the staff who support them) to focus more fully on strategic and policy decisions. The new delegation framework, which truncates decision-making for certain routine decisions at the level of ECB Senior Manager, has considerably shortened timetables, and delegation of other types of decisions that involve limited discretion is under discussion. In emergency situations, the decision-making timeframe can be reduced substantially using fast-track procedures, and the assessors saw evidence of the use of these procedures. With the SEP, ECB banking supervision has a well-structured process for determining and prioritizing its resource needs. An important constraint on this process, however, is that the aggregate resources available to ECB banking supervision to supervise SIs are variable and beyond its control. In the first place, the Supervisory Board does not exercise control over the ECB's supervisory budget; resources for supervision are allocated within broader organizational priorities of the ECB. Hence, within the ECB itself the supervisory function may need to compete for resources within a given ECB budget envelope. Budget arrangements appear to have worked well to date, and ECB banking supervision has been able to augment its original staffing allocation. However, supervisory priorities may not always coincide with the ECB's broader organizational objectives on matters related to resources and remuneration, in which case the timely resourcing of the ECB supervision function could not be assured. In the second place, the ECB does not have full control over the levels of NCA staff dedicated to the supervision of SIs, nor over their suitability and performance. Assessors were advised that the ECB has experienced varying levels of cooperation from NCAs in making up supervisory teams, but collaboration is improving for offsite supervision. In some cases, JSTs have been given sufficient NCA headcount at the beginning of the planning cycle but found that team members were pulled away for a time with little notice because of exigencies at the NCA, or were changed over the cycle. This resulted in a loss of continuity and left some JSTs very stretched. In other cases, the commitment of staffing has been constrained by budget pressures facing NCAs or by shortages of appropriate skills, particularly in smaller NCAs that may have lost key staff to the ECB. At times, close relationship management has been required. As the SSM moves beyond its "settling in" phase and the relationship between ECB banking supervision and the NCAs matures, some of these staffing tensions may ease. However, if collaborative efforts cannot ensure the level, suitability and availability of NCA staff committed to JSTs, more formal arrangements may be necessary. One option would be a

	binding commitment on NCAs that staff for SI supervision must be available for a minimum of at least 75 percent of their time. One issue raised with assessors was that the attitude of individual NCA team members may be problematic if these members view JST work as being secondary to other NCA work since their performance appraisal, remuneration, and promotion prospects are determined by their NCA. The ECB is now trialing arrangements under which the JST Coordinator provides feedback to the local JST sub-coordinator on their performance. However, there is no guarantee that this feedback will be considered in the formal local performance review, and the arrangements are facing resistance on privacy and labor law grounds.
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.[45]
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions, and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	**Cooperation in the framework of the SSM** The SSM envisages a highly structured form of cooperation for Euro Area banking supervision, which goes well beyond the duties to exchange information and cooperate in good faith, as laid down in CRD IV and applicable to all EEA NCAs. The focal point of this heightened cooperation is the Supervisory Board itself, which is an internal ECB body and includes members of the ECB and one representative per competent authority of the participating Member States. The JSTs, which are the building block of Euro Area supervision, reinforce that cooperation, since the ECB relies heavily on NCA resources to staff the JSTs. For SIs operating entirely within the Euro Area, JSTs have replaced the previous cross-border supervisory framework based on the home-host division of labor and cooperation in supervisory colleges. Particular elements of cooperation between ECB banking supervision and Euro Area NCAs, in addition to ongoing supervision, include the full integration of the NCAs in the performance of the three so-called “common procedures” (authorization to take up the business of credit institution, lapsing and withdrawal of an authorization, acquisition of qualifying holdings in a credit institution), and the appointment of Heads of Missions for onsite inspections in consultation with the NCAs. Euro area NCAs are also regularly involved in the discussion of general and overarching supervisory issues through networks of

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

national experts. Involvement on specific projects, such as the negotiation of MoUs with third countries, is also common at the staff level.

Cooperation between the ECB and non-SSM NCAs

Cooperation between the ECB and the non-SSM NCAs is based on the provisions of CRD IV. On top of that, under "step in" arrangements the ECB became a principal in the MoUs that these NCAs already had in place with the SSM NCAs.

In accordance with Article 3 of the SSMR, the ECB is mandated to conclude an MoU with the NCAs of the non-participating Member States, including those that are home to at least one G-SII, as defined in Union law,[46] although cooperation and exchange of information between competent authorities within the EU is already covered under CRD IV. The purpose of these MoUs is, *inter alia*, to clarify the information and consultation mechanisms in cases where ECB decisions on supervised credit institutions established in a participating Member State affect subsidiaries or branches established in non-participating Member States. To date, however, no MoUs or close cooperation agreements have been concluded with non-SSM NCAs.

Cooperation between the ECB and relevant EU authorities

Under the SSMR, the ECB is required to cooperate closely with the EBA, ESMA, EIOPA, and the ESRB and other authorities that form part of the European System of Financial Supervision. The ECB is also obliged to cooperate, and exchange supervisory information on supervised entities, with National Market Authorities (NMAs) of EU Member States if the information is sufficiently related to the responsibilities of the NMA and there are no overriding reasons not to disclose. This obligation, which applies even if no MoU is in place, does not imply that the ECB shares all information available on a specific supervised entity; the tasks and responsibilities of the requesting NMA must be taken into account.

Against this background, 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 while the EBA can be invited to participate in the ECB's Supervisory Board. The ECB has concluded an MoU with ESMA, among other things to reap the synergies deriving from the activities of both authorities. The ECB has also concluded with ESMA a Template MoU that the ECB is prepared to sign on a bilateral basis with NMAs upon an expression of interest from the NMAs. The ECB has signed such a Template MoU with the Italian Commissione Nazionale per le Societá e la Borsa, the Netherlands Authority for the Financial Markets, and the German Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). Requests by NMAs for the disclosure of confidential information related to specific SIs have been increasing.

The establishment of the SSM brought about important changes in the macroprudential framework in the EU. As before, the national competent or designated authorities can

[46] See Article 131 of CRD IV

	deploy two sets of macroprudential tools: (i) tools to counter systemic or macroprudential risks in the banking sector identified in the CRR/CRD IV and national specific law and (ii) other macroprudential tools identified in national legislation relating to the banking sector or other components of the financial system. However, the ECB can apply higher requirements or more stringent measures within the scope of the tools identified in the CRR/CRD IV. Thus, the ECB shares responsibility for macroprudential supervision with the national authorities. The ESRB is responsible for macroprudential oversight of the financial system within the EU and issuing warning and recommendations, when necessary. The participation of the ECB in the General Board of the ESRB (through high-level representatives) and in its Advisory Technical Committee allows for the interaction between the ESRB and the ECB, as well as the NCAs, and an exchange of views regarding the issuance of warnings/recommendations. Since the ESRB was established prior to the introduction of the Banking Union, the specific engagement of ECB banking supervision with the ESRB has not yet been formalized, although it is currently invited as an observer without voting rights. To strengthen cooperation and information flows, the EC in September 2017 put forward proposals to add the Chair of the ECB's Supervisory Board and the Chair of the SRB as voting members of the ESRB General Board. **Supplementary supervision** In the EU, Directive 2002/87/EC (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. The legal framework is supplementary to those in place for the sectorial supervision of the individual entities of conglomerates, in the sense that it is applied by using supervisory tools that add to (and do not replace) the sectoral rules. Supplementary supervision aims to provide a systematic monitoring of the risks stemming mainly from the interrelation between the insurance activities and the banking/financial activities within a same group. The financial position of financial conglomerates is mainly assessed through evaluation of capital adequacy, risk concentration, intra-group transactions, and internal controls within the conglomerate (see CP 12). FICOD 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. FICOD also identifies which other authorities should participate in supplementary supervision and establishes the cooperation framework. Under the SSMR, the ECB has authority, for prudential supervisory purposes, to participate in supplementary supervision of financial conglomerates in relation to the credit institutions included in them. In the case of SIs, the ECB also assumes the coordinator role where it is appointed as such in accordance with FICOD; it is currently the coordinator for 27 financial conglomerates.

	Within the FICOD framework, the ECB is obliged to provide certain information to EU insurance supervisors, and vice-versa. At this point, there are no MoUs in place with EU insurance supervisors or with EIOPA. However, where ECB banking supervision chairs banking colleges for institutions designated as financial conglomerates, it has invited insurance/markets supervisors to attend as observers; ad hoc meetings have also been held between JSTs and insurance supervisors whether or not there is a college.
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC2	In the EEA, the principles of collaboration with authorities responsible for subsidiaries or branches of SSM-banking groups in third countries are based on the framework of supervisory colleges. The ECB sees supervisory colleges as a key mechanism for coordinating the supervision of cross-border banking groups. 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 Member States where the parent, subsidiaries, and significant branches are established have the right to participate as observers. 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 Article 10 of the SSMFR (see CP 13). The ECB currently participates in 45 supervisory colleges and, as the consolidating supervisor under CRD IV, is responsible for the operation of 30 of these colleges (plus a further four colleges that do not include EU participants other than the ECB). As the consolidating supervisor, the ECB is negotiating Written Coordination and Cooperation Arrangements (WCCAs) in order to facilitate crisis management within these colleges, and had concluded WCCAs for 16 colleges by end-February 2018. The Commissions' 2017 Report on the SSM noted that supervisory colleges are viewed as particularly important where the ECB is host supervisor for subsidiaries of groups headquartered outside the Euro Area or for branches of non-Euro Area banks that are considered SIs. The participation of third-country authorities in EU colleges depends upon the evaluation of the equivalence of their confidentiality regime to the EU confidentiality regime. Under CRD IV, members of the colleges are to reach an agreement on this. The ECB has confirmed its compliance with the EBA Recommendations on the equivalence of confidentiality regimes. In order to ensure continuity with the cooperation framework and supervisory practices before the SSM, the ECB under "step in" arrangements became a principal in the MoUs that individual NCAs already had in place with some third-country authorities. As of September 2017, the ECB has become part of the MoUs and similar arrangements that 49 third countries had in place.

	ECB banking supervision also has the capacity to enter into administrative arrangements with the supervisory authorities of third countries in its own right, to provide the basis for information exchange and cooperation on matters such as authorization procedures, establishment of branches and subsidiaries, and the conduct of onsite inspections. The ECB has set up a network of national experts to work together with ECB staff to this end; the network has provided additional support for the drafting of an MoU template that is being used by the ECB as a basis for negotiating cooperation agreements with third country supervisory authorities. This template is largely based on the Basel Committee on Banking Supervision's (BCBS) Statement of cooperation between banking supervisors (2014). In this context, the ECB is currently negotiating MoUs with supervisory authorities in a number of non-EU countries. The countries include the United States (Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation), Canada, Hong Kong, Japan, Singapore, and Switzerland. In December 2016, the ECB signed an MoU with the relevant authorities of Denmark, Finland, Norway, and Sweden for the conclusion of a cooperation agreement on the supervision of significant cross-border branches. An accession agreement to this MoU by the competent authorities of Estonia, Iceland, Latvia, and Lithuania was signed in April 2017. The ECB has also signed an MoU with Banco Central do Brazil and with the Mexican supervisory authority, Comisión Nacional Bancaria y de Valores. Negotiations with the supervisory authorities of South-eastern European countries (Albania, Kosovo, Serbia, Montenegro, Bosnia Herzegovina/Republika Srpska, FYRO Macedonia) have been finalized and the MoUs will be signed shortly. Home-host relationships have been augmented by trilateral meetings between ECB banking supervision and the Bank of England's Prudential Regulation Authority (PRA) and the U.S. Federal Reserve Board. These meetings, two or three times a year, enable information to be shared at senior level on current supervisory issues and practices, and on detailed developments in individual G-SIBs and other banks.
EC3	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 EC3	CRD IV identifies a broad-ranging duty of cooperation within the EEA (Article 56) but also subjects the staff of competent authorities (and, individually, the persons working on behalf of the authorities, such as auditors) to a strict obligation of professional secrecy (Article 53). For ECB staff, the confidentiality rule is also laid down in Article 27 of the SSMR and in Article 37 of the Statute of the ESCB and of the ECB. The possible uses of confidential information by the receiving authority are limited. In particular, the information may only be used for specified supervisory purposes (Article 54

	of CRD IV) and exchanged with a number of other institutions only in the discharge of specified purposes (Articles 56–59 of CRD IV). CRD IV allows for information sharing with authorities outside the EEA, provided that, under its national law, the receiving authority is subject to a confidentiality duty at least equivalent to that in the EU (Article 55). 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 (Article 53(1)). 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. As mentioned under EC 2, participation in colleges with third-country authorities can only take place insofar as such authorities are subject to an equivalent confidentiality regime. In this respect, the ECB has declared that it complies with the EBA Recommendations identifying those third country authorities whose regime can be considered equivalent. On top of this, ensuring confidentiality of the information provided is of utmost importance when arranging bilateral cooperation between the ECB and the third country authorities through MoUs. 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. To cater for the possibility that the MoUs allow for the exchange of specific information related to individuals, the data protection officer is kept informed and provides its view during negotiations. It also identifies the clauses that the negotiating parties need to accept for the MoU to be in line with EU data protection legislation.
EC4	The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.
Description and findings re EC4	Confidential information received from another authority falls under the professional secrecy provisions described in EC 3. Under Article 54 of CRD IV, 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. Forward sharing of information is only permitted in selected circumstances (Articles 55–59); in particular, the information originating in another Member State can only be disclosed with the express agreement of the originating authority. By virtue of the primacy of EU law, these provisions take priority over incompatible national legislation providing for disclosure of confidential information beyond relevant EU law. This principle of primacy of EU law can be relied on in national and European courts.
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	Supervision and resolution are key building blocks of the Banking Union, and the EU crisis management framework creates a duty to cooperate between supervisory and resolution authorities. As outlined under CP 1, the primary partner of the ECB for cooperation in crisis management is the SRB, which will 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. From a legal and operational standpoint, the nature of cooperation can be considered at different phases of supervisory and crisis management activities. **Preparation and planning** 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's particular focus is whether recovery plans pose any obstacles to resolution. 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. **Early intervention** ECB banking supervision plays the leading role in early intervention for SIs. Once it has determined that the preconditions for early intervention have been met in relation to an SI, the SRB has legally to be notified without delay. In practice, to foster timely cooperation, an SRB Board Member is invited to participate as observer in the ECB banking supervision meeting where the decision on early intervention may be taken. In addition, ECB banking supervision has to inform the SRB about any crisis prevention measures (e.g., the exercise of powers to direct removal of deficiencies or impediments to recoverability) or any specific requirements imposed on an institution (e.g., to increase own funds, apply a specific provisioning policy or limit business operations) pursuant to Article 104 of CRD IV, once the preconditions for early intervention have been met in relation to an SI. **Determination that an institution is failing or likely to fail**

	If ECB banking supervision determines, after consultation with the SRB, that an SI is failing or likely to fail, or if it receives such a determination from an institution itself, ECB banking supervision must first notify, inter alia, the SRB. In practice, to foster close cooperation and timely exchange of information, the SRB will be involved at an earlier stage, for instance by being invited to participate in the Institution-Specific Crisis Management Team meeting (see EC 7 of CP 8). The failing or likely to fail determination triggers the transfer of responsibilities for the institution to the SRB. Likewise, the SRB may make a determination that an institution is failing or likely to fail, but must first inform ECB banking supervision that it intends to make this determination, and allow the ECB three calendar days to make an assessment of the institution's viability. Since its establishment, ECB banking supervision has made a failing or likely to fail determination in respect of three institutions. **Conduct of resolution actions** The SRB decides which resolution tools to use to resolve an institution, and ECB banking supervision gives support to the SRB, if needed. Furthermore, at a resolution stage, the BRRD envisages certain tasks that may need to be performed by the supervisory authority. The authority may have to adjust certain supervisory procedures; for example, if a sale of business tool or bail-in instrument is used, the assessment of the acquisition and/or a resulting qualifying holding has to be performed within the timelines imposed by the resolution authority. If a bridge institution is set up by the resolution authority, it may submit a request to the supervisory authority for a temporary exemption of the conditions for authorization. In such a case, ECB banking supervision would grant authorization and could become the competent authority for the bridge institution if it is classified as an SI. The resolution authority may submit a request to the ECB for a temporary exemption of the conditions for authorization of the bridge institution. The resolution authority will also request that the ECB publish 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 on activities. 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 relevant information with all participating authorities, if possible. **Memorandum of Understanding between the ECB and SRB** Central to cooperation arrangements is the MoU between the ECB and SRB signed in December 2015. The MoU covers cooperation and the exchange of information between the two authorities with respect to all institutions directly supervised by the ECB as well as all cross-border LSIs under direct responsibility of the SRB as far as the so-called "common procedures" are concerned (see EC 1). The MoU includes arrangements for cooperation and information exchange in the different phases of supervisory and crisis management activities outlined above, and also contains provisions regarding communication, knowledge exchange, confidentiality, data protection, and cooperation with regard to non-participating Member States and third-country authorities.

	In the area of information exchange, ECB banking supervision shares all relevant supervisory information with the SRB, for example for the purpose of resolution planning. The SRB has access to relevant supervisory reporting data and recovery plans, which contain a significant amount of valuable information for the purpose of resolution planning. In addition, the ECB granted the SRB shared access to parts of its supervisory information platform in 2016 in order to support the SRB in the performance of its tasks and facilitate information exchange. Information sharing with the SRB is now automatic once an SI is assigned a certain SREP rating. To strengthen coordination, the ECB designates a representative entitled to participate, as a permanent observer, in the meetings of executive sessions and plenary sessions of the SRB. The ECB representative is entitled to participate in the debates and has access to all documents. In the same vein, 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. In its Special Report 02/2018, *The operational efficiency of the ECB's crisis management for banks* (January 2018), the ECA recommended that the ECB improve its information exchange with the SRB, noting in particular that there was no pre-specified package of information to be provided to the SRB in crisis situations. The ECB has accepted this recommendation. The level of information shared with the SRB was based on an initial assessment of needs at the time the MoU was finalized, and an early review of the effectiveness of information exchange in the light of experience was provided for in the MoU. That review is now underway and, according to the ECB, is expected to lead to an increase in the amount of information that is automatically shared with the SRB.
Assessment of Principle 3	Compliant
Comments	ECB banking supervision has an extensive and effective framework for cooperation and collaboration. Within the SSM, the framework is inherent in the various structures and elements of cooperation between ECB banking supervision and the Euro Area NCAs, with the Supervisory Board at the apex. Outside the SSM, ECB banking supervision has been seeking to build on the highly developed communication channels it inherited from the NCAs under "step in" arrangements. ECB banking supervision's progress in finalizing MoUs in its own right with third country authorities, within and outside the EEA, has been slower than expected, due to complexities in negotiations arising from substantial differences between legal systems and national legal requirements). Similar complexities have been the main factor affecting the finalization of WCCAs for crisis management coordination in supervisory colleges in which the ECB is consolidating supervisor, although substantial progress in this area is now expected. The absence of formal arrangements has not, however, precluded effective working

	relationships with key authorities, with confidentiality of supervisory information covered in exchanges of letters where necessary. The trilateral meetings between ECB banking supervision and the PRA and the U.S. Federal Reserve Board are examples of constructive collaboration at the working level. The SSM's preparations for Brexit from a banking supervision viewpoint have involved heightened interaction with other supervisory authorities. Through the Supervisory Board, SSM networks and bilateral meetings with Euro Area NCAs, ECB banking supervision has been exchanging information on Brexit plans of "incoming" banks, and to ensure consistent application of Brexit policy stances across the SSM for both SIs and LSIs. The ECB has also been in regular contact with other relevant third parties, such as the EBA, the PRA, and other third-country supervisors, in order to exchange information and promote alignment on operational issues. The effectiveness of cooperation arrangements between ECB banking supervision and the SRB have been "road tested" in three episodes of bank distress in 2017 where ECB banking supervision made a failing or likely to fail determination. This experience is vital input into the current review of the effectiveness of the MoU between the ECB and the SRB, which is expected to result in enhanced information sharing. ECB staff view these three episodes as confirming the effectiveness of cooperation arrangements with the SRB, although the assessors have noted (in CP 8) that there is room for improvement.
Principle 4	**Permissible activities**. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled**.**
Essential criteria	
EC1	The term "bank" is clearly defined in laws or regulations.
Description and findings re EC1	At the European level, there is no definition of the term "bank." Both the CRR and CRD IV 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" (CRR Article 4(1)(1) and CRD IV Article 3(1)(1)). Therefore, the term "credit institution" is defined in terms of its range of permitted activities. This definition has been transposed into national laws.
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	The types of activities that a credit institution as defined in the CRR/CRD IV can carry out are not exhaustively determined at the EU level, although the activities must at least include taking deposits or other repayable funds from the public and granting credits for its own account. A credit institution license can only be granted—and is required—if the proposed activities in which the applicant will be engaged include these two essential elements, CRD IV Recital 14 stipulates that "this Directive should not affect the application of national laws which provide for special supplementary authorizations permitting credit institutions to carry out specific activities or undertake specific kinds of operations." In addition, CRD IV

	Annex I provides a list of activities that can be performed by credit institutions authorized in one of the Member States without acquiring additional authorization from the host authorities ('List of activities subject to mutual recognition'), although this does not restrict a Member State from allowing credit institutions to perform fewer or other activities in the jurisdiction. National laws define whether a credit institution is allowed to undertake activities other than the taking of deposits or other repayable funds from the public and the granting of credits for its own account. In Austria, for example, the banking activities that require authorization as a credit institution are broader than these two elements, and include building savings and loan business, investment fund business and real estate investment fund business; in Greece, credit institutions may be allowed to carry out financial or secondary activities additional to those listed in CRD IV Annex I. The ECB's procedure for authorization of a credit institution applies to all activities that credit institutions are allowed to undertake, including activities subject to mutual recognition as well as other regulated activities that require authorization under national laws. This means that the authorization procedure also applies to situations where a credit institution that already has a banking license requires an extension of its authorization to undertake a new regulated activity. Furthermore, Article 104(1)(e) of CRD IV provides that competent authorities shall 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. In this respect, the ECB can directly exercise this power with respect to SIs or, where such power was not conferred on the ECB, can require the NCA to make use of this power by way of instructions.
EC3	The use of the word "bank" and any derivations such as "banking" in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	There are no EU-level restrictions regarding the use of the word "bank" and any derivations. The ECB has no powers in relation to the restrictive and designated use of the word "bank" that are designed to ensure that the general public is not misled. Restrictions regarding the use of the term "bank" are imposed at the national level. Broadly speaking, the term "credit institution" is a protected designation, but 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 (Germany) or if the activities of these enterprises precludes the impression that they conduct banking business (Germany, Greece). In the 2016 Detailed Assessment Report for Germany, assessors noted that they had access to several 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. Article 19 of CRD IV 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."
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks.[47]
Description and findings re EC4	Article 9 of CRD IV 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" and "Such restriction shall 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." The ECB itself has no powers to enforce the general prohibition on taking deposits or other repayable funds from the public by institutions that are not authorized as credit institutions. The prohibition has been transposed into national laws.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	Article 20(2) of CRD IV requires the EBA to publish on its website,[48] and update regularly, a list of the names of all credit institutions that have been granted authorization, although the frequency of updating is not defined. This information is available under the Credit Institution Register on the EBA website, which contains names of (a) institutions set up in the Member States; (b) branches of institutions established in EEA countries that have the right to passport their activities; and (c) branches of other foreign banks. The Credit Institution Register is updated on a real-time basis with notifications of newly licensed institutions or withdrawal of authorization by competent authorities. The ECB publishes on its website (www.ecb.europa.eu) a list of the SIs it directly supervises as well as a list of the LSIs supervised by the NCAs. The ECB lists are updated regularly, based on decisions taken with regard to authorizations and the withdrawal or lapsing of authorizations, decisions amending the significance of supervised institutions, or relevant notifications received from the NCAs.

[47] The Committee recognizes the presence in some countries of nonbanking 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.

[48] Website of the EBA at eba.europa.eu ECB.

Assessment of Principle 4	Largely Compliant
Comments	European law as transposed into national laws covers the main elements of this Core Principle, with the necessary powers residing in most cases with NCAs. The ECB, for example, has not been conferred powers in relation to the restrictive and designated use of the word "bank," nor to enforce the prohibition on the taking of deposits from the public by nonbanks; these matters are generally pursued at the national level. Previous BCP assessments have not identified any material deficiencies in Euro Area countries on this score. The Commission's recent report on the SSM raised concerns about the growth of "bank-like" activities in the EU. It noted structural market developments showing a trend for third-country groups to have increasingly complex structures in the EU, operating through entities that escape ECB supervision. A specific concern related to the largest investment firms that provide key wholesale market and investment banking services across the EU, which are bank-like in nature. These firms are subject to the CRR and CRD IV but are supervised at the national level; they are not authorized and supervised by the ECB as credit institutions. This opens the door to regulatory and supervisory arbitrage and creates an unlevel playing field in the application of the CRR and CRD IV. The Commission's report suggested that current consultations on the Commission's proposed amendments to the CRR/CRD IV framework for credit institutions might provide a good opportunity to address this concern. The Commission's report also highlighted that the lack of ECB supervisory powers in relation to Euro Area branches of non-EU or EEA banks creates scope for regulatory and supervisory arbitrage. In its opinion of November 2017, the ECB noted that large and complex bank-like investment firms, particularly those with cross-border operations, can pose increased financial stability risks as well as an increased risk of spill-over effects on other banks. The ECB took the view that the consolidated and solo supervision of such bank-like investment firms in the EU warranted further consideration, to ensure prudent and consistent supervisory standards commensurate with the risks these firms can pose. One option it suggested would be to amend the CRR/CRD IV in order to ensure that large cross-border investment firms, which frequently carry out bank-like activities that are also carried out by banks, are authorized and supervised as credit institutions. However, for investment firms not in that category, the current differentiation of treatment reflected in national arrangements should be preserved.
Principle 5	**Licensing criteria.** The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management)[49] of the bank and its

[49] This document refers to a governance structure composed of a board and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries

	wider group, and its strategic and operating plan, internal controls, risk management, and projected financial condition (including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	Article 4(1)(a) of the SSMR establishes the ECB as the exclusive competent authority for the authorization of credit institutions (as defined in the CRR/CRD IV) in Euro Area Member States, whether the institutions are SIs for whom the ECB is also the supervisory authority, or LSIs directly supervised by the NCAs. The ECB is also the exclusive competent authority for the withdrawal of such authorizations. Authorization and withdrawal of authorization are two of the three tasks (referred to as "common procedures") conferred on the ECB with regard to all Euro Area credit institutions (SIs and LSIs); assessment of acquisitions of qualifying holdings is the third (see CP 6). Nonetheless, the NCAs are fully integrated in the authorization process and authorization decisions are taken on the basis of applicable national law. NCAs represent the entry point for applications for authorizations and maintain contacts with the applicants; analysis of all applications takes place initially at the NCAs; and only viable applications are forwarded to the ECB. If the applicant complies with all conditions of authorization, the NCA prepares a draft decision for the Governing Council, which is deemed to be adopted unless the Governing Council objects to it within ten working days (extendable once in justified cases). In the case of LSIs, where the licensing authority and primary supervisor are separate agencies, this authorization mechanism ensures that the right of the supervisor to have its views and/or concerns about an application is addressed. Withdrawals of authorizations can be taken at the initiative of the NCAs or the ECB itself. In the latter case, the ECB must consult with the NCA concerned, at least 25 working days before the date on which it plans to make the decision: in urgent cases, the timeframe can be reduced to five working days. Resolution authorities may object to the ECB's intention to withdraw an authorization of an institution entering resolution if they consider that this

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

	would affect resolution or financial stability. The ECB has not, to date, taken the initiative to withdraw an authorization. Article 6(2) of the SSMR underlines that the ECB and NCAs are subject to a duty of cooperation in good faith, and an obligation to exchange information. Accordingly, the ECB and the relevant NCA share all relevant findings during the assessment of an application for an authorization, and the content of the draft decision reflects this active coordination and exchange of information. Any information that the ECB has in its capacity as licensing authority that may be material to the NCA in its capacity as supervisory authority, is shared with the latter.
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	Minimum conditions for authorization of a credit institution are set out in Articles 10 to 14 of CRD IV. These cover the institution's program of operations, structural organization, 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 the registered office or jurisdiction where business is actually carried out. Detailed requirements giving effect to these criteria are set out in national laws implementing CRD IV. Member States have the power to specify additional criteria, provided that they are not assessing the economic need for the bank to exist, which is prohibited under Article 11 of CRD IV. For example, credit institutions established in Ireland must comply with the Corporate Governance Code for Credit Institutions and Insurance Undertakings adopted by the Central Bank of Ireland. As the final decision on an authorization is based on the NCA's draft proposal, in practice the ECB applies any additional licensing criteria included in the national laws of the participating Member States. The power to reject an application is implied by Articles 11 to 15 of CRD IV, which state that the NCA will only grant authorization if criteria are complied with; information on a rejection needs to be communicated to applicants within 12 months. An application for authorization may be rejected by the NCA and by the ECB. However, the ECB may only 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. Germany is one Member State in which the criteria for rejecting an application, which distinguish between mandatory and discretionary reasons for refusal, are explicit in national law. The information requirements necessary for authorization are covered by Articles 8, 10, and 14 of CRD IV. Both the NCA and the ECB have the right to ask an applicant to provide all relevant information in order to assess whether the applicant meets the requirements for

	authorization. In July 2017, the EBA released the RTS specifying the information to be provided to NCAs in applications for authorization as a credit institution, detailing requirements applicable to shareholders and members with qualifying holdings, and addressing obstacles to the effective exercise of supervisory functions. The power to revoke an authorization found to have been granted on the basis of false information or other irregular means is set out in Article 18(b) of CRD IV. If the ECB becomes aware of such, it may withdraw the license. The same applies for the NCA, in accordance with the relevant national law. In September 2017, the ECB released for public consultation a guide to the assessment of license applications from fintech credit institutions. For the purposes of the guide, a fintech credit institution is defined as having "a business model in which the production and delivery of banking products and services are based on technology-enabled innovation." A fintech entity that meets the legal definition of a credit institution in terms of CRR/CRD IV (i.e., whose activities include taking deposits or other repayable funds from the public and granting credits for its own account) must seek authorization as a credit institution and will be subject to the same authorization requirements and assessment procedures as other credit institutions. The purpose of the guide is to enhance transparency for potential fintech bank applicants and increase their understanding of the ECB's procedures and criteria for assessing license applications.
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	Although not explicitly stated in EU law, the criteria for authorization are generally consistent with those applied in ongoing supervision. Pursuant to Article 18 of CRD IV, one of the possible reasons for withdrawing an authorization is that the credit institution "no longer fulfils the conditions under which authorization was granted." As a result, all conditions for obtaining a license—including the conditions specified by national law—need to be fulfilled on an ongoing basis by the licensed bank (except for the demand for a program of operations). In certain cases (Spain), national law specifies other possible reasons for withdrawing an authorization, but these are closely linked to conditions with which credit institutions need to comply on an ongoing basis. The ECB may withdraw an authorization in the cases set out in relevant EU law on its own initiative, following consultations with the NCA, or on a proposal from the NCA.
EC4	The licensing authority determines that the proposed legal, managerial, operational, and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis.[50] The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.

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

Description and findings re EC4	Under CRD IV, the conditions for granting authorization include 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. Authorization will be refused: • if the licensing authority is not satisfied as to the suitability of the shareholders or members; • where any close links between the credit institution and other natural or legal persons prevent the effective exercise of supervisory functions;[51] and • 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 supervisory functions. These conditions have been broadly transposed to national laws implementing CRD IV. In Italy, however, transposition is awaiting implementation and fit-and-proper assessments are bound by the current legal framework, which is not consistent with CRD IV. In this case, ECB banking supervision has been working with the NCA to overcome assessment gaps and to ensure the suitability of board members through supervisory dialogue with relevant banks. Developing a complete understanding of the proposed legal, managerial, operational, and ownership structures of the bank, both on 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. The EBA's recent RTS on information to be provided in authorization application addresses the identification of obstacles that could prevent the effective exercise of supervisory functions, 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. To this point, concerns about these types of close links have not provided the basis for rejection of an application for authorization of a credit institution, but have been the basis for rejecting applications for acquisition of qualifying holdings (see CP 6).
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.

[51] Close links are defined by Article 4(38) of the CRR as "a situation in which two or more natural or legal persons are linked in any of the following ways: (a) participation in the form of ownership, direct or by way of control, of 20 percent or more of the voting rights or capital of an undertaking; (b) control; (c) a permanent link of both or all of them to the same third person by a control relationship."

Description and findings re EC5	Article 14 of CRD IV addresses 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. As part of the NCA assessment process—and accordingly applied by the ECB as well—applicants are required to identify prospective shareholders, whether direct or indirect, natural or legal persons, that have a qualifying holding and the amounts of that holding or, where there are no qualifying holdings, the 20 largest shareholders. A background check is conducted both on the suitability and the financial soundness of these shareholders, including a check on the existence of reasonable grounds to suspect that there is a risk related to money laundering or terrorist financing. This check therefore identifies the sources of initial capital and ensures transparency of ownership. The EBA's recent RTS on information to be provided in authorization applications requires the applicant to provide an explanation of the available funding sources for capital and, where available, evidence of the availability of those funding sources. This includes a summary of the use of private financial resources (including their availability and source). 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.
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	Article 12 of CRD IV specifies a minimum initial capital amount for an authorized credit institution of EUR 5 million. The initial capital, which must be held in the form of common equity tier 1, is a floor below which an institution may not fall. In a small number of cases (mainly arising out of grandfathering arrangements), the minimum capital is EUR 1 million, but a ratchet applies. That is, any increase in common equity tier 1 becomes the new floor until the institution's capital exceeds EUR 5 million. On top of the required minimum initial capital, NCAs generally require a level of own funds that is commensurate with the expected business plan of the applicant institution; this level is accordingly applied by the ECB. For example, a minimum initial capital requirement of EUR 8.7 million applies in Luxembourg, EUR 18 million in Spain and Greece (although in the case of Greece, the Bank of Greece can reduce that threshold to EUR 5 million), and EUR 20 million in Slovakia (EUR 30 million for mortgage banks). Under its "policy stance" on authorizations, ECB banking supervision generally requires new credit institutions to have sufficient initial capital to cover the minimum requirement set out in CRD IV, plus losses over the first three years of operation projected on the basis of a severe but plausible adverse scenario in the business plan. Where new credit institutions are

	subject to higher minimum initial requirements under national legislation, the "add on" may be limited to one year's losses.
EC7	The licensing authority, at authorization, evaluates the bank's proposed Board members and senior management as to expertise and integrity (fit-and-proper test), and any potential for conflicts of interest. The fit-and-proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.[52] 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.
Description and findings re EC7	Under Article 13 of CRD IV, authorization of a credit institution can be granted only where at least two persons effectively direct the business of the institution. That is, there must be a clear distinction in the governance structure between risk-taking activities and risk management. Article 91 of the CRD IV establishes fit-and-proper requirements for the members of a credit institution's "management body," that is, the body empowered to set the institution's strategy, objectives, and overall direction, and which oversees and monitors management decision-making. Authorization will be refused if the members of the management body do not meet the requirements that at all times they be, inter alia, of sufficiently good repute and possess sufficient knowledge, skills and experience to perform their duties. Member States must 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 prevention of conflicts of interest. A key principle is that 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. The EBA/ESMA has issued joint Guidelines on the assessment of the suitability of members of the management body and key function holders, which will apply from June 30, 2018. Record of criminal activities and adverse regulatory judgments are mentioned in Guideline 8 regarding reputation, honesty, and integrity, while Guideline 6 addresses knowledge, skills, and experience. The new Joint Guidelines include discussion of the assessment of the collective suitability of the management body. As part of the authorization process, 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 body has sufficient competence, experience, and ability to direct the policies of the bank in a safe and sound manner, taking into account the

[52] Please refer to Principle 14, Essential Criterion 8.

	circumstances and plans of the organization. The ECB has responsibility for taking decisions on the appointment of all members of the management bodies of SIs that fall under its direct supervision, and of LSIs in the case of licensing or qualifying holdings. To promote harmonization of supervisory practices and convergence in fit-and-proper assessments in the Euro Area, the ECB issued a Guide to fit-and-proper assessments in May 2017. This serves as a guide for the suitability assessment of board members conducted by the NCAs and the ECB and covers all assessment criteria: (1) reputation, (2) time commitment, (3) experience, (4) independence of mind/conflicts of interest, and (5) collective suitability of the management body. The Guide also covers the criteria for conditional approvals and interviews with candidates; in addition, an SSM methodology for fit-and-proper interviews has been approved by the Supervisory Board. In its opinion of November 2017, the ECB recommended that EU law be amended to further harmonize the processes for fit-and-proper assessments.
EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management, and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.[53]
Description and findings re EC8	Applications for authorization must be accompanied by a program of operations setting out the types of business envisaged and the structural organization of the credit institution. The content of such a program is specified in Article 6 of the EBA's July 2017 RTS on information to be provided in authorization applications. The program must cover the first three years of operations, on a base case and stress scenario basis, and include information on the geographical distribution of activities, the viability of the business model, the organizational structure and the internal control framework; the latter must include the budgetary and human resources devoted to the compliance, risk management, and internal audit functions.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	Applications for authorization must be accompanied by a range of information on the financial situation of the institution. This information, set out in Article 5 of the July 2017 RTS, must inter alia include: forecasts on a base case and stress scenario of balance sheets; profit and loss accounts and cash flow statements for the first three complete business years; planning assumptions for these forecasts; forecast calculations of own funds requirements; funding profile and diversification; internal liquidity adequacy assessment;

[53] Please refer to Principle 29.

	and an outline of any indebtedness incurred or expected to be incurred prior to commencement of its activities as a credit institution. Information to be provided on the suitability of the principal shareholders of the applicant institution is specified in Article 11 of the RTS. This information includes the reputation and the financial soundness of these shareholders, particularly in relation to the type of business expected to be undertaken by the institution.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	Under Article 17 of CRD IV, no authorization is required for branches of credit institutions established in another Member State. The credit institution must notify the home supervisor, and the home supervisor may oppose the passporting if it has reason to doubt the adequacy of the administrative structure or the financial situation of the credit institution, taking into account the activities envisaged (Article 35.3 of CRD IV). If it does not so oppose, it will communicate that information to the NCA in the host Member State within three months and inform the credit institution accordingly. In the case of subsidiaries of authorized credit institutions established in another Member State, Article 16 of CRD IV requires the host authority to consult the home supervisor before granting any authorization. Authorization will not be granted if 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 supervisory functions. In respect of authorizing a subsidiary or branch of a credit institution that is authorized in a third country (non-EU or EEA) and subject to consolidated supervision, Articles 47 and 48 of CRD IV state that, on the basis of an agreement concluded between the Union and the respective third country, NCAs are allowed to cooperate with that country regarding the means of exercising supervision on a consolidated basis. Currently, Euro Area branches of non-EU or EEA banks, unlike their subsidiaries, are neither subject to CRD IV/CRR (and related EBA RTS/ITS and guidelines), nor to consolidated supervision at the EU level. They are regulated by national laws and regulations and supervised directly by local NCAs; they are not authorized or supervised by the ECB. Such branches may not be subject to more preferential treatment than would or does apply to an EU Member State branch. As at end-March 2017, there were 77 third-country branches in the Euro Area, belonging to 54 third-country banking groups; 17 of these groups were operating via branches in more than one Euro Area country. This number could increase once the exit of the United Kingdom from the EU becomes effective.

EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	Once a new credit institution is authorized, its ongoing supervision if it is an SI is conducted in terms of the SEP set up by the relevant JST (see CP 9). The 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. If there are conditions attaching 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.
Assessment of Principle 5	Largely Compliant
Comments	Within the SSM, the ECB has become the licensing authority for new credit institutions, and EU law establishes clear criteria for granting or withdrawing authorizations. However, ECB decisions are taken on the basis of applicable national laws and NCAs are fully involved in the authorization process. This process has been supported by publication, over the past year, of various EBA, EBA/ESMA and ECB guidance on different aspects of the authorization process, including for potential fintech bank applications, and by detailed procedures set out in the SSM Supervisory Manual. Taken together, the legal framework and complementary material provide a comprehensive basis for supervisory assessments of applications for authorization. Since the establishment of the SSM, the ECB has granted 49 authorizations of credit institutions and withdrawn 108 authorizations. The assessors saw evidence of the thoroughness of the authorization process, including supporting documentation for draft decisions prepared by different NCAs. The Commission's recent report on the SSM acknowledged that the common procedures for authorizations represented a challenging task for the ECB, given inter alia the complexity of assessing proposals prepared by NCAs based on the different national legal frameworks. The report concluded that "… the ECB and NCAs have done a remarkable job and managed to create tools and procedures that help the ECB deliver on its tasks within the applicable constraining timeframe." The ECB does not have authority to authorize and supervise Euro Area branches of non-EU or EEA banks. These branches are not subject to CRD IV/CRR (and related EBA RTS/ITS and guidelines), nor to consolidated supervision at the EU level; they are regulated by national laws and regulations and supervised directly by local NCAs. These arrangements create regulatory and supervisory arbitrage opportunities for non-EU banks, which can, *inter alia*, establish a presence in the Euro Area through branches and avoid ECB supervision. The

	Commission's recent report on the SSM drew attention to these arbitrage risks. As part of its review of CRR/CRD IV, the Commission has proposed that third country banking groups with two or more institutions established in the EU be required to establish intermediate EU parent undertakings, thus allowing consolidated supervision and the application of prudential requirements on a consolidated basis. The ECB has welcomed this proposal, but has argued in its opinion of November 2017 that, in order to avoid regulatory arbitrage, the requirement should apply to third country credit institutions and branches and that, once an intermediate EU parent undertaking is established, existing branches of the same third country banking group exceeding a certain threshold should be re-established as branches of a credit institution authorized by the ECB.
Principle 6	**Transfer of significant ownership.** The supervisor[54] has the power to review, reject, and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of "significant ownership" and "controlling interest."
Description and findings re EC1	Under the CRR, a "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 voting rights; 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 as the relationship between a parent undertaking and a subsidiary, or the accounting standards to which an institution is subject, or a similar relationship between any natural or legal person and an undertaking. Member States cannot impose more stringent requirements for notification to, or approval by, the competent authorities of direct or indirect acquisitions of voting rights or capital. According to the December 2016 EBA/ESMA/EIOPA's Joint Guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector, which became effective from October 2017, the supervisor of the target undertaking (target supervisor) should take a number of factors into account in assessing whether significant influence may be exercised, including: the existence of material and regular transactions between the proposed acquirer and the target undertaking; the ownership structure of the target undertaking; and the proposed acquirer's ability to participate in the operating and financial strategy of the target undertaking. The Joint Guidelines also sets out the relevant tests for assessing if a qualifying holding is acquired indirectly and the size of such holding when: (a) a natural or legal person acquires or increases a direct or indirect participation in an existing holder of a qualifying holding; or (b) a natural or legal person has a direct or indirect holding in a person which acquires or increases a direct participation in a target undertaking.

[54] 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.

EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	Articles 22 and 25 of CRD IV deal with acquisitions, increases, and divestitures of qualifying holdings. The proposed acquirer(s) has(ve) to indicate to the competent authority the size of the intended holdings and provide relevant information, as specified in Article 23(4) of CRD IV. These requirements have been transposed into national legislation. Legal and natural persons wishing to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase, directly or indirectly, such a qualifying holding as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 percent, 30 percent, or 50 percent or so that the credit institution would become its subsidiary (the "proposed acquisition"), need to notify the target NCA in advance, and the NCA may decide to oppose the acquisition. If a holding is acquired despite opposition by the competent authorities, Member States must provide either for the exercise of the corresponding voting rights to be suspended, or for the annulment of votes cast or for the possibility of their annulment. The ECB is the competent authority for both SIs and LSIs for approval of acquisitions or disposals of qualifying holdings in a credit institution (though not in the case of a bank in resolution). As with the other "common procedures," the NCAs are fully integrated in the approval process. The assessment of the application is carried out by the target NCA on the basis of national law. Throughout the assessment, the NCA coordinates with and informs ECB banking supervision about progress; it also collects the views/objections of other NCAs involved in the supervision of the applicant (if it is a credit institution or other regulated financial undertaking). National laws set out their own due process requirements, in particular with regard to information required by the NCA, and to the corporate holding structures that need to be notified if they are considered to be a direct or indirect acquirer of a qualifying holding. These process requirements need to be taken into consideration, provided that they do not contradict EU law. The NCA forwards a proposal to the ECB, which may include conditions to be fulfilled by the applicant. Strict timelines apply to the approval process. The ECB has adopted internal rules for proposed acquisitions of qualifying holdings that set out the recommended approach on how to impose binding conditions or obligations, as well as non-binding recommendations. These rules also clarify when such provisions may be used, their impact on the timeline and the cases in which the right to be heard should be granted. The main task of ECB banking supervision is to ensure that NCAs follow common procedures regarding qualifying holdings as laid down in the SSMFR and the SSM

	Supervisory Manual, and that the application complies with the requirements set out in EU law. According to the EBA/ESMA/EIOPA's 2016 Joint Guidelines, target supervisors should take the following non-exhaustive list of elements into account in order to assess whether a decision to acquire has been made: (a) whether the proposed acquirer was aware or, considering information to which it could have had access, should have been aware of the acquisition/increase of a qualifying holding and the transaction giving rise to it; and (b) whether the proposed acquirer had the ability to influence, to object to or to prevent the proposed acquisition or increase of a qualifying holding. Should shareholders cross a threshold involuntarily, they must notify the competent authorities immediately upon becoming aware of such an event, even if they intend to reduce their level of shareholding to below the threshold level.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.
Description and findings re EC3	Article 23(2) of CRD IV sets out the conditions under which an application may be rejected, namely if there are reasonable grounds for doing so on the basis of five criteria set out in Article 23(1) or if the information provided by the proposed acquirer is incomplete. The five criteria are (i) reputation of the proposed acquirer; (ii) the reputation, knowledge, skills and experience of the proposed new managers of the target institution; (iii) the financial soundness of the acquirer; (iv) the prudential Impact on the target; and (v) whether there is any suspicion of money laundering or terrorist financing activities. Member States cannot reject the application based on economic needs of the market (Article 23(3)). The EBA/ESMA/EIOPA's 2016 Joint Guidelines outline supervisory practices for assessing an applicant against these five criteria. ECB banking supervision applies more stringent assessment processes for acquirers with a high level of complexity (i.e., private equity funds, hedge funds, sovereign funds, large nonbanking groups, acquirers from third countries). In such cases, the assessment seeks to ensure that the credit institution will not be put under stress because part of the acquisition was financed by debt that needs to be repaid by the institution. Where applicable, ECB banking supervision seeks 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, specific acquirers may need to provide commitments relating 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. Detailed analysis of the specific acquirer's corporate governance is also 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 from the specific acquirer. As noted in EC 2, the ECB has also developed internal rules and supervisory practices to be used as a reference in the prudential assessment of acquisitions of qualifying holdings in credit institutions. Some of these are related to the procedural rules prescribed under Articles 22(2) to 22(6) of CRD IV. Article 26(2) of CRD IV deals with the measures a Member State may take in cases where the applicant for a change in qualifying holdings has failed to provide the required notification or a qualifying holding has been acquired despite the opposition of the supervisor (see EC 5 below). However, there are no specific measures relating to the provision of false information. The response in such a case will depend on national legislation, and may require the suspension of voting rights and subsequent disposal of the qualifying holding on the basis of the lack of integrity of the shareholder.
EC4	The supervisor obtains from banks, through periodic reporting or onsite examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	Pursuant to Article 26(1) of CRD IV, credit institutions whose shares are listed on a regulated market are required to inform the competent authorities, at least annually, of the names of holders of qualifying holdings and of the size of such holdings. Administrative penalties and other administrative measures apply for breaches of this requirement. Credit institutions are also required to inform these authorities upon becoming aware of acquisitions or disposals of holdings in their capital that 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, identification of the ultimate beneficial owners is not always required. According to 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." In the assessment of applications, and in the case of credit institutions whose shares are listed on a regulated market, all beneficial owners, limited partners, and all intermediaries within the holding chain must disclose their identity, i.e., their names and stakes. Participants holding participations above five percent in the (acquiring) funds would be asked to provide detailed information (CVs, criminal records, assessments from other authorities). For non-listed credit institutions, an assessment is needed of natural persons and (managers of) legal persons holding indirect participation of more than 10 percent, or a lower percentage if that allows them to exercise significant influence in the target.

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	Article 26(2) of CRD IV deals with the measures a Member State may take in cases where the applicant for a change in qualifying holdings has failed to provide the required notification or a qualifying holding has been acquired despite the opposition of the supervisor. In the first case, the measures may include 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. In the second case, Member States may provide either for exercise of the corresponding voting rights to be suspended, or for the annulment of votes cast or for the possibility of their annulment. These measures have been broadly transposed into national law. Article 66 (1) of CRD IV stipulates that Member States shall ensure that their laws, regulations and administrative provisions provide for administrative penalties and other administrative measures at least in respect of, inter alia, the acquisition, directly or indirectly, of a qualifying holding in a credit institution or a further increase, directly or indirectly, of such a qualifying holding as a result of which the proportion of the voting rights or of the capital held would reach or exceed the thresholds referred to in EC 2 above or so that the credit institution would become its subsidiary, without notifying in writing the supervisor of that institution during the assessment period, or against the opposition of the competent authorities, in breach of Article 22(1) of CRD IV. The sanctions for such a breach include possible pecuniary penalties; order to cease the conduct and desist; and suspension of voting rights. There are no specific requirements relating to the modification or reversal of a change of control that took place without proper authorization.
EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	There are no specific requirements in the CRR or CRD IV 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. The application of a notification requirement in national laws is not consistent. In Latvia, the obligation on banks to notify the supervisor about material information is explicit in national law, while in the Netherlands, the obligation to notify the supervisor about any change in the reputation of a major shareholder applies to the major shareholder itself. In Spain, banks must ensure the suitability of qualifying shareholders at all times, and compliance with this requirement is monitored as part of ongoing supervision. In Germany and Austria, there are no explicit legal requirements on banks dealing with material information about the suitability of major shareholders, but there are obligations on bank auditors to report to the supervisor any observations which may be of supervisory relevance, including facts concerning qualifying shareholders. In other Member States, the

	notification requirement is more general. For example, in Greece any change in the data and information submitted for obtaining authorization of a bank that occurs during its operation has to be notified to the supervisor.
Assessment of principle 6	Largely Compliant
Comments	EU law, as transposed into national laws, establishes a clear basis for approving acquisitions or disposals of qualifying holdings in a credit institution by the ECB, the competent authority in this area. As with the other "common procedures," the NCAs are fully integrated in the approval process and conduct assessments of applications on the basis of national laws, which have various due process requirements. The approval process is supported by the EBA/ESMA/EIOPA 2016 Joint Guidelines, ECB internal rules and detailed procedures set out in the SSM Supervisory Manual. The assessors saw evidence of the approval process, involving complex proposals and preparation of draft decisions by different NCAs. The conclusions in the Commission's recent report on the SSM that the ECB and NCAs had done a "remarkable job" in implementing the common procedures for authorizations also applied to assessment of the acquisition of qualifying holdings. The legal framework does not, however, address all the Essential Criteria in this Core Principle. In particular, there are no specific EU requirements 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, while notification requirements in national law are not consistent. Unless the supervisory relationship with individual SIs encourages a "no surprises" approach, information about a deterioration in the suitability of a major shareholder may take time to surface. In addition, there is no consistent requirement for periodic reporting by credit institutions of the ultimate beneficial owners of qualifying holdings, nor are there specific requirements for administrative penalties in respect of the modification or reversal of a change of control that took place without proper authorization.
Principle 7	**Major acquisitions.** The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.

Description and findings re EC1	**Acquisitions in undertakings outside the financial sector** Acquisitions by a credit institution in an undertaking outside the financial sector, or in an undertaking that does not carry on activities considered as a direct extension of banking, ancillary to banking, or in leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity, are subject to Articles 89 to 91 of the CRR, both in respect of type and amount of the acquisition. Neither supervisory approval nor pre-notification under these rules is required under the CRR, if the amount of the significant ownership in the nominal capital of the undertaking does not exceed 15 percent of the eligible capital of the credit institution, or the total amount of such significant ownerships held by the institution does not exceed 60 percent of the eligible capital (Tier 1 plus Tier 2 limited to 1/3 of Tier 1) of the institution. For any acquisition above the 15 percent threshold, or where the sum of such acquisitions exceeds 60 percent of eligible capital, credit institutions must apply a risk weight of 1,250 percent to the amounts in excess of these thresholds, or deduct those amounts from Common Equity Tier 1. Some national laws have notification or approval requirements for these types of acquisitions. In Ireland, certain prior approval requirements (for major acquisitions) and prior notification requirements (for other acquisitions) have been applied by the supervisor by means of a license condition. Where jurisdictions have notification/approval requirements, they are aimed mainly at safeguarding the sound and prudent management of the acquiring credit institution, and assessments address the impact of the acquisition on the capital and liquidity situation of that institution. **Acquisitions in an EU financial sector entity** The acquisition by a credit institution of a qualifying holding in another EU credit institution (or other EU financial regulated entity such as an investment firm, insurance company, etc.) is covered in Articles 22–27 of CRD IV. In contrast to acquisitions in undertakings outside the financial sector, these Articles grant power to the supervisor of the target institution and aim primarily at safeguarding the sound and prudent management of the target undertaking. Hence, approval and notification requirements are determined by reference to the size of voting rights/capital of the target undertaking and the assessment is made from the perspective of that undertaking. These requirements in the case of credit institutions are described in CP 6. **Acquisitions of a non-EU bank** Such acquisitions are not covered by the CRR or CRD IV. Article 22 of CRD IV only regulates the acquisition of qualifying holdings in a credit institution established in the EU but does not include explicit provisions on the acquisition of holdings in non-credit institutions or in credit institutions outside the EU.

	A small majority of Euro Area Member States provide for powers regarding the approval of acquisitions by credit institutions of holdings in a non-credit institution or a credit institution outside the EU. Such powers exist, for example, in Belgium, Finland, Italy, Netherlands, Portugal, and Spain, but are absent in a number of other Member States. The Supervisory Board has clarified that, as from January 1, 2017, supervisory powers related to the acquisition of holdings in a non-credit institution or a credit institution (also outside the EU) are to be directly exercised by the ECB for SIs, with the main purpose being to ensure the sound and prudent management of the acquiring credit institution. Use of these powers, in accordance with the SSMR, CRD IV, and the national laws of some Member States, is intended to ensure compliance with prudential requirements in the areas of own funds, liquidity and leverage. Where national laws do not specify any requirements for supervisory approval of such acquisitions, the ECB can assess the acquisitions only against the general requirement under Article 16 (1) (c) of the SSMR that the strategies of the acquiring institution should ensure a sound management and coverage of its risks.
EC2	Laws or regulations provide criteria by which to judge individual proposals.
Description and findings re EC2	There are no harmonized procedures or criteria at EU level for assessment of acquisitions by credit institutions. Only in a few Member States (e.g., Ireland, Slovenia) do national laws specify assessment criteria. However, as explained above, the ECB directly exercises supervisory powers related to the acquisition of holdings in a non-credit institution or a credit institution (also outside the EU) by SIs when national law provides for such power. Additionally, an acquisition by a credit institution may impact on the 15/60 thresholds and will therefore be subject to the relevant EU provisions (See EC 1). If the credit institution acquires another EU credit institution (or other EU financial regulated entity), a qualifying holding procedure as described in CP 6 will be conducted by the target supervisor. The criteria for assessing this acquisition are set out in Article 23(1) of CRD IV (See AC 1).
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.[55] The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.

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

Description and findings re EC3	There are no harmonized criteria at EU level relating to these specific requirements. In most Member States, national law is silent on such criteria. In Spain, the competent authority may refuse an application from a bank seeking to open a branch in a non-EU country if it considers that the activities of the branch will not be subject to effective control by the supervisory authority in the host country, or because of the existence of legal or other impediments preventing or hindering the control and inspection of the branch by the competent authority. Similar criteria apply in Ireland (regulation), and in Finland, Luxembourg, and Slovenia (national law). However, ECB banking supervision has clearly communicated to SIs, on an individual basis, that it needs to be aware of transactions that materially affect the risk profile of an institution in order to assess them prior to completing the transaction. In its assessment, ECB banking supervision 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 and liquidity, governance and organizational aspects. Where ECB banking supervision is of the view that the transaction would negatively affect the institution, it can take measures under Article 16 (2) of the SSMR, including capital and liquidity add-ons, governance and organizational reinforcements, and can require divestment of activities that pose excessive risk. The possibility of such measures is 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. In addition, the impact of acquisitions will figure prominently in the SREPs following such transactions and may lead to requirements in the SREP decision.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial, and organizational resources to handle the acquisition/investment.
Description and findings re EC4	There are no specific requirements for assessment of the adequacy of the financial, managerial or organizational resources of the bank prior to it making an acquisition. In the case of investment in a nonfinancial sector entity, the risks are managed through the 15/60 percent thresholds as set out in Articles 89–91 of the CRR, but there is no requirement or limit for acquisitions of non-EU banks (see EC 1 above). National law in Germany has the general requirement that institutions have an organizational structure and risk management adequate to their size, complexity, and business structure on a single entity basis and on a group-wide basis. Similar general requirements apply in Ireland (through license conditions) and Slovenia (national law). As noted in EC 3 above, however, ECB banking supervision has clearly 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 completing the transaction. In its assessment, ECB banking supervision 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 and liquidity, governance, and organizational aspects.

EC5	The supervisor is aware of the risks that nonbanking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in nonbanking activities.
Description and findings re EC5	ECB banking supervision is aware of the risks that nonbanking activities can pose to a banking group. Nonbanking risks are assessed as part of the SREP and the entire range of qualitative and quantitative supervisory measures at the disposal of the ECB may be taken to mitigate such risks. Such an assessment and reaction is also possible outside the SREP, as explained in EC 3 above. Where ECB banking supervision is aware of a transaction in advance of its completion, it will also consider the ability of the bank to manage nonbanking risks and take appropriate measures where it is not convinced. In Austria, acquisition of participations in nonbank business does not need supervisory approval. However, an acquisition is only permitted up to a limited amount of own funds; any amount in excess of that limit must be fully covered by own funds. In Spain, national law permits the competent authority to limit certain activities when deemed appropriate according to the bank`s solvency situation. In Ireland, risks that nonbanking activities can pose to a banking group are taken into account in license conditions.
AC1	The supervisor reviews major acquisitions or investments by other entities in the banking group to determine that these do not expose the bank to any undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.[56] Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.
Description and findings re AC1	There is no specific authorization procedure in the EU framework regarding acquisitions by other entities (subsidiaries) in the banking group. However, when the target of the acquiring credit institution is a supervised institution located in the EU (another credit institution, an insurance company or an investment firm), the competent authority of the acquiring credit institution may request cooperation from the target supervisor (Article 24 of CRD IV). In a few Member States (Belgium, Finland, Ireland), credit institutions must notify the NCA of major acquisitions by unregulated members of the banking group. In other Member States (Germany, France, Slovenia), requirements in national law relating to the acquisition of a participating interest in another enterprise apply for direct participating interests as well as for indirect participating interests.
Assessment of Principle 7	Materially Non-Compliant

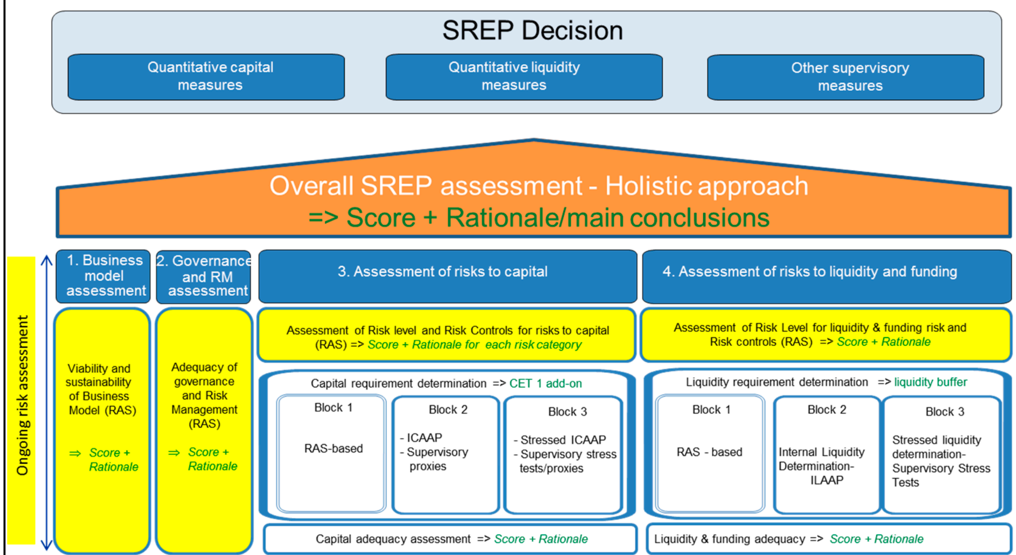
[56] Please refer to Footnote 33 under Principle 7, Essential Criterion 3.

Comments	EU law does not provide an adequate or consistent basis for ECB banking supervision to approve or reject, and impose prudential conditions on, major acquisitions or investments by a credit institution. In particular: • there are no prior notification or approval requirements for acquisitions in an undertaking outside the financial sector; • requirements relating to the acquisition of a qualifying holding in another EU credit institution are focused on safeguarding the sound and prudent management of the target, not the acquiring, institution; • there are no explicit requirements on the acquisition of holdings in credit institutions outside the EU; and • there are no harmonized procedures or criteria at EU level for assessment of major acquisitions by credit institutions, including whether the acquisitions expose the credit institution to undue risks or hinder effective supervision. National laws in a number of Member States have granted the relevant NCA supervisory powers to impose various notification and approval requirements, but the coverage is neither consistent nor complete across the Euro Area. The ECB has clarified that, where such powers exist, it is exclusively and directly competent to exercise them. The ECB can also assess major acquisitions against the general requirement that the acquisition should not jeopardize the sound and prudent management of the acquiring institution but, in the absence of pre-notification requirements, there can be no assurance that such assessments will have any *ex ante* influence on the acquisition. In its opinion on the Commission's proposed amendments to CRR/CRD IV, the ECB noted that despite the recent clarification of its competence in this area, providing the NCAs' existing supervisory powers with a common legal basis in EU law would trigger a requirement for their transposition and would foster a level playing field in EU banking supervision through the harmonization of supervisory powers. To achieve this, the ECB has argued that EU law should include a clear reference to additional supervisory powers in relation to material acquisitions in third countries. The reference would state that: "Member States shall require any credit institution that has taken a decision to undertake, directly or indirectly, a material acquisition or investment within or outside of the Union (the proposed transaction) to notify the competent authority in writing in advance of the proposed transaction. The competent authority shall have the power to approve or reject the proposed transaction."
Principle 8	**Supervisory approach**. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess, and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.

Essential criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system. The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment, and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.
Description and findings re EC1	The main tool for assessing on an ongoing basis the nature, impact and scope of risks for credit institutions is the SREP. In application of the CRD and its national implementation, the ECB as the competent authority is required to carry out a SREP and to take decisions for SIs. Within a group, this applies at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In the case of a financial conglomerate, the SREP decisions also need to consider the outcome of the supplementary supervision as required by FICOD. The SSM SREP is based on a harmonized methodology developed along the lines of the EBA Guidelines on common procedures and methodologies for the SREP (EBA/GL/2014/13). It is applied in a proportionate manner to institutions depending on the nature, scale, and complexity of their activities, and, when relevant, on their situation within a group, its overseas and interbank ties, its significance for the overall market or a relevant sub-segment of the market, and the institution's overall risk situation, taking into account all relevant risks, its risk management processes and its capital and liquidity. The SREP methodology is in continuous development to reflect international and European regulatory work and best practices and encompasses evolving banks' practices. The EBA is also undertaking a consultation and review of its current SREP Guidelines: https://www.eba.europa.eu/regulation-and-policy/supervisory-review-and-evaluation-srep-and-pillar-2. The ECB is also looking at streamlining the SREP without limiting its effectiveness. The SREP methodology relies extensively on quantitative and qualitative analysis. It combines data and expert judgment following a principle of "constrained judgment," with a view to ensuring that the SREP decision fits best with an institution's risk profile (and is not a "mechanical" process), takes into account the risks which banks or banking groups present to the safety and soundness of the banking system while also ensuring consistency and accountability across the SSM. The assessment of the risks which banks or banking

groups present to the safety and soundness of the banking system is based on the clusters used by ECB banking supervision to identify banks' riskiness. This clustering is regularly updated and benefits from the ongoing monitoring of markets and financial stability developments by the SSM Risk Analysis Division.

The SSM SREP is built on four elements (see the following Figure):



- business model and profitability assessment;
- internal governance and risk management assessment;
- risk-by-risk assessment of risks to capital;
- risk-by-risk assessment of risks to liquidity and funding.

The assessments performed for the four elements result in an overall SREP assessment, which underpins a wide range of possible supervisory actions, including the decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. There is a direct link between the supervisory assessment, the necessary supervisory measures, and the SEP. The SREP score drives the intensity of the supervision—level of engagement—on an institution.

This overall architecture facilitates comparisons across banks. For each element, the assessment can also be tailored to the specific situation of each institution. The various assessments are performed at different frequencies (MELs), defined as a result of the SREP in the SEP, which can be fine-tuned by the SEP for each individual institution.

The JST is expected to update its assessments and remediation actions whenever it is warranted by new information. The assessments performed by the JST are documented in the ECB's Information Management System (IMAS) on an ongoing basis. At least once a year, a SREP decision is taken. Examples of SREP decisions, including one with identified deficiencies, were provided to the assessors. The decisions describe the findings in detail and where appropriate establish enforceable prudential requirements for the institution.

	Assessors saw evidence of a direct link between offsite supervision and follow up with the institution reflected in the SEP. With respect to the assessment of resolvability, see EC6.
EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	The SREP methodology establishes a forward-looking view of the profile since JSTs shall take all necessary actions in a timely manner to ensure institutions' future viability (See EC1). The assessments need to be carried out taking into account a forward-looking perspective. The SREP assesses an institution's viability at a 12-month horizon, in the medium term (3 to 5 years), and over the cycle. To do so, ECB banking supervision relies on a wide range of backward and forward-looking, quantitative and qualitative information, such as stress testing. The ECB's RAS supports the JST's day-to-day supervisory work. It is used for evaluating banks' risk levels and controls, their business model, their internal governance, their capital adequacy and their liquidity adequacy on an ongoing basis. The assessment of an institution's capital, and liquidity needs is based on the outcome of the ongoing RAS, supplemented with a periodic more comprehensive review of the institution's capital and liquid positions, in the light of the latter's own assessments (internal capital adequacy assessment processes (ICAAP)/ILAAP) taking into account normal and stressed conditions. To that purpose, supervisors may challenge the ICAAP/ILAAP of the bank based on its own quantification (supervisory "proxies") as well as supervisory stress tests (such as those conducted by the EBA or the ECB's comprehensive assessments). These various dimensions provide supervisors with both a static and forward-looking perspective on the bank. The assessments of the first two elements (business model and profitability, and governance and risk management assessments) (see Figure shown in EC1), together with the assessments of risks to capital and to liquidity are conducted on the basis of regular reporting, such as common reporting (COREP) and financial reporting (in the EU) (FINREP), qualitative information, and also ad hoc information received by JSTs from various sources on an ongoing basis: other data (e.g., STE data), reports (e.g., external audit reports), meetings, etc. The outcome of this analysis is a risk analysis with short narratives summarized in scores that facilitate comparison and internal communication. The outcome of the SREP is taken into account together with ECB banking supervision analysis of the risk environment as well as other factors such as changes in the regulatory landscape to identify supervisory priorities and derive a SEP. The SEP defines the supervisory activities for ongoing supervision, onsite inspections, and internal model investigations to be carried at the SI over a predetermined time horizon (typically one year for ongoing activities and for the onsite inspections and internal model

	investigations). Pursuant to Article 12 of the SSMR, and as part of the SEP, in order to carry out the tasks assigned to it by the SSMR, the ECB appoints onsite inspection teams as laid down in Article 144 of Regulation 468/2014 of the ECB of April 16, 2014 (SSMFR) to conduct all necessary onsite inspections on the premises of a legal person as referred to in Article 10(1) of the SSMR (SSMFR Article 143). The fundamentals of the ECB's methodological framework for supervision are sound. It also has been refined through the experience gained since its initial launch in 2015. This process of continual assessment and improvement should continue as the SREP matures.
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	The relevant Articles in CRD IV include Articles 73, 97, 98, and 99. In addition, in accordance with Article 10 of the SSMR, the ECB has the power to require institutions and parent undertakings to provide all information that is necessary in order to carry out its supervisory tasks. Part of the ECB's mandate is to ensure that banks comply with the relevant Union law that imposes prudential requirements on credit institutions in the areas of own funds requirements, securitization, large exposure limits, liquidity, leverage, and reporting and public disclosure of information on those matters (See Article 4(1)(d) of the SSMR). The ECB also is charged with ensuring that banks comply with the relevant Union law requiring credit institutions to have in place robust governance arrangements, including "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 ICAAP, including Internal Ratings-Based (IRB) models. ECB banking supervision must assess whether the institutions of the group have implemented appropriate arrangements, strategies, processes, and mechanisms to comply with all requirements of CRD IV and CRR that set out the relevant prudential and other requirements. The assessment of banks' and banking groups' compliance with prudential regulations and other legal requirements is made on a regular basis in the context of the SREP. In particular, for each relevant risk category there is an assessment of compliance with the applicable laws and regulations covering own funds requirements; securitization; large exposure limits; liquidity; leverage; and 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 ICAAP, including IRB models. A credit institution's written SREP decision from the ECB tells the institution whether it has correctly implemented the arrangements, strategies, processes, and mechanisms necessary to comply with all requirements of CRD IV and CRR. If the ECB has evidence that the credit

	institution is likely to breach the requirements of the relevant union law within the next 12 months, it may at an early stage exercise the powers provided for by Article 16(2) of the SSMR. If an institution is rated 3 minus or 4, the SRB is granted automatic access to IMAS data on the institution. The entity's internal governance assessment also assesses the compliance function. The compliance function is assessed in the following areas: (i) whether the institution is prepared for future regulation and evaluates the impact that regulation will have on its activities. This relates to both the rules resulting from the institution's own policy in this area and those resulting from banking law and its implementing regulations, along with other legal and regulatory provisions applicable to the banking sector (for instance, transparency, AML, etc.) as well as litigation and reputational risk; (ii) whether the institution adheres to the aforementioned procedures and instructions on an ongoing basis (including a comprehensive incident database and analysis); reports periodically the results of such monitoring and awareness testing to the institution's management body in its management function and management body in its supervisory function. Please refer to CP 25 for a discussion of AML as an operational risk factor. In addition, during onsite inspections one of the aims is to assess the institution's compliance with banking regulation. The JST engages with SIs on an ongoing basis through regular meetings, onsite examinations, and thematic reviews and through the receipt of information sources such as internal and external audit reports. Discussions between assessors and JSTs from a cross-section of institutions show a high level of engagement with business line and senior management as well as risk managers. The availability of adequate resources for onsite supervision continues to be a challenge for the ECB. Resource related issues may vary by NCA and supervision program. While cooperation, planning, and coordination between the ECB and NCAs has improved, these efforts should continue. Otherwise, this may impact the ability of the ECB to fulfill their supervision responsibilities (See CP 2). The ECB conducts thematic reviews of significant areas on a horizontal basis (See EC 4). In 2017, the ECB launched the Targeted Review of Internal Models (TRIM) exercise, with the overall objective to enhance the credibility and to confirm the adequacy and appropriateness of approved Pillar I internal models for credit, market, and CCR of all SIs using internal models within the SSM with a view to ensure compliance with regulatory requirements and to harmonize supervisory practices. In this connection, the exercise aims to reduce the non-risk-based variability of risk-weighted assets calculated with internal models and foster a level playing field within the SSM. TRIM is an SSM-wide project jointly performed by the ECB and NCAs, with consultancy support, and it is planned to run until 2019. Overall, about 200 onsite investigations are expected to be conducted in the context of the project, reviewing all internal models for

	market and counterparty credit risk, and reviewing the most material and critical models for credit risk, ensuring coverage of at least 60 percent of total IRB Exposure at Default and risk-weighted assets of SIs. A draft General Topics chapter to the ECB Guide to Internal Models was published in October 2017: fhttps://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170727.en.html A public consultation on the General Topics, which will reflect the results of TRIM's internal model assessments, is expected at the end of the first quarter of 2018.
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in nonbank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	Article 97 of CRD IV requires the competent authorities to evaluate the risks institutions are or might be exposed to, risks that an institution poses to the financial system, and risks revealed by stress-testing taking into account the nature, scale, and complexity of an institution's activities. Key Institutions' internal arrangements to be reviewed as part of this SREP comprise the ICAAP as set out by Article73 of CRD IV and the ILAAP as set out by Article 86 of CRD IV. The macroeconomic situation and macroprudential considerations are taken into account in microprudential supervision through the strategic planning exercise, as well as in the SREP. The strategic planning exercise, conducted by the DG MS IV Planning Division with input from the Risk Analysis Division, is conducted yearly and includes a broad stocktaking of risks, which takes into account the viewpoints of NCAs/macroprudential authorities, several Directorates General of the ECB (e.g., DG-MF) and international bodies (e.g., the ESRB, the EBA and the IMF) to complement the Risk Analysis Division's own research. Therefore, macro views are an important driving factor in the determination of supervisory priorities within the SSM and an input for the minimum engagement levels in the operational planning process. Risks stemming out of the external environment, such as sectoral risks, conduct risks, or cybercrime, come into play in SREP, either when assessing a specific risk category or in the holistic approach, taking all information available to arrive at the final assessment of the risk profile of the bank. In addition, there are risks that reflect another dimension: global/European (risks that could affect all banks and do not stem from a specific country or sector, e.g., cybercrime or reversal of the search for yield); cross-border sectoral (risk stemming from a specific sector, e.g., credit risk stemming from the global shipping sector); domestic country-wide (non-sectoral risks specific to a country, e.g., a credit-rating downgrade of the government of country Y); or domestic sectoral (sectoral risk in one country, e.g., deteriorating SME loans in

	country X). In the case of country and/or sector specific risks, JSTs need only assess those risks where the supervised bank has significant exposures. The JST assesses the institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic, and financial developments. This is done using a wide range of information sources, including the institution's internal stressed projections, SSM's stressed supervisory proxies, and the outcome of supervisory (bottom-up and/or top-down) stress tests when available. Following the clarification of the EBA of July 2016 on the use of the 2016 EU-wide stress test results in the SREP process, the ECB has reflected the quantitative outcome of the stress test in capital guidance (See CP 9). The on-going supervision that is conducted by the JST and supported by the ECB and NCAs' horizontal divisions includes the review of prudential returns and of financial statements. With regard to providing a forward-looking assessment of an institution's capital position, the supervisor relies on an institution's internal stress test, on the supervisor's micro stress and sensitivity analysis, and on system-wide supervisory stress tests when available. Institutions usually rely on a wide range of internal stress tests and sensitivity analyses to determine their capital trajectory and their ability to raise own funds over a certain horizon. This helps them identifying backstop actions that may be warranted at an early stage should adverse scenarios materialize. To review these stress tests, ECB banking supervision follows the principles and recommendations of international supervisory bodies. Supervisors should expect institutions to analyze at least a baseline scenario and a stressed scenario, and make projections of its main balance sheet, profit and loss, and off-balance sheet items in view of the institution's strategic plan, including the capitalized profit, dividends, share issues, subordinated capital issues, and capital charges in line with the expected business growth, changes in the Pillar 1 risk profile, other risks assessed in the ICAAP, regulatory changes, one-off transactions, etc. Stress tests should be conducted as part of the ICAAP to identify those events or changes in the market conditions in which institutions operate that may adversely affect their future solvency. At least one comprehensive adverse scenario, reflecting severe but plausible adverse developments of the institution's operating conditions, should be used for capital planning. Supervisors should assess the underlying assumptions and the adequacy of the translation of these assumptions into stressed capital and risk projections over at least the upcoming three years. Furthermore, any embedded management actions should be scrutinized. The Risk Analysis Division is responsible for taking into account cross-sectoral developments through quantitative impact studies (not covered by the Methodology and Standards Development Division) and cross-sectional analysis of results, and institution-

	specific quantitative impact analysis of the macroprudential policies that use microprudential instruments (which is generally the case). The Risk Analysis Division and the ECB's macroprudential function cooperate closely by exchanging views on risks and vulnerabilities e.g., in regular meetings. The ECB also established cooperation arrangements with other regulators, including insurance and market regulators (See CP 3). The ECB maintains frequent contact with NCAs and international bank regulatory authorities through supervisory colleges (See CP 13). It also maintains contact with other nonbank financial regulators such as securities and insurance supervisors in a variety of fora to discuss a common view of risks in the particular banking group supervised, supervisory approaches, and potential concerns on the banking group or subsidiaries (See CP 12).
EC5	The supervisor, in conjunction with other relevant authorities, identifies, monitors, and assesses the build-up of risks, trends, and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	ECB banking supervision's SREP strives for high-quality supervision and to ensure financial stability within the SSM. This entails enhancing institutions' resilience to shocks. The JSTs are expected to carry out their assessment in a conservative manner, acting in a fair but tough manner, taking into account horizontal developments that may affect institutions under the ECB's supervision. As the SREP is performed simultaneously for all SIs under the ECB's direct supervision, the ECB is in a unique position to identify common trends likely to affect all or part of the institutions under its responsibility. Moreover, in order to ensure consistency and identify common trends, horizontal analyses are integral to the SREP methodology. This approach permits peer comparisons and the consistent application of supervision practices. Horizontal analyses are performed by the ECB's horizontal function—mainly the MSD and RIA divisions. Their results are communicated to the Supervisory Board, which takes them into account in making final SREP decisions. The structure of the ECB's decision-making bodies ensures that where appropriate, the identification of significant trends or emerging risks is communicated to the central banking and financial stability functions of the ECB. Horizontal analysis or ad-hoc thematic analysis may give rise to immediate communication to and/or actions by the institutions, when needed. Where individual measures are addressed to institutions, they should result in a forward-looking view of the situation of the bank and minimize the risk of underestimation of risks (See Assessment of CP 9).

	Assessments of the ECB's supervision of specific substantive areas are found in: CP 18 on problem assets; CP 21 on country risk; CP 22 market risk; CP 23 on interest rate risk; CP 24 on liquidity; and, CP 25 on operational risk. The assessors identified a gap area in the ECB's identification of a build-up of risks. The ECB should consider the risk management risk, and operational risk and liquidity impacts of high risk business models even though the activity may involve substantive areas regulated by NCAs or national authorities such as AML (See CP 25).
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	The EU legal framework for resolution planning (e.g., the SRM Regulation and BRRD), gives the resolution authority the responsibility for resolution planning, including the assessment of the bank's resolvability and the taking of measures to address impediments to its resolvability. The ECB, as the competent supervisory authority, has a consultative role in the drawing up of resolution plans for SIs and in the assessment of resolvability. The ECB cooperates with the SRM under the framework of the BRRD and the SRM Regulation for resolution planning. The ECB shares relevant information on SIs with the SRB for the purpose of resolution planning in line with Article 30 SRMR. The SRB is required to consult the ECB with respect to the resolution plans and respective resolvability assessment of individual SIs, in line with Article 8 and 10 SRMR. The assessors saw written examples of this consultation between the ECB and SRB. If the SRB after consulting the ECB determines that there are substantive impediments to the resolvability of that SI, the SRB shall notify in writing that determination to the institution concerned, to the ECB and to the resolution authorities of the jurisdictions in which significant branches are located. Within four months of the date of receipt of a notification, the institution shall propose to the SRB possible measures to address or remove the substantive impediments identified in the notification. The SRB, after consulting the ECB, assesses whether those measures effectively address or remove the substantive impediments in question. If the measures proposed by the entity or parent undertaking concerned do not effectively reduce or remove the impediments to resolvability, the SRB shall take a decision, after consulting the ECB and, where appropriate, the designated macroprudential authority, indicating that the measures proposed do not effectively reduce or remove the impediments to resolvability, and instructing the national resolution authorities to require the institution, the parent undertaking, or any subsidiary of the group concerned, to take the below listed alternative measures. In identifying alternative measures, the SRB is required to demonstrate how the measures proposed by the institution would not be able to remove the impediments to resolvability and how the alternative measures proposed are proportionate in removing them. The SRB also must take into account the threat to financial stability of those impediments to resolvability and the

	effect of the measures on the business of the institution, its stability and its ability to contribute to the economy. For the purposes described above, SRB shall have the power to take any of the following measures: (a) require the institution to revise any intragroup financing agreements or review the absence thereof, or draw up service agreements, whether intra-group or with third parties, to cover the provision of critical functions; (b) require the institution to limit its maximum individual and aggregate exposures; (c) impose specific or regular additional information requirements relevant for resolution purposes; (d) require the institution to divest specific assets; (e) require the institution to limit or cease specific existing or proposed activities; (f) restrict or prevent the development of new or existing business lines or sale of new or existing products; (g) require changes to legal or operational structures of the institution or any group entity, either directly or indirectly under its control, so as to reduce complexity in order to ensure that critical functions may be legally and operationally separated from other functions through the application of the resolution tools; (h) require an institution or a parent undertaking to set up a parent financial holding company in a Member State or a Union parent financial holding company; (i) require an institution to issue eligible liabilities to meet the requirements of Article 45 of the BRRD; (j) require an institution to take other steps to meet the minimum requirement for own funds and eligible liabilities under Article 45 of the BRRD; and (k) where an institution is the subsidiary of a mixed-activity holding company, requiring that the mixed-activity holding company set up a separate financial holding company to control the institution. Before identifying any of the above-mentioned measures, the SRB, must consult with the ECB and, if appropriate, the designated national macroprudential authority, and is required to consider the potential effect of those measures on the particular institution, on the internal market for financial services, on the financial stability in other Member States and Union as a whole. In case of a Union parent undertaking, the joint decision process described in Article 18 of the BRRD applies. The ECB should continue to work with the SRB to develop and refine appropriate operational policies and procedures to implement their respective resolution planning roles (See EC7).
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	The ECB's crisis management framework covers several phases depending on the specific situation of the credit institution. It ranges from preparatory activities in the ongoing supervision to involvement in decisions on resolution. However, during the resolution process, the main decision-makers are the resolution authorities (i.e., the SRB and the NRAs). Within this context, the ECB plays an advisory role and cooperates with NRAs/SRB on any necessary follow-up actions (See EC6). A successful resolution requires a high level of coordination and information sharing between the SRB, ECB banking supervision, and

	liquidity providers. The robustness and feasibility of an SI's liquidity contingency funding plans are essential (See CP 24 EC 6). The ECB's ongoing supervision includes the early identification and remediation of emerging risks, and the assessment of recovery plans and the use of stress tests. The framework for stress testing by the ECB is further explained in EC4. Moreover, the ECB performs regular risk assessments and monitors the risk profile of an institution including whether the conditions required for authorization to continue exist, pursuant to Articles 97 and 107 of CRD IV. When the financial situation of an institution deteriorates, the ECB determines the appropriate supervisory action and the relevant JST steps up the supervisory activity for the institution, following an escalation process.[57] The ECB escalation process should be understood by both ECB and SRB staff. Information that is relevant to the resolution process should be shared promptly. Advance preparation of resolution actions can prevent value destruction. Preliminary staff level discussions between the ECB and the SRB should occur shortly after a SI is projected to fail within a 12-month time horizon and well before the ECB forms a crisis management team (CMT). The ECB and SRB should adopt policies and operational arrangements to ensure that formal FOLTF determinations and the 'resolution weekend' are closely coordinated and can be prescheduled allowing for advance resolution preparation and the problem bank can be seamlessly transferred from the ECB to the SRB On the operational side, the ECB has designed an Emergency Action Plan that includes the operational steps for crisis management and crisis mitigation for SIs in the context of the ECB crisis management framework set out in the SSM Supervisory Manual. The ECB's intermediate structures and horizontal divisions are informed about the deterioration in the risk profile. In particular, when the JST coordinator sees that the financial situation of a bank deteriorates materially either in a short period of time or gradually with a clear trend, the JST coordinator shall inform the head of the Crisis Management Division, while NCAs will be automatically involved through the JST. As a result, the Crisis Management Division will start monitoring the situation and cooperate with the JST. Those banks with a potential deterioration of liquidity or capital situation will be monitored more closely. Expert support is provided by the Crisis Management Division as regards both the analysis of the financial situation of the credit institution/banking group and the preparation of a draft decision proposal on remedial actions. In particular, the Crisis Management Division will share its knowledge and experience from other comparable situations and from its interaction and cooperation with the relevant crisis management functions of the NCAs.

[57] Experience indicates that the escalation process should act as a reference only, as many crisis situations evolve rapidly, without following a step-wise pattern.

	Before selecting the most appropriate intervention tools, the JST and the Crisis Management Division gather any analysis prepared by the DG MS IV Risk Analysis Division based on its monitoring of the SSM banking system. In a crisis situation, the JST coordinator and the head of the CRM may propose the establishment of an institution-specific CMT. The institution-specific CMT acts as the central internal coordination body with respect to necessary institution-specific supervisory actions within the SSM to mitigate a crisis situation. It is also the central hub for information sharing and coordination of the ECB supervisory response. While it is not a formal decision-making body, the IS CMT allocates concrete tasks and proposes draft decisions to be considered by the ECB decision-making bodies, as well as monitors progress, effectiveness, and efficiency of crisis management activities at the working level. Further, the IS CMT coordinates interactions with the institution in difficulty via the JST coordinator and relevant Banking Union NCAs. Cooperation with relevant representatives of NRAs and the SRB is then coordinated by CRM. Each IS CMT is composed of: the Chair and Vice-Chair of the Supervisory Board; the JST coordinator; his Head of Division and Director General; the Head of Division of CRM as well as the DG of DG MS IV; the Secretary of the Supervisory Board; and the Supervisory Board member(s) of the NCA(s) directly affected. Other senior representatives of Banking Union NCAs, including Supervisory Board members of directly affected NCAs, other ECB banking supervision staff (the non-affected DG MS I or II and DG MS III) and ECB divisions at DG level can be invited to IS CMT meetings. Where appropriate, other relevant ECB divisions (e.g., DG Communications, DG Market Operations) are debriefed after the IS CMT meeting on a need-to-know basis. In case of emergencies, the Chair of the Supervisory Board shall convene a meeting in time to take the necessary decisions; as appropriate, this can also be by means of teleconferencing under derogation from the general rules. The assessors note that the Supervisory Board has used emergency procedures for expedited decisions in time-sensitive situations. The relevant ECB DG submits, where necessary in cooperation with other competent DGs, to the Secretariat of the Supervisory Board, a proposal for a complete draft decision stating that an emergency decision is required. When a DG is preparing a proposal for a complete draft decision, the opinions of the NCAs are captured within the process. The ECB follows a specific decision-making procedure. This procedure respects the EU Treaty rules governing decision-making within the ECB, which assign decision-making powers exclusively to the Governing Council and the Executive Board. Under this procedure, the Supervisory Board proposes 'complete draft decisions' to the Governing Council, but the Supervisory Board cannot take legally binding ECB decisions of its own initiative, nor can decision-making powers be delegated to it.

	The Supervisory Board meeting is convened either in person, via conference call, or through written procedure, for a swift decision. The Supervisory Board is responsible for assessing all proposals for complete draft decisions submitted for approval through the Directorates General and to decide on the final proposal to be transmitted to the Governing Council. The decision is adopted by the Governing Council in the context of a physical meeting, via conference call, or through written procedure. The Governing Council cannot change complete draft decisions but only approve or object to them. Approval can also occur tacitly in the sense that complete draft decisions proposed to the Governing Council are considered adopted where it does not object within a defined time period (non-objection procedure). Overall, in crisis or emergency situations, decision-taking is speeded up significantly via a specific "fast-track" procedure. Where process steps are sequential, they are undertaken back-to-back. In the case of a cross-border banking group, the ECB, as the consolidating supervisor, plans and coordinates the supervisory activities (e.g., early intervention measures) within the supervisory college framework. Where appropriate, the ECB informs resolution authorities of any material deterioration in the financial soundness of an institution and of the implementation of early intervention measures (See Articles 27 and 30 of the BRRD). In accordance with Article 32(1)(a) of the BRRD and Article 18(1) of the SSMR, the ECB coordinates consultation with the SRB on the determination of failing or likely to fail. Where a "failing or likely to fail" determination is taken, the ECB informs all relevant stakeholders (e.g., the SRB and the Commission in line with Article 18(1) of the SSMR, other external stakeholders in line with Article 81(3), e.g., the relevant deposit guarantee scheme(s), the competent ministries, etc.). The ECB demonstrated to the assessors that this expedited approval process was used effectively in 2017 in connection with the resolutions of failed institutions. While a formal resolution framework is in place, the timeliness and level of coordination and collaboration between the ECB and SRB could be improved. The ECA assessed the operational efficiency of the management of the ECB in crisis management. (Special Report No. 02/2018: The Operational Efficiency of the ECB's Crisis Management for Banks, 16/01/2018). The audit found that while the ECB has established a substantial framework for crisis management, it noted some design flaws and inefficient implementation that should be addressed. The audit recommended making better use of recovery plan assessments and developing operational guidance for crisis management activities and to enhance management reporting systems. Internal ECB processes should be reviewed for effectiveness in light of recent resolution experience. The assessors recommend that the ECB and SRB forge closer working relationships in recovery and resolution planning. Ongoing negotiations to revise the existing MoU should

	conclude as soon as possible. Automatic information sharing with the SRB has been established at the assignment of certain SREP ratings. Discussions about shared information should occur early in the process, well before formal "early intervention" and "failure or likely to fail" notifications are required to facilitate seamless recovery and resolution planning.
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	Where the ECB becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter or of banks restructuring their activities to avoid the regulatory perimeter, the ECB brings the matter to the attention of the responsible authority if such authority exists. The assessors note that the ECB lacks express authority to legally constrain activities outside its remit. The ECB cannot address directly the issue of jurisdiction-specific bank-like activities being conducted without adequate licensing authorities. The ECB cannot mitigate this gap without express Union powers or the authority to enforce national laws or regulations addressing the activity in question. Where SIs, intentionally or negligently, breach a requirement under relevant Union law, the ECB may impose administrative pecuniary penalties or fines (hereafter "sanctions") to penalize the misconduct of business by the credit institution (Article 18(1) of the SSMR) or, in the cases specified in Article 18(5) of the SSMR, require NCAs to do so. In the case of a breach of ECB regulations or decisions, the ECB may sanction supervised entities with fines. In cases of ongoing breaches of regulations or national laws implementing relevant directives or ECB decisions, the ECB may impose enforcement measures to compel entities to comply with regulatory or supervisory requirements, make use of enforcement measures available to NCAs under national transposition of EU law or instruct NCAs to use their purely national enforcement powers, when available (See CP11).
Assessment of Principle 8	Largely Compliant
Comments	The fundamentals of the ECB's methodological framework for supervision are sound. The main elements of the supervision methodology—SREP, RAS, and SEP—are well in in place. The methodology has been refined through the experience gained since its initial launch in 2015. This process of continual assessment and improvement should continue as the SREP, RAS and SEP mature over time. The greater emphasis on quantitative analysis is consistent with the EBA's SREP Guidelines. The methodology meets the requirements of CP 8 as being a forward-looking risk-based assessment of individual banks and banking groups, proportionate to their systemic importance. The ECB's supervisory approach identifies risks within banks and the banking system as a whole. The ECB should seek a balance between thematic and ongoing supervision after its level setting effort.

	ECB decision-making processes are complex and may impede timely supervisory action in the ordinary course. Furthermore, the volume, quality and availability of resources for the supervision of SIs are in some instances beyond the ECB's control. In exigent circumstance, the Supervisory Board and the Governing Council, however, have demonstrated an ability to act. These bodies adopted emergency procedures that have been successfully tested in recent resolutions. It is important to address these constraints, even though some of them are structurally imbedded. The assessors reviewed the ECB's supervisory histories for recent resolutions of SIs. The ECB in conjunction with the SRB and NRAs is a key participant in the Euro Area's early intervention and resolution framework. Additional work, however, is required in the recovery and resolution planning area. Internal ECB processes should be reviewed in light of recent resolution experience. While a formal resolution framework is in place, the timeliness and level of coordination and collaboration between the ECB and SRB could be improved. Based upon the assessors' review of the supervisory histories, the ECB's crisis management function could make better use of recovery plan assessments and developing operational guidance for crisis management activities and to enhance management reporting systems (See also Special Report No. 02/2018: The Operational Efficiency of the ECB's Crisis Management for Banks, 16/01/2018). The assessors recommend that the ECB and SRB forge closer working relationships in recovery and resolution planning at the earliest possible time. Ongoing negotiations to revise the existing MoU should conclude as soon as possible. Automatic information sharing with the SRB has been established at the assignment of certain SREP ratings. Informal discussions about information gaps, liquidity and preliminary resolution strategies should occur early in the process, well before formal "early intervention" and "failure or likely to fail" processes are required, to facilitate seamless recovery and resolution planning.
Principle 9	**Supervisory techniques and tools.** The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential criteria	
EC1	The supervisor employs an appropriate mix of onsite[58] and offsite[59] supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between onsite and offsite supervision may be determined by the particular conditions and

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

[59] Offsite work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks, and help identify the priorities, scope of further offsite and onsite work, etc.

	circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its onsite and offsite functions, and amends its approach, as needed.
Description and findings re EC1	The relevant EU legislation pertaining to the mix of onsite and offsite supervision is contained within Articles 97, 98 and 99 of CRD IV (See CP 8 EC1–2). In addition, the EBA guidelines on common procedures and methodologies for supervisory review and evaluation (SREP guidelines) provide detailed instructions on the risk assessment process. The EBA is undertaking a consultation on and review of these guidelines. Article 99 of CRD IV sets out the minimum expectations for NCAs to, at least annually, adopt a supervisory assessment program. According to Article 99, the program must include a plan for the activities and resources (paragraph 1(a)), identification of institutions for enhanced supervision (paragraph 1(b)) and a plan for onsite examinations (paragraph 1 (c)). Furthermore, the requirements of CRD IV provide for supervisors to adjust the intensity of supervision depending upon the risks identified, including a permanent onsite presence of the NCA (paragraph 3(b)), more frequent reporting (paragraph 3c)), and thematic inspections (paragraph 3(e)). The ECB is empowered: (i) to carry out offsite supervision in accordance with Article 4 of the SSMR; (ii) to adopt supervisory measures in accordance with Article 16 of the SSMR; (iii) to carry out onsite inspections in accordance with Article 12 of SSMR and Articles 143 to 146 of the SSMFR. The ECB communicates its broad supervisory priorities to the banking industry and the general public. In 2017 it identified three priority risk areas: business models and profitability drivers; credit risk, with a focus on NPLs and concentrations; and risk management. These messages were delivered in a variety of media and fora. Examples include the ECB's SSM website; meetings with trade groups (e.g., European Banking Association meeting on January 23, 2017); and conference calls with banks, analysts, and journalists (e.g., December 15, 2017 SREP and Supervisory priorities conference call). The assessors believe that transparency on supervisory expectations, concerns, techniques, and strategies, to the extent permitted by confidentiality requirements, assists sound supervision. ECB banking supervision's supervisory process starts with the planning of the regular supervisory activities, which is laid down in the SEP. The SEP covers the tasks and activities related to offsite ongoing supervision and onsite missions, in line with available resources. The appropriate mix between onsite and offsite supervision for a given institution and Euro Area-wide results from the SEP, which is defined in accordance with the process below. Offsite ongoing supervision entails a number of activities that are conducted regularly or on an ad hoc basis and that are aimed at checking compliance with prudential regulation,

	assessing the risk profile through the SREP and adopting capital, liquidity, or qualitative measures as appropriate. For SIs, these tasks fall under the responsibility of the JSTs. In addition, horizontal thematic reviews, in-depth reviews and ad hoc reviews are conducted on certain topics by offsite analyses and dedicated onsite missions. Examples are the 2015–2016 Governance and Risk Appetite and the 2017–2019 Internal Model (TRIM) thematic reviews and investigations. The onsite inspections are typically carried out by an inspection team, which—while organizationally independent—works in close cooperation with the JST (see EC 4). The various supervisory activities typically result in supervisory measures (e.g., recommendations, requirements, decisions) in the form of an operational act directed to the SI. Final decisions are taken at the level of the Supervisory Board and the Governing Council. Supervisory activities and decisions are typically followed by a number of routine steps including communication to the institution, the hearing of the institution, the monitoring of compliance and, if necessary, enforcement and sanctioning (See CP 11). CRD IV provides that supervision must be both risk-based and proportionate to the institutions concerned. The overall supervisory resources (i.e., resources available for ongoing supervision, onsite inspections, and horizontal work) therefore need to be allocated to the supervision of the different institutions in a way that considers these two objectives (See CP1 EC8). This leads to a different supervisory engagement—defined here as the type, intensity, and frequency of supervisory work (e.g., offsite analysis, meetings, ad hoc data requests, and onsite inspections)—for different types of institutions. SIs are grouped into five different categories to each of which a different level of supervisory engagement applies. The grouping of an institution reflects both the potential impact of its demise on financial stability (first step of the categorization) and its intrinsic riskiness (second step of the categorization). The categorization is updated annually or whenever there are new developments changing the assessment of the impact, supervisory complexity, or riskiness (e.g., the purchase of another bank). In a first step, "impact" is assessed in the same way as in the Financial Stability Board context for Systemically Important Financial Institutions, taking into account five dimensions: size, complexity and geographical diversification, substitutability, interconnectedness, and implicit groups. Size and complexity (including geographical diversification and some business model-related aspects) are relatively easy to measure and are used as the leading indicators. As these two dimensions do not necessarily provide a comprehensive view of each bank's impact on the Euro Area financial system, additional, more specific, but harder to measure, information is incorporated into the analysis. The impact categorization also may be adjusted to reflect other aspects such as the complexity of supervising an institution (e.g., a financial conglomerate or a bank using many sophisticated internal models) or thematic reviews conducted by the ECB. The Step 1

	categorization is to be performed jointly by the DGs responsible for the microprudential supervision of the individual institution and by DG MS IV. As a result, institutions are grouped into five different clusters. In a second step, the outcome of Step 1 (Cluster) is combined with the "riskiness" of the institution, the latter based on the last available RAS overall rating assigned by the JST, to provide the supervisory overall engagement level. An assessment matrix is provided by the Planning Division within DG MS IV. A different level of supervisory engagement applies to each of these categories in terms of (i) supervisory expectations and (ii) resources allocated (especially with regard to JST resources), with both dimensions being interrelated. In practice, the de facto supervisory engagement may differ from the ex-ante required supervisory engagement in the event of unforeseen developments. The matrix determines for each combination of cluster and riskiness the overall supervisory engagement level to be applied. The bigger, more complex and riskier institutions are allocated a higher engagement level. The engagement level defines the minimum set of supervisory activities to be performed in the SI and therefore is directly linked to (i) supervisory work/expectations and (ii) resources allocated (especially with regard to JST resources), with both dimensions being interrelated. In practice, the de facto supervisory engagement may differ from the ex-ante required supervisory engagement in the event of unforeseen developments. In practice, the de facto supervisory engagement may differ from the ex-ante required supervisory engagement in the event of unforeseen developments. In such cases, ad-hoc tasks to address the most urgent issues should be prioritized when necessary, overruling the initial plan. Adjustments to the adopted program of onsite inspections and internal model examinations for reasons of optimization of resources and adaption to new priorities are approved by the Supervisory board and approved by the Governing Council under non-objection procedures. The Supervisory Board also receives periodic status reports on the SEP for SIs. The same approach is used for each RAS risk category, in order to fine-tune the level of engagement to be applied on a risk-by-risk basis. In this way, each institution will have an overall supervisory engagement level, according to which overall supervisory expectations and resource allocation are to be made, as well as a supervisory engagement level per risk category, according to which the minimum intensity and frequency of supervisory work and types of supervisory actions are defined per risk category. For significant subsidiaries two engagement levels have been defined according to the SREP approach.
EC2	The supervisor has a coherent process for planning and executing onsite and offsite 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 onsite and offsite functions.
Description and findings re EC2	The process for planning and executing onsite and offsite activities is defined in the confidential SSM Supervisory Manual. The JST sets up an individual SEP for the SI it supervises. The SEP defines the supervisory activities for offsite on-going supervision, onsite inspections, and internal model investigations to be carried at the SI over a predetermined time horizon (typically one year for offsite on-going activities and for the onsite inspections and internal model investigations). The SEPs must be aligned with the determined Supervisory Priorities and follow the principles of a risk-based approach and proportionality. This is accomplished through the establishment of MELs (see EC 1) by the Planning and Coordination of SEP Division in close cooperation with other Divisions in DGMS IV and DGMS I and II. For on-going SEP activities, Planning and Coordination of SEP Division formulates a first draft proposal of on-going SEPs activities that includes the minimum engagement level activities (MEL activities) for each SI. Then JSTs assess this proposal on a comply or explain basis and include in the draft SEPs on-going "additional SEP" activities to address the needs and specificities of the institution. For onsite SEP activities (onsite inspections and internal model investigations), the JSTs formulate a first draft proposal, taking into account the available resources. Following unforeseen developments, amendments to the individual SEP throughout the year are possible. The SEP may be subject to ex post reviews by the DG MS IV SQA Division, although primarily it is the responsibility of management and staff of operating units to ensure permanent compliance with the SSM Manual. Based on the available input and macro evidence, draft SEPs are formulated in detail by the JSTs for each SI. In practice, the macro-calendar of supervisory activities regarding on-going supervision, onsite inspections, and internal model investigations is defined in a horizontal way. The JST also considers information provided by non-SSM competent authorities for other entities within the group, in cases where the consolidated supervision of the group in question is the responsibility of an EEA home supervisor. All these activities, except in exceptional cases, are undertaken to comply with the minimum engagement level defined in the strategic planning process by the Planning and Coordination Division. The activities must be prioritized to allow for a replacement buffer for possible ad hoc needs. The SEP is discussed in the core JST. The individual SEP proposal should be associated with a first evaluation of the allocation of tasks and needed resources, including an estimation of the number of resources to be requested for onsite inspection teams and the specialized expertise functions (e.g.,

	specialists on risk analysis or internal models). These additional resources may be supplied by the ECB or from the NCAs' horizontal functions. In its 2016 review of the SSM, the ECA noted indications that staffing levels in ECB banking supervision at that time were insufficient and recommended that the ECB substantially increase the presence of its own staff in onsite inspections. The ECB accepted this recommendation (See CP 2). JSTs need to clear their draft SEPs with their ECB intermediate structures and senior management (i.e., Heads of Division and Directors General) before submitting them to the Planning and Coordination of SEP Division. This process step may include feedback on and revision of individual SEPs. In addition, there is a dialogue between the ECB and NCA senior management that provides input to the establishment of the SEP, especially regarding diverging views not yet resolved by the core JST. The individual SEPs are submitted to the Planning and Coordination of SEP Division, which will perform a final check for compliance with the MELs and consistency across similar SIs. This may result in some adjustments to the original individual SEPs to be discussed and agreed with the respective JSTs. The Planning and Coordination of SEP Division will then translate the proposals of the individual SEPs into a single consolidated SEP. At this point, the Centralized Onsite Inspections (COI) and Internal Models Divisions will also perform content quality checks on the requests for onsite inspections and internal model investigations. This may result in some adjustments to the individual SEPs to be discussed and agreed with the respective JSTs. The draft consolidated SEP will be consolidated accordingly. The ECB horizontal divisions liaise with their counterparties in the NCAs to plan the onsite inspections and internal model investigations to be performed, taking into account the "prioritized demand" for missions required by the JSTs and the availability of resources to carry them out in the ECB, NCAs, and if necessary, by external providers. One should note that in principle, onsite inspections are planned with a time-horizon of one year. However, specific inspections may be requested by the JST on an ad hoc basis. The onsite inspection (OSI) planning strategy is designed around the Targeted Engagement Level (TEL) for onsite inspections. The TEL is a flexible framework tool taking into account both Supervisory Priorities, SREP reviews (RAS scoring and cluster of the individual SI) and the historical perspective; the TEL provides indicative expectations about the number of OSIs and their related risk focus and as such serves as a base-line tool for JSTs when requesting OSIs; it is also used as an indicative benchmark for prioritizing requests from DG-MS I and DG-MS II Senior Management. This process may require some amendments to the individual SEPs to be discussed and agreed with the respective JSTs. The draft consolidated SEP will be consolidated accordingly. The onsite inspections and internal model investigations resulting from this step (selected missions to be approved by the Supervisory Board and carried out during the next year) must be confirmed by the Heads of Division, Senior Management of DG MSF I, DG MS II, and DG MS IV and the NCAs.

	The planning process is concluded with a meeting (or alternative form of contact) of the Head of the Planning and Coordination Division, other HDs/Senior Management involved, and the ECB intermediate structures in charge of DGs MS I, II, and IV. The purpose of this meeting (or alternative form of contact) is to settle any remaining issues relating to conflicting plans or resource constraints regarding the draft integrated SEP. This may be achieved by reprioritizing, rescheduling, or cancelling certain activities or by requesting the allocation of additional resources from NCAs. The Planning and Coordination of SEP Division will finalize the consolidated SEP with the support of the COI and Internal Model Divisions. The consolidated SEP, with separate details for each SI, is submitted for information to the Supervisory Board. The list of onsite inspections and internal model investigations included in the consolidated SEP, with separate details for each SI, is submitted for approval to the Supervisory Board and the Governing Council will be invited to adopt it under the non-objection procedure. Its approval (including potential changes) is notified to the JST coordinators and NCAs. In order to ensure a pragmatic implementation of the onsite program, the optimal use of available resources and a fast adaptation to new priorities, proposals for adjustments of the approved list may be submitted on a monthly basis to the Supervisory Board. Such adjustments may include changes to previously approved missions as well as new missions to be carried out. The SEPs are implemented by the JSTs, the onsite inspections and the internal model investigation teams, with the support of the Planning and Coordination of SEP Division and other horizontal divisions involved, according to the defined schedules. A monitoring process is established, encompassing checks on the SEPs' adoption and implementation. The Planning and Coordination of SEP Division, in close cooperation with the COI and Internal Models Divisions, monitors the execution of the program semi-annually. On this basis, the JST coordinators, the COI and Internal Models Divisions cooperate with the Planning and Coordination of SEP Division also on the implementation of the SEPs, providing information on any possible issues that could prevent the fulfillment of the planned tasks (e.g., limited capacity, a change in priorities, sudden events to be taken into account, etc.), so that back-up measures can be devised. The Planning and Coordination of SEP Division may act to ensure that SEPs are implemented, coordinating with the JSTs, the COI and Internal Models Divisions and the NCAs any necessary adjustments to the SEPs.
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available

	information. The supervisor determines that information provided by banks is reliable[60] and obtains, as necessary, additional information on the banks and their related entities.
Description and findings re EC3	In accordance with Article 10 of the SSMR, the ECB has the power to require institutions and parent undertakings to provide all information that is necessary to carry out its supervisory tasks. Additional legal support is found in Articles in 73, 97, 98, and 99 of CRD IV. The 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 foster consistency and comparability. Key sources of quantitative information include: (i) risk indicators based on FINREP and COREP data (available on a consolidated level since mid-2014); (ii) risk indicators from sources other than FINREP/COREP (e.g., from the ECB's STE data collection); (iii) indicators on economic and market conditions (GDP, sector NPL, market volatility etc.); (iv) other regulatory data, not harmonized (central credit register, etc.); (v) a bank's internal estimates (ICAAP, ILAAP, stress tests, internal reports); (vi) financial statements, Pillar 3 disclosures; (vii) peer group indicators; (viii) supervisory stress test results; and (ix) market views (external ratings, investors' quantitative analyses, etc.) Quantitative reporting to ECB banking supervision management and senior management is managed in cooperation with ECB's DG-Statistics, which is responsible for performing data consistency and quality checks. Qualitative information is also necessary for identifying weaknesses and includes: (i) supervisory findings (onsite inspection reports, meeting reports, etc.) (ii) institutions' internal documents (ICAAPs/ILAAPs, financial statements, board memos, organizational charts, internal audit reports, whistle-blower reports, etc.) (iii) business and risk management reports (dashboards, limit reports, etc.) (iv) reports on the environment in which they operate (risk trends, new areas of focus, analysts' reports, rating agencies' reports, equity analyst recommendations, news, etc.). Please refer to CP 10 for a discussion of the ECB's Supervisory Reporting Manual and possible data gaps.
EC4	The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as: (a) analysis of financial statements and accounts; (b) business model analysis;

[60] Please refer to Principle 10.

	(c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC4	Under CRD IV, the ECB as the competent authority is required to carry out a SREP and to take decisions for SIs (See CP 8 for a complete discussion). Within a group, this applies at the consolidated, sub-consolidated and single-entity levels unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In a case of a financial conglomerate, the SREP decisions also need to take into account the outcome of the supplementary supervision as required by FICOD. The SREP is the main tool to regularly review and assess the safety and soundness of banks and the banking system. It is a harmonized methodology developed on the basis of the EBA guidelines on SREP. It is applied in a proportionate manner to institutions depending on the nature, scale, and complexity of their activities, and, when relevant, on their situation within a group. The SREP methodology relies extensively on quantitative and qualitative analysis. It combines data and expert judgment following a principle of "constrained judgment," with a view to ensuring that the SREP decision fits best with an institution's risk profile (and is not a "mechanical" process) while also ensuring consistency and accountability across the SSM. Please refer to CP 8 for a full description of the SREP methodology. The assessments performed for the four elements result in an overall SREP assessment, which underpins a wide range of possible supervisory actions, including the decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. There is a direct link between the supervisory assessment, the necessary supervisory measures, and the SEP. This overall architecture facilitates comparisons across banks. For each element, the assessment can also be tailored to the specific situation of each institution. The various assessments are performed at different frequencies, defined as a result of the SREP in the SEP's "MELs," which can be fine-tuned by the SEP for each individual institution. The JST is expected to update its assessments and remediation actions whenever it is warranted by new information:

	The analysis of financial statements and accounts, apart from their use to perform the SREP, is carried out by JSTs on an on-going basis. The annual financial statements are certified by external auditors. Annual accounts are complemented by interim financial information on a risk-oriented basis. With FINREP, a harmonized financial reporting exists on a quarterly basis. In addition, for those banks or groups using nGAAP instead of IFRS, a reporting framework has been introduced on a solo basis since March 2014 and on consolidated basis since September 2014. For more detailed information see CP 27. The assessment of an institution's business model is split into three parts: (i) its business model viability (or the institution's ability to generate an acceptable return over the next 12 months); (ii) its business model sustainability (i.e., its ability to generate an acceptable return over the next three years); and (iii) its business model sustainability over a full business/economic cycle (i.e., its ability to generate an acceptable return over periods longer than three years). Business model analysis may also give rise to targeted horizontal analysis on an ad hoc basis. A horizontal peer review is an essential part of ECB banking supervision's supervisory approach and is an integral part of the SREP. The overall SREP score is based on the integration of the four SREP elements following a common approach for all banks with the need for JSTs—where appropriate—to adjust the overall score based on: (i) their knowledge of the bank; (ii) peer comparisons; (iii) the macro environment under which the institution operates; (iv) its capital/liquidity planning to ensure a sound trajectory towards the full implementation of CRD IV/CRR; and (v) the SSM risk tolerance. Peer comparison is also part of the assessment of business model viability indicators. The objective is to assess the viability of the current business model by means of a quantitative analysis of several risk indicators at the consolidated level and the comparison to peers. These aspects taken together should give the analyst a full picture of the real and concrete strategy pursued from the bank and the key metrics regarding profitability at the consolidated level. The assessors note that the ECB has successfully benchmarked in a number of areas. A pan European view was unavailable prior to the creation of the SSM. The consolidated annual accounts of at least the past three years, and the most recent monthly/quarterly management reports for the current year budget (including year-to-date realization) should be used. All available information from FINREP and COREP, data and indicators available in IMAS, as well as data from SNL Financial, an external data provider, forms the starting point of the analysis. These data should be used to understand how the main risk indicators have developed over time and how their current levels and volatility compare to the peer group. When assessing peer comparisons, the JSTs should understand the reasons behind the level of difference from peers bearing in mind that the differences may be reasonable and acceptable when fully understood but also surprising and unacceptable depending on the context.

	When assessing business model sustainability, peer review plays a role in the forward-looking business environment. The business environment is the context in which an institution operates and seeks to generate profits and influences both the bank and its peers. The scope of the business environment analysis is determined by the hypotheses and should include a number of key areas. One is the macroeconomic environment, as measured by key macroeconomic variables that may have an impact on the area of the bank under assessment. Another is the competitive landscape—consider the activities of the main players and competitors of the institution or business area being analyzed (the peer group), and assess how the competitive landscape is likely to evolve. ECB banking supervision also relies on peer review in the context of thematic reviews. Dedicated horizontal analysis may be launched on specific topics—e.g., governance. JSTs analyze on the basis of a common methodology common issues for all—or a subset of—SSM SIs. The outcome of these thematic reviews may give rise to specific recommendations or measures addressed to institutions either through dedicated decisions or in the context of the annual SREP decision. The stress tests undertaken by banks are used by the JSTs to assess the institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic and financial developments. This is done using a wide range of information sources, including the institution's internal stressed projections, the SSM's stressed supervisory proxies, and the outcome of supervisory (bottom-up and/or top-down) stress tests when available. To provide a forward-looking assessment of an institution's capital positions, the supervisor relies on an institution's internal stress test, on the supervisor's micro stress and sensitivity analysis, and on system-wide supervisory stress tests when available. To review these stress tests, ECB banking supervision follows the principles and recommendations established by international supervisory bodies. Supervisors should expect institutions to analyze at least a baseline scenario and a stressed scenario, and make projections of its main balance sheet, profit and loss, and off-balance sheet items in view of the institution's strategic plan, including the capitalized profit, dividends, share issues, subordinated capital issues, and capital charges in line with the expected business growth, changes in the Pillar 1 risk profile, other risks assessed in the ICAAP, regulatory changes, one-off transactions, etc. Stress tests should be conducted as part of the ICAAP to identify those events or changes in the market conditions in which institutions operate that may adversely affect their future solvency. At least one comprehensive adverse scenario, reflecting severe but plausible adverse developments of the institution's operating conditions, should be used for capital planning. JSTs should assess in this regard the underlying assumptions (Sufficiently severe? Plausible?) and the adequacy of the translation of these assumptions into stressed capital and risk projections over at least the upcoming three years. Furthermore, any embedded

	management actions should be scrutinized. Discussions of corporate governance, risk management, and internal control requirements are found in CP 14, 15, and 26. The analyses and assessments by JSTs are performed and documented in IMAS on an ongoing basis. At least once a year, a SREP decision including appropriate supervisory measures is taken and communicated to the bank. JSTs may also communicate findings, decisions or recommendations to the institutions under their responsibility whenever necessary after having complied with the SSM's decision-making procedures. Onsite supervision is conducted through inspections, which are in-depth investigations of risks, risk controls, and governance that follow specific procedures described within the SSM Supervisory Manual. The scope and frequency of onsite inspections takes into account the supervisory strategy, the characteristics of the credit institution (size, nature of activities, and risk culture) and the specific areas of the credit institution perceived as more vulnerable. Onsite inspections are conducted in an independent manner, in close liaison with the JSTs, based on a coordinated approach steered by ECB banking supervision. Both on-going supervision and onsite inspections are essential for effective supervision. They are complementary and cannot substitute for the other. Supervisors must have a permanent in-depth knowledge of the institution. This knowledge is obtained through on-going supervision, which mainly relies on the information reported by the institution (regulatory, external, and internal reporting), complemented by onsite inspections to check inter alia the accurateness of the information used by on-going supervision. Accordingly, in the SSM organizational model, the onsite inspections function is embedded and anchored in the overall SSM framework without jeopardizing its independence or allowing that independence to imply isolation. This principle of independent inspections is made operational through a separation in the performance of the two types of supervision: (i) the JST performs on-going supervision; and (ii) independent inspection teams conduct the onsite inspections. The close liaison between the JSTs and the onsite inspections is achieved by permitting JST members to participate in inspections. However, JSTs are not allowed to act as head of onsite inspection teams. Onsite inspections can be conducted on a number of different levels. An inspection can be done at a group level, in which case the scope includes the parent entity as well as some or all of the subsidiaries and branches of that group or; it can be conducted at an individual level of the group member in which case the inspection is of a subsidiary of a group. An individual subsidiary inspected may be located within the SSM, or in an EU non-SSM Member State, or in a third-party country.

The rationale for performing onsite inspections is to gain a more in-depth knowledge of the respective institution by interacting with the key individuals responsible for the management of business or risk areas subject to inspection and having access to and the ability to test the underlying documentation found in regulatory reports and the institution's information management and reporting systems.

By doing so, the inspection team is given the opportunity to assess, inter alia, processes, systems and quality of management across the institution, enabling the team to challenge the senior management and management body in an informed way, based on this more in-depth assessment of the institution, gained by verification in situ.

Onsite inspections are carried out based on a predefined scope, timeline and resources, and use investigating and inspecting techniques to test controls and substantive procedures, following certain standards. The outcome of onsite inspections is a report that includes an executive summary, the list of facts and findings, and the body of the report. Appendices should be added.

In particular, onsite inspections aim at: examining and assessing the level, nature and features of the inherent risks, also taking into account the risk culture; examining and assessing the appropriateness and quality of the institution's corporate governance and internal control framework in view of the nature of its business and risks; assessing the control systems and risk management processes, focusing, in particular, on detecting weaknesses or vulnerabilities that can have an impact on the own funds of the institution; examining the quality of balance sheet items and the financial situation of the institution; and assessing compliance with banking regulation.

In line with the supervisory principles for the functioning of the SSM, inspections are risk-based, proportional, intrusive, and forward-looking.

Onsite inspections are limited in time and performed to reach a pre-defined objective following a focused, comprehensive and coordinated approach. They can be classified in several ways, depending on the aspects taken into account. More than one type of inspection may apply: full scope vs. targeted inspection; thematic inspections; program versus ad hoc inspections; follow-up inspections.

Onsite inspections are an important part of the ECB's integrated supervisory approach. They also keep the JST informed on the key dimensions of the institution. Hence, the scope of the inspections must be aligned as much as possible with the methodology used by the on-going supervision (RAS and SREP concepts) and with the assessment and division of work decided by the respective JST. This alignment is ensured by the respective Directorates General of the ECB.

Following the list of issues mentioned in the RAS, the main topics inspections can cover are: business model and profitability; internal governance and risk management; credit risk and

	counterparty credit risk; market risk; operational risk; IRRBB; capital adequacy; liquidity and funding risk. These aspects are not mutually exclusive; on the contrary, an inspection may explicitly cover several of them and good onsite work is characterized by being attentive to all of them, particularly to how the transactions or areas under review affect the overall situation of the inspected legal entity regarding liquidity, capital or profit, and compliance with regulations. The overall inspection life cycle involves the following phases: planning, pre-inspection, investigation, reporting, consistency review, follow-up. The onsite inspection teams are, in principle, led by NCA staff. These staff members can either be staff members from the NCA of the country in which the inspection takes place or staff members from any other NCA within the SSM. This does not preclude the possibility of the ECB taking the lead of any inspection. In order to ensure that onsite inspections are conducted in an independent manner, the Head of Mission (HoM) cannot be held by a JST member or by an external expert. The choice of a HoM is based on a combination of technical and non-technical competences, including: the type of expertise needed for a specific mission, managerial capabilities (especially for international teams), soft skills necessary to constructively interact with a large number of stakeholders (e.g., the institution, JST Coordinators, ECB COI Division team responsible for on-going monitoring, teams performing the consistency reviews of reports, etc.). Due attention must be paid to the general principle of rotation of the HoMs. The composition of the team, in terms of size, skills, expertise, and seniority, is commensurate with the inspection entrusted to it. The inspection team is composed by at least two persons, including the HoM. The ECB's IPCS Division appoints the team members after consultation with all the concerned parties. To this aim the ECB's IPCS Division is informed of the resources available for inspections. The composition of the team must be in line with the SEP, while taking into account the evolution of the portfolio or area to inspect since the SEP was adopted. In addition, COI Division may appoint its own staff as members to join the onsite inspection team. Upon request of the JST Coordinator, JST members may join an inspection team. To safeguard the efficiency and the independence of judgment of the onsite inspection, the JST members assigned to the team should be placed under the functional authority of the HoM for the duration of their involvement in the mission. The onsite inspection teams may be composed of professionals coming from NCAs, ECB staff members, as well as external experts.
EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the

	potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	The SREP framework sets out the risk factors to be assessed as part of the supervisory review, the topics to be included, and the supervisory measures to be implemented based on the identification of risk. The framework includes risks to the bank as well as risks to the system as required for in Article 97 (see paragraph 1(b) and Article 99 paragraph 2(b)) of CRD IV. In terms of the identification and assessment of emerging risks throughout the EU area, one of the responsibilities of the EBA is to ensure the orderly functioning and integrity of financial markets and the stability of the financial system in the EU. To this end, the EBA is mandated to monitor and assess market developments as well as to identify trends, potential risks and vulnerabilities stemming from the microprudential level. One of the primary supervisory tools to conduct such an analysis is the EU-wide stress test exercise. The EBA Regulation gives the Authority powers to initiate and coordinate the EU-wide stress tests, in cooperation with the ESRB. The aim of such tests is to assess the resilience of financial institutions to adverse market developments, as well as to contribute to the overall assessment of systemic risk in the EU financial system. Building upon this work, the ECB's specific horizontal risk analysis function is in charge of supporting other ECB banking supervision operating units (such as other DGs, horizontal divisions, and JSTs) by providing up-to-date information on current risks and vulnerabilities affecting the SSM; conducting regular in-depth risk analysis and broader microprudential analysis and research on the banking sector; and identifying on a timely basis trends, developments and emerging risks affecting multiple banks for further supervisory review and action. Furthermore, the SSM methodologies for SREP contain specifics for the use of stress testing as an input into the supervisory assessment process for individual credit institutions. In particular, in Element 3—Assessment of risks to capital—the JST assesses, among other things, the institution's capacity to cover its capital needs from a forward-looking perspective, assuming stressed economic and financial developments. This is done using a wide range of information sources, including the institution's internal stressed projections, ECB stressed supervisory proxies, and the outcome of supervisory (bottom-up and/or top-down) stress tests when available. In Element 4—Assessment of risks to liquidity and funding—the JST assesses, among other things, the institution's capacity to cover its liquidity needs from a forward-looking perspective, assuming stressed economic and financial developments (See CP 24). This is done using a wide range of information sources, including the institution's internal stressed projections, ECB stressed supervisory proxies, and the outcome of supervisory (bottom-up

	and/or top-down) stress tests when available—e.g., a stress scenario based on a deposit run and no access to wholesale markets for a prolonged period. The assessments of these features contribute to the overall SREP assessment, which underpins a wide range of possible supervisory actions, including decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. Since 2016, following the EBA clarification on the use of the 2016 EU-wide stress test results in the SREP process (link), the ECB has introduced a pillar 2 capital guidance that is used to take account the outcome of system-wide supervisory stress tests in the SREP. There is a direct link between the supervisory assessment, the necessary supervisory measures, and the SEP. ECB banking supervision communicates the outcome of the risk assessment via informal supervisory dialogue with the institutions, using a comprehensive set of information. ECB banking supervision also organizes horizontal communications and workshops held every year with CEOs. In addition, the key aspects of the SSM SREP methodology and the outcomes of each SREP cycle are published on the ECB website. Moreover, comprehensive assessments—including assets quality review and stress tests—are performed on new SIs or periodically if deemed appropriate.
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	Articles 97 and 98 of CRD IV provide the legal basis for supervisors to evaluate the work of the independent audit function within the supervisory assessment. The work of the internal audit function is evaluated within Element 2—Internal governance and risk management—of the SREP (see CP 26). Internal audit reports are key sources of qualitative information to perform SREP assessments. In addition, the internal audit function may be subject to onsite inspection to obtain assurance that the function meets generally accepted principles on internal audit with respect to governance, status and organization, scope of activity, and internal audit life cycle. Based on the assessment of the internal audit function carried out during the SREP and onsite inspection, JSTs determine whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk (See CP 26).
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's Board, non-executive Board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems, and internal controls.

	Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	Article 98 of CRD IV establishes the legal underpinnings for supervisors to review and evaluate governance arrangements of institutions, their corporate culture and values, and the ability of members of the management body to perform their duties (see paragraph 7). In conducting that review, the supervisor examines at a minimum agenda, supporting documentation for meetings of the management body and its committees, and the results of internal and external performance evaluations. The assessors were provided samples of such internal governance reviews presentation, agendas, and other materials. The ECB maintains ongoing and effective communication and engagement with SI's Board, non-executive Board members and senior and middle management. JSTs oversee all external written and oral communication with the SI. 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 and gather information on the bank's strategies and activities, as well as to complement and crosscheck the data used in the supervisory process. Meeting with the bank to discuss strategic planning is a critical component of the offsite process. A top-level meeting is held with heads of the supervisory board and/or management board and/or risk managers to discuss the bank's condition, its strategic and operational perspectives, governance issues, and the business policies (also with reference to specific sectors), with particular regard to risk management, capital and organizational safeguards related to risks, and internal controls. JSTs may challenge the adequacy of the bank's strategies and business model and request further information from the board and senior management. Where appropriate, JSTs may also participate in board meetings. The ECB expects independent supervisory board members to be active and informed so as to provide a credible challenge to management (See CP 14). Governance and Risk Management is one of the four pillars of the SREP assessment process. The SREP along with the recommendations of the ECB's thematic review on governance and risk appetite has made supervisory board involvement more robust (See CP 8 and CP 14). Meetings also are held with mid-level management and are technical and operational in nature focusing on areas such as risk management methodologies, self-assessment of capital adequacy, and control systems.
EC8	The supervisor communicates to the bank the findings of its on- and offsite 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, as necessary.
Description and findings re EC8	*Onsite:*

	The reporting phase commences when the HoM is of the view that the conclusions of the onsite inspection are firm and can be presented to the JST and to any other level of the SSM framework. Based on individual notes, the inspection team prepares a draft report containing facts and findings. The HoM leads the preparation of the draft report and gives guidance with the aim of ensuring that the findings are clear, concise, and to the point. At any time, the inspection team may consult the JST to clarify issues, as well as to keep the team informally informed on the findings of the inspection. Based on the draft report of the inspection, the HoM calls an exit meeting with the institution. This meeting is the last meeting of the onsite inspection where the facts and the findings described in the draft report are presented. The objective of this meeting is to gain assurance on the accuracy of the facts and findings and to check the degree of awareness of the institution. To allow the inspected legal entity to prepare for the meeting the draft report is sent 3–5 days in advance. If the inspected legal entity is the subsidiary of a parent located in the SSM, the draft report may be sent to the parent as well as the subsidiary. The draft report is discussed at the exit meeting and the inspected legal entity is granted a 2-week period to submit written comments on a standardized template (3-column-table) which are then assessed by the HoM. If necessary, the HoM will revise the report. The feedback template including the HoM's answers to the inspected bank's feedback are then attached to the final report as annex. The inspected entities comments should focus on the executive summary, the findings and on possible factual errors. The report must be clear, concise, and to the point and contain an executive summary, findings and an overall assessment of the topics covered by the mission. The length of the document should be commensurate with the scope and magnitude of the inspection. The reports are produced in English, whereby the annexes can be kept in the original languages, unless produced by the inspection team (i.e., if the annexes include documents produced by the bank, they can be kept in the original language), in accordance with the SSM provisions for language-related issues. A finding contains the following elements: Criteria (What should be); Condition (What is); Root Cause(s) (Why did it happen); and Effect (What are the consequences and the potential risks). As an onsite 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 a finding. By contrast, no findings should be reported in respect of deficiencies that had already been corrected before the inspection began. Where appropriate, this could be mentioned in the report. Prior to the exit meeting, the HoM sends the draft report for a consistency review to the ECB's COI Division. The consistency review process focuses on the internal consistency of the report; its consistency with other reports with comparable scope, throughout the SSM;

	and its consistency with the SSM Supervisory Manual, in particular the methodology for onsite inspections, and with relevant European legislation and standards. The aim of this review is not to replicate onsite activities. Although COI Division is ultimately responsible for all consistency reviews of SSM onsite draft reports, the ECB recently instituted a joint consistency review process that also consists of NCA personnel. Only staff members that have not been members of the respective inspection team will be entrusted with consistency reviews, otherwise they will not be regarded as independent. The joint consistency review teams improve efficiency and foster mutual understanding among NCA and ECB staff. If the HoM decides not to accept the COI Division's recommendations, he/she must provide a reasoned rationale. All consistency review workflows are archived. The HoM is expected to support the COI Division's consistency efforts to ensure homogeneity and the implementation of common standards. The HoM signs the report and sends it to the JST Coordinator, COI Division, and the NCAs concerned. This signed version of the report contains the final version of the findings. Based on the report, the JST is responsible for drafting a follow-up letter including recommendations and an action plan, comprising deadlines or supervisory measures as the results of the onsite inspection. The signed final report, together with the draft follow-up letter, is then sent by the ECB COI Division to the institution and a closing meeting with the institution's senior management takes place. This meeting is held by the JST Coordinator (the HoM might participate, as an observer). After the closing meeting, the JST conveys the final recommendations to the institution and to the respective NCA(s). After receiving the follow-up letter, the institution is requested to send an official response with its proposed action plan explaining how it intends to address the recommendations within specific timeframes. A follow-up procedure is needed to guarantee that the institution's action plan is appropriate. The JST is responsible for assessing this official response, if needed in consultation with the HoM. During this phase, several follow-up steps may occur: a request for additional information, the implementation of additional corrective measures, a request for a readjustment of the institution's plan, or the preparation of a complete draft decision for consideration by the Supervisory Board and the Governing Council. When the JST has verified and concludes that the mitigation measures recommended to the institution have been implemented, the follow-up process is closed. The assessors were provided with anonymized onsite inspection reports, Supervisory Board decisions and follow-up materials from a random sampling of SIs. *Offsite*:

	The decision on adequate levels of capital and liquidity as well as any additional supervisory measures, as set out in Article 104 of CRD IV and Article 16 of the SSMR, is communicated to the institution (both the parent company of the group and the single entities concerned) following the formal decision-making process of the ECB. The draft decision is sent to the institution, which has the right to be heard in accordance with Article 31 of the SSMFR. However, before starting the formal decision-making process, the JST coordinator organizes a dialogue on decisions with the management body of the SSM area parent institution and the relevant subsidiaries. The level of hierarchy for the participation of ECB and NCA management is discussed and decided in the core JST. JSTs may organize meetings with the independent members of the Board as deemed necessary.
EC9	The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.
Description and findings re EC9	Supervisory measures (e.g., recommendations, requirements, or other decisions) are monitored though a dedicated IT tool. It is the responsibility of the JSTs to decide on how to monitor (including reporting) implementation of remedial measures by the relevant parties. Moreover, JSTs must include the follow-up of supervisory measures in the supervisory calendar for the relevant institution. The length of time an SI has for taking corrective measures is dependent upon the nature and complexity of the matter. If an institution does not comply with a supervisory measure within the specified timeframe, the JST must consider taking additional action against the institution. JSTs have a wide range of possible responses that can be initiated. They range from informal notifications to the institution concerned, or the use of additional supervisory powers, to enforcement measures or even sanctions, depending on the nature of the original supervisory measure and the extent of the non-compliance. Every monitoring task is performed by the JSTs. The follow-up of decisions may be based on periodical or ad hoc reports only or may take place through a closer interaction with the institution. The closer interaction procedure may involve specific meetings with the institution's management, or follow-up inspections to monitor the implementation activities of the institution. Based on the information provided, the JST assesses whether progress on 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 to the Supervisory Board and/or the Governing Council, if deemed relevant. The NCA is kept informed too.

	Based on these follow-up notes provided by the JST, the Supervisory Board and the Governing Council, as well as the relevant ECB functions and the NCAs, may wish to issue recommendations to the respective JST. If the institution does not start implementing remedial measures, the JST refers the case to the Enforcement and Sanctions Division if it considers that an enforcement measure is needed or that there is reason to suspect that a breach has been committed. If the JST considers that additional supervisory action—other than enforcement measures or sanctions—is needed, it prepares a note to the Supervisory Board and the Governing Council detailing which supervisory action should be taken against the institution. Any non-material adjustment to the supervisory measures to be implemented by the institution can be directly endorsed by the JST. A discussion of the ECB's supervisory remediation powers and its formal enforcement and sanctioning authorities against institutions is found in CP 11.
EC10	The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.
Description and findings re EC10	The ECB expects but does not require banks to notify it in advance of all substantive changes in their activities, structure, and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements. This topic is described in greater detail in CP 4 to CP 7. Breaches of any legally required notifications are subject to mandatory referral to the ECB's independent enforcement and sanctions unit for review and potential action if it is institution related (see Article 18 of the SSMR). Breaches regarding individuals or violations of Directives transposed into national laws are referred to the appropriate NCA for further action (see CP 11). The assessors recommend that the ECB seek a mandatory notification requirement for all substantive changes in an institution's activities, structure, and overall condition, or as soon as they become aware of any material adverse developments.
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	The ECB onsite function operates under a joint ECB and NCA staffing model. Onsite inspections are ordinarily performed by staff from the NCAs and/or the ECB. Nevertheless, the ECB can use external experts when it is deemed advisable or appropriate. External experts are appointed as ECB team members and carry out the tasks assigned under the lead of a HoM supplied by the NCAs or from COI Division. The ECB has used consultancy firms and auditors as members of internal model investigations missions under the TRIM initiative. The use of external experts is permitted under Article 12 (2) of the SSMR. External consultants may participate in onsite inspection and internal model investigation missions in case there is a lack of appropriate resources

	within the inspection team, following the COI Division guidelines. To ensure that the responsibility is not outsourced, external consultants can only participate as team members and cannot act as a HoM. Prior to the appointment of external consultants, the HoM provides a sound rationale, which must be appropriately approved, for the need for external consultants and a description of the expected tasks and outputs to be produced. To ensure the independence of the external provider, the audit firm must provide the ECB with some background information about its relationship with the inspected entity as well as its self-assessment about the potential existence of a conflict of interest. Based on this information, COI Division will review the self-assessment and officially clear the firm prior to accepting any offer and submitting the legally binding order. Depending of the fees, the contract is then signed at different management levels according to the generic provision of delegation of power. During the onsite inspection, external consultants perform the same tasks as ECB banking supervision staff and apply the SSM methodology under the supervision and direction of the HoM. Their presence is transparently communicated to the institution. The ECB's quality assurance program and the HoM's direct oversight of all team members, including any external consultants, permits the use and reliance on such consultants' work product.
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	Directorate General Information Systems provides, maintains, and develops the information and communications systems necessary for ECB banking supervision to carry out its tasks. This includes the provision of information governance and security. The unit is also responsible for providing support services for end-users as well as quality, supplier, and license management. DG Statistics ensures the availability of reliable and accurate supervisory data across the SSM for supervision and statistics purposes. The data is made available to end-users according to the SSM Information Security Policies and IT system entitlements. DG Statistics checks the completeness and data accuracy of each report received as well as the presentation of the information to ensure that different reporting entities use the same format (allowing for data consistency and making historical or sector-wide analysis easier). In addition, it monitors compliance with the submission deadline for each report. These different processes are computerized to ensure a sound and efficient follow-up on the reports, as their number is quite significant. On the issues of erroneous data, missing data, or reports and failures to meet submission deadlines, DG Statistics liaises closely with the reporting entities as well as with the NCAs. It keeps track of all its requests to the reporting entities to be sure to have received a satisfactory reply to each of them. In cases where, after a certain predetermined period (as

	set out in the reporting schedules), no response is received, DG Statistics sends a reminder to the reporting entity concerned. Thereafter, it ensures that the database always contains the last and most correct version of the reports; historical data is kept in the database but should be clearly marked as such. The Directorate General informs end-users whenever new updates of supervisory data are available. In cases where it receives an amendment to a report that has already been released, DG Statistics informs the end-users and provides them with an updated version of the report as soon as possible. To facilitate the processing, monitoring, and analysis of prudential information and assist the identification of areas requiring follow-up action, ECB banking supervision and the NCAs rely on the IMAS system. It provides an integrated supervisory tool facilitating the analysis of prudential data, the prioritization and monitoring of tasks, as well as the performance of SREP. Please refer to CP 10 for additional information and recommendations for enhancing the ECB's supervisory reporting.
Additional criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use, and makes changes as appropriate.
Description and findings re AC1	ECB banking supervision's supervisory activities are performed under the ECB internal control framework, which relies on a three-lines-of-defense model. It is the responsibility of the ECB's operational management to establish appropriate systems of internal controls. Thus, operational management acts as the first line of defense. The risk management, control, compliance, and oversight functions established and deployed by management represent the second line of defense. The Supervisory Quality Assurance (SQA) Division has been set up to provide regular feedback to ECB banking supervision managers on the quality of their supervisory output in terms of consistency and effectiveness. The SQA Division operates by means of desk reviews, interviews with stakeholders and factual checks and analysis. Once a year the SQA Division issues a "lessons learned" report for discussion by the Supervisory Board, which may decide on further actions. The ECB's Directorate Internal Audit (D/IA) provides independent and objective assurance and consulting services designed to add value and to improve the ECB's operations. D/IA acts as a third, independent line of defense within the ECB governance framework. The D/IA helps the ECB in accomplishing its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness and efficiency of risk management, control, and governance processes. All activities, operations and processes of the ECB may be subject to internal auditing.

	Moreover, D/IA coordinates and performs audit work under the umbrella of the Internal Auditors Committee (IAC). The scope of the IAC covers the performance of the euro system/ESCB and SSM tasks and activities as defined in the Statute of the ESCB and the ECB and in the SSMR, including their enabling processes and risks associated with them, and/or activities decided by the Executive Board, Governing Council, or General Council. The supervisory activities of the ECB are reviewed by the European Commission and the ECA, which reviews SSM operations with a specific focus on operational efficiency. The assessors reviewed the Commission's review of the ECB's implementation of CRD IV (Report from The Commission to The European Parliament and The Council, on the SSM established pursuant to Regulation (EU) No 1024/2013, October 11, 2017). The Commission gave an overall positive assessment of the application of the SSMR and the first years of the ECB acting in its supervisory capacity, especially in terms of levelling the playing field and fostering confidence from the integrated supervision of credit institutions. The ECA also assesses the ECB supervisory activities. The assessors reviewed the ECA report on the ECB's SSM operations. (Special Report No. 29/2016: SSM—Good start but further improvement needed, November 18, 2016). The Court of Auditors examined the SSM's governance, accountability, and offsite and onsite inspection programs. The report assessed the SSM's reliance on the NCA for resources (See CP 2 EC6). The ECA also assessed the operational efficiency of the ECB in crisis management. (Special Report No. 02/2018: The Operational Efficiency of the ECB's Crisis Management for Banks, 16/01/2018). The audit found that while the ECB has established a substantial framework for crisis management, it noted some design flaws and inefficient implementation that should be addressed. The audit recommended making better use of recovery plan assessments and developing operational guidance for crisis management activities and to enhance management reporting systems. The ECB formally responded to the findings and recommendations of both reports. The assessors found that the ECB supervisory functions operate under an effective internal control environment that is augmented by oversight from external bodies, which include the European Parliament, the European Commission, and the ECA.
Assessment of Principle 9	Compliant
Comments	The ECB, through the SREP, uses a mix of offsite analysis and onsite inspections that focus on both horizontal risk themes and vertical assessments of institution-specific risks. The techniques and tools to implement the supervisory approach appear to be appropriately designed, as evidenced by the confidential SSM Supervisory Manual and Appendices. The SEPs and onsite inspections also appear to be appropriately calibrated according to institutions' risk profiles and systemic importance. Further refinements to the supervision program should be adopted incrementally as the ECB gains additional

	experience over time. The availability and allocation of staff for the joint JST and onsite inspection teams are assessed in CP 2. The assessors' limited interviews with JSTs, senior staff members and experts in DGI, DGII, and DGIV, the SSM Supervisory Manual, sample SREP decisions, examples of onsite inspections, memoranda, presentations, and other related materials appear to support this assessment. The ECB should consider streamlining its internal reporting lines to ensure the timely communication of supervisory and other information. The assessors recommend that the ECB seek a mandatory notification requirement rather than the current expectation that institutions report all substantive changes in their activities, structure, and overall condition, or as soon as they become aware of any material adverse developments. The assessors recommend that the ECB be more transparent about its supervisory expectations, approaches, and techniques through the publication of guides on supervisory topics. The July 2017 Guide to onsite inspections and internal model investigations is a good primer on the ECB's supervisory activities that is suited for public consumption. Supervision is enhanced, and potential issues are eliminated if the ECB's identifies and communicates to SIs and interested parties its priorities and any emerging concerns it discerns from its ongoing and horizontal supervision of SIs and their activities. This also is an international best practice adopted by other supervisors of large banking institutions. The ECB's practice of publishing guides on important supervisory topics should be continued. A condensed version of the SSM Supervisory Manual was published in March 2018 after the assessors' onsite visit. The published manual removed much of the detail on supervisory techniques or information. Such transparency helps institutions comply with the ECB's expectations and assures the public that the SSM operates under well designed supervisory processes. The ECB is in the process of reviewing additional elements of the Supervisory Manual for later publication.
Principle 10	**Supervisory reporting.** The supervisor collects, reviews and analyses prudential reports and statistical returns[61] from banks on both a solo and a consolidated basis, and independently verifies these reports through either onsite examinations or use of external experts.
Essential criteria	
EC1	The supervisor has the power[62] to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk

[61] 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.

[62] Please refer to Principle 2.

	concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	The core of supervisory reporting requirements in the EU is established in the CRR and detailed in the EC Implementing Regulation (or ITS) N. 680/2014, on supervisory reporting; it constitutes the sole EU-wide legal framework for supervisory reporting and a maximum harmonization instrument. As clarified by the EBA in a Q&A, "This means that, with regard to the scope of application of the Implementing Regulation, competent authorities cannot add nor delete data to be reported, nor can they require the reporting of that data in a different format nor in a different (less or more granular) breakdown, nor in a combination, other than in accordance with the CRR and with Directive 2013/36/EU ('CRD IV'). The opposite would lead to different ways of application of the Implementing Regulation across the Union, thus leading to 'less than maximum harmonization' and would defeat the purposes of the Regulation as a legal instrument (as opposed to a Directive), and would be contrary to the will of the EU legislators as explicitly provided in Article 99 CRR. The Implementing Regulation shall only be modified by adopting amendments by the EBA and endorsement of the Commission." The harmonized reporting includes information on: • Solvency/COREP (capital adequacy) • Financial information/FINREP (on- and off-balance sheet assets and liabilities, profit and loss, asset quality (NPLs, forbearance), loan loss provisioning, related party transactions, geographical, sectoral concentration) • Large exposures (concentration per counterparty sector and region) • Losses from immovable property • Leverage ratio • Liquidity (LCR and NSFR (with detail of significant currencies) and additional monitoring metrics) • Asset encumbrance • Supervisory benchmarking • Funding plans • Remuneration policies Reporting is required both on a consolidated (prudential scope of consolidation) and on a solo basis; it covers on- and off-balance sheet items. The frequency varies between reporting from monthly (liquidity) to quarterly and semi-annual or annual for some individual templates. While FINREP was originally mandatory only for IFRS institutions on a consolidated level, Regulation (EU) 2015/534 of the ECB gradually extends the financial supervisory reporting to institutions under other accounting standards (national GAAP or nGAAP) and on a 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). Competent authorities can also, under certain conditions

	explicitly spelled out in the CRR, waive institutions from reporting on an individual level. Approximately 250 supervised entities belonging to SI groups have been granted a waiver for reporting of own funds on a solo basis; most of these are also exempted from FINREP. Other areas not addressed by the EBA ITS on Supervisory Reporting can be covered via additional data collections: as explained in the abovementioned EBA Q&A, "In other areas of reporting, not covered by the scope of the Implementing Regulation as defined in Article 1 of the Implementing Regulation, competent authorities and/or central banks may be in a position to require further reporting by institutions in these other areas, as the case may be and depending on the legal basis available." Having identified the SREP as one of these areas, the ECB launched in 2015 a data collection named Short-term Exercise (STE), aimed at supporting the SSM activities leading to the SREP with data not available in the ITS reporting framework. The legal basis for the data collection by the ECB is represented by Article 10 of the SSMR (power to require credit institutions and other legal or natural persons to provide all information necessary to carry out its tasks, including information to be provided at recurring intervals and in specified formats for supervisory and related statistical purposes) and Article 141 of the SSMFR ("the ECB may require supervised entities to report additional supervisory information whenever such information is necessary for the ECB to carry out the tasks conferred on it by the SSMR. Subject to the conditions set out in relevant Union law, the ECB may specify in particular the categories of information that should be reported as well as the processes, formats, frequencies, and time limits for provision of the information concerned"). The STE covers all SIs plus some significant subsidiaries; it encompasses, among others, the following information needs: • Profitability (budget and planned data on income and expenses) • Credit Risk (breakdown of exposures and loan loss provisions by classification, type of collateral, loan-to-value and transition matrices) • Concentration risk (100 largest exposures of all counterparties) • Market risk (sensitivities to interest rate, equity, commodity, credit spread, and FX risks) • IRRBB • Sovereign risk (direct and indirect exposures to sovereigns in both the banking and trading book) • Liquidity risk (NSFR, funding plans) • Operational risk 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. Over the medium to long term, the ECB aims to propose to the EBA appropriate amendments to the ITS reporting framework and to reduce accordingly the STE for SREP data collection.

	The ESCB has launched initiatives for BIRD and IReF—focusing mainly on ESCB statistical requirements for the moment—that could lead to the creation of a single, common, ultra-granular data source for users' multiple information needs. This would grant flexibility in the extraction of the relevant information from the same source, improving cross-consistency among different reports and, potentially, their data quality. Through time these initiatives could lead to a reduction in the overall reporting burden on banks.
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	According to Article 24 of the CRR, the valuation of assets and off-balance sheet items shall be affected in accordance with the applicable accounting framework. According to Article 99(2) of the CRR, SIs that prepare their consolidated accounts in conformity with IFRS are required to provide FINREP reporting templates for supervisory purposes. For other supervised entities, the ECB has issued Regulation (EU) 2015/534 to require supervisory financial information for non-IFRS reporters and at solo level. In eight member states, SIs with no securities traded on regulated markets are allowed to report on a consolidated basis according to their national GAAPs (though in two of these states nGAAP is considered fully compatible with IFRS); there are currently 11 SIs (representing 3 percent of total assets and 2 percent of RWAs in the SSM) that use nGAAP for reporting on a consolidated level. According to Article 24(2) of the CRR, the ECB could require those non-IFRS SIs to apply IFRS at a consolidated level; however, this would require such SIs to maintain two different accounting regimes in place. The ECB regulation on reporting of supervisory financial information uses templates designed by the EBA that form part of Commission Implementing Regulation (EU) No 680/2014. In particular, there are dedicated national GAAP reporting templates that harmonize the reporting of entities under these accounting standards while respecting their differences vis-à-vis IFRS. The ECB is collaborating with the NCAs to provide national GAAP banks with further guidance to facilitate their reporting.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	Article 76(2) of CRD IV requires the management body to devote sufficient time to the consideration of risk issues as well as the valuation of assets, the use of external credit ratings, and internal models relating to those risks.

	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 (IAS 39, IFRS 13). In relation to internal modeling approaches, Article 78 of CRD IV requires that, at least annually, competent authorities assess the consistency and comparability of risk-weighted assets produced by institutions' internal modeling approaches (except for operational risk) which competent authorities have granted permission to use for capital purposes. EBA RTS (EBA/RTS/2015/01) provide supervisors with a benchmarking tool to enable competent authorities to compare the outcomes of banks' models. The ITS specify the benchmarking portfolios as well as the templates, definitions, and IT solutions that should be applied in the benchmarking exercise for market and credit risk. The RTS for prudential valuation (EBA/RTS/2014/06/rev1) establishes approaches for prudential valuation adjustments as required by the CRR (see CP 22, EC4). The EU-wide legislation does not cover the capacity for the supervisor to require a bank to make adjustments to its reporting for capital adequacy or regulatory reporting in order to impose a specific provision if valuations are deemed not sufficiently prudent. However, the ECB has the power to influence the provisioning policy of a bank within the limits of accounting standards. The ECB is also entitled 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. In other words, the ECB has the power—for the purposes of own funds calculations (i.e., only for determining the capital ratios for prudential purposes)—to go beyond the accounting treatment when this is considered not prudent.
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	EU harmonized supervisory reporting is subject to the following minimum frequencies: • Solvency/COREP (quarterly with some templates semi-annually) • Financial information/FINREP (quarterly with some templates semi-annually or annually) • Large exposures (quarterly) • Losses from immovable property (semi-annually) • Leverage ratio (quarterly) • Liquidity (monthly) • Asset encumbrance (quarterly) • Supervisory benchmarking (annually) • Funding plans (annually) • Remuneration policies (annually)

	The frequency of collection and analysis of information from banks can be adjusted depending on the risk profile and systemic importance of the bank as per Article 104 paragraph 1(j)) a of CRD IV. Currently there are approximately 50 SIs that are subject to additional reporting requirements (including an increased reporting frequency). Most STE data is collected quarterly.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	ECB banking supervision 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 perimeter of the entities included in the prudential scope of consolidation is defined in the CRR (Chapter 2, "Prudential consolidation") and is applied to all institutions supervised within the SSM. The ITS on supervisory reporting provides harmonized reporting requirements for all these entities (FINREP only for IFRS institutions at the consolidated level). In order to ensure comparability between banks with different year-ends, according to Article 2 of Commission Implementing Regulation (EU) No 680/2014: "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, so that reporting of financial information is done every three, six, or twelve months from their accounting year-end, respectively." There are currently eight entities (part of SI groups) allowed to report their year-end results at dates not coinciding with calendar year-ends.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	Article 4 of CRD IV regarding the designation of powers to the competent authorities provides the legal basis for supervisors to have access to all relevant information from credit institutions as well as entities in the wider group. Paragraph 3 states that Member States shall ensure that appropriate measures are in place to enable the competent authority to obtain the information needed to assess the compliance of institutions, and of financial holding companies and mixed financial holding companies. Paragraph 5 states that Member States shall also ensure that internal control mechanisms and administrative accounting procedures of the institution permit the checking of their compliance with such rules at all times.

	Article 10 of the SSMR allows the ECB to require all information necessary to carry out the tasks of prudential supervision conferred on in by that Regulation, including: • compliance with prudential requirements (Article 4.1d); and • compliance with requirements on robust governance arrangements, including the fit-and-proper requirements for the persons responsible for the management of credit institutions, risk management processes, internal control mechanisms, remuneration policies and practices and effective ICAAP, including IRB models (Article 4.1.e). The assessors saw evidence of the capacity of JSTs to obtain, from banks and entities in the wider group, internal management information and any supplementary information needed for its assessment of the bank or banking group condition.
EC7	The supervisor has the power to access[63] all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management, and staff, when required.
Description and findings re EC7	Article 11 of the SSMR allows the ECB to "examine the books and records of the persons referred to in Article 10(1) and take copies or extracts from such books and records," and "obtain written or oral explanations from any person referred to in Article 10(1) or their representatives or staff." The (legal and natural) persons referred to in Article 10(1) are the following: a) credit institutions established in the participating Member States; b) financial holding companies established in the participating Member States; c) mixed financial holding companies established in the participating Member States; d) mixed-activity holding companies established in the participating Member States; e) persons belonging to the entities referred to in points (a) to (d); f) third parties to whom the entities referred to in points (a) to (d) have outsourced functions or activities.
EC8	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 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 EC8	Article 67 of CRD IV, in paragraphs (e) to (m), establishes the capacity for the competent authority to enforce compliance with the requirement that information submitted for regulatory purposes is accurately and timely. The ECB decision of July 2, 2014 (ECB/2014/29) specifies that the ECB will ensure compliance with the provisions of Union law that impose prudential requirements on credit

[63] Please refer to Principle 1, Essential Criterion 5.

	institutions as regards reporting. Article 3 specifies the remittance dates to the ECB, with different deadlines according to the nature of the reporting entity. SIs directly supervised by the ECB have an earlier remittance date than LSIs. Article 4 requires NCAs to monitor and ensure the quality and reliability of the data made available to the ECB, by applying the validation rules specified in Annex XV of the EBA ITS on supervisory reporting, and to apply the additional data quality checks defined by the ECB in cooperation with the NCAs. Further, the information must be complete: existing gaps must be acknowledged, explained to the ECB and, if applicable, filled in without undue delay. Article 18(1) of the SSMR empowers the ECB to open infringement proceedings against and impose administrative pecuniary penalties on SIs for breaches, inter alia, of the reporting obligations stemming from the CRR. The ECB may also, pursuant to Article 18(5) of the SSMR, request NCAs to open proceedings in order to impose non-pecuniary penalties on SIs and/or sanctions against natural persons belonging to these entities. Moreover, on the basis of Article 9(1) second paragraph of the SSMR and for the exclusive purpose of carrying out the supervisory tasks conferred on it by that regulation, the ECB is empowered to directly impose on SIs the national enforcement measures stemming from the transposition of the relevant Directives; likewise and according to Article 9(1) third paragraph of the SSMR and Article 22(1) of the SSMFR, where national laws provide NCAs with enforcement powers, the ECB may require, by way of instructions, these authorities to make use of their enforcement powers with respect to breaches of reporting obligations. In case the reporting obligations breached are contained in an ECB decision or regulation, the ECB may also impose on SIs and LSIs periodic penalty payments (PPPs) and fines provided for in Article 122 of the SSMFR. As a result of the data quality process carried out by the ECB (Supervisory Statistics Division within the Directorate General Statistics) together with the NCAs, banks can be requested to resubmit their reports when the information received is found to be incomplete or inaccurate. In the EU framework, there is no indication of the appropriate level of the bank's senior management to be held responsible for the accuracy of supervisory returns.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.[64]
Description and findings re EC9	The ITS reporting framework developed by the EBA defines data items and binding validation rules that ensure consistent application of the requirements. In addition, the EBA has developed additional quality checks for use by NCAs when reviewing the reported information.

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

	According to Article 140(4) of the SSMFR, "the ECB shall organize the processes relating to collection and quality review of data reported by supervised entities subject to, and in compliance with, relevant Union law and EBA implementing technical standards." Therefore, the ECB organizes the quality review of the data and the NCAs monitor and ensure the quality and reliability of the data made available to the ECB. The Banking Supervision Data Division (BSDD) is responsible for carrying out these tasks, as established in the SSM Supervisory Manual. 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 which perform the first data quality checks on this data. BSDD collaborates with NCAs (and supervised entities in case of direct reporting to the ECB) through the sequential approach with the objective of putting into place efficient processes for the collection and the data quality assessment of the supervisory reports. The BSDD also ensures that reporters follow reporting deadlines established in the EBA ITS. Additionally, the BSDD assesses whether the data are submitted in a timely manner, and 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-users according to the SSM Information Security Policies and IT-system entitlements. The BSDD produces regular supervisory statistics, KRIs, reports and dashboards for end-users. The BSDD is solely responsible for planning and executing its own tasks and activities. In cases of reporting errors (missing reports, false reports, or missed deadlines) that require further action, and where a reporting agent does not respond to repeated requests, the BSDD liaises with the JSTs and the Enforcement and Sanctioning Division as necessary. This process is currently under review with the objective of letting the BSDD have more direct contact with reporting agents in these matters. The STE reporting is also subject to data quality controls, but subject to a lower number of validation rules and according to a less structured process.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts,[65] including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	In cases where external experts are required to support the ECB in carrying out its prudential supervisory tasks, including the direct supervision of SIs, the rules followed are those that apply generally within the ECB.

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

	The ECB initiates the tender process by means of a contract notice published in the Official Journal of the EU with highly qualified external providers. The aim is to have the appropriate expertise and resources available when required, including at short notice, to assist the ECB's head of supervisory assignments. The selection process is conducted in compliance with ECB Decisions (for example Decision ECB/2007/5 for the 2015 process), laying down the Rules on Procurement. The publication is followed by a selection and an award phase. The ECB evaluates the tenders received based on the formal requirements and award criteria in order to select the economically most advantageous tender, i.e., offering the best price/quality ratio, taking into account the award criteria. In light of the information collected, the framework agreement to be entered into with a selected entity further elaborates on the conditions under which a contractor may be considered to be subject to a conflict of interest and would therefore not be deployed for certain supervisory assignments. In addition, according to Article 24(4) of the Decision, the ECB may exclude tenderers from participation at any time if they or their management, staff, or agents are subject to a conflict of interest. To this end, tenderers are requested to certify that they are not subject to such a conflict of interest and/or provide such evidence specified in the contract notice. If such circumstances arise in the course of the procedure, the tenderer concerned shall inform the ECB without undue delay. When such external contractors are used, they would be contractually required to work in accordance with SSM methodologies and in close collaboration with ECB staff, and the head of the supervisory assignment, in particular. The quality of work of external experts is closely monitored and assessed by the ECB/SSM staff working on the specific task before taking it into account for supervisory conclusions. External contractors would be subject to the same professional secrecy requirements as ECB staff members when they provide services related to the discharge of supervisory duties. Furthermore, as with all of the ECB's other activities, the use of external contractors is guided by the principle of prudent management of resources and by the goal of finding effective and cost-efficient solutions. External contractors are to be used only in limited circumstances. In the past two years they have been used in support of onsite missions and internal model investigations, in support of the preparatory and execution phases of TRIM, and in support of the preparatory and execution phases of EBA and SREP stress test exercises. In the cases of onsite missions or internal models investigations, a central ECB team, together with the SSM HoMs, assesses the suitability of each proposed external expert for the specific task. The SSM HoM reviews the output delivered by the expert team(s) and remains in charge and responsible for the mission team's deliverables. Feedback from the HoMs is collected centrally and regularly for each mission and discussed in regular meetings with the experts' employers.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.

Description and findings re EC11	In cases where external experts are required to support ECB banking supervision in its supervisory duties, the rules followed are those applied by the ECB. When such external contractors are used, they are contractually required to work under the instructions of ECB staff, and the HoM in particular. The integration of external experts into the assessment teams and their frequent interaction with the HoM ensure that any material shortcoming of banks' compliance is promptly brought to the attention of the HoM.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The SSM is represented in the relevant bodies responsible for the establishment of reporting requirements, such as the EBA Reporting Subgroup and the EBA Standing Committee on Accounting, Reporting, and Auditing (as regards EBA ITS data) and the ECB Statistical Committee (as regards statistical data). It also coordinates various SSM networks involving NCAs, where the users' needs on supervisory reporting are discussed: e.g., the network 'User requirements of Supervisory Reporting' discusses on a regular basis additional data gaps that could be discussed with the EBA when considering future enhancements of the EBA ITS reporting. As regards the EBA ITS data, there is no EU-wide framework for competent authorities to periodically review the information collected from banks and to determine whether it still satisfies supervisory needs. No framework has been established so far for competent authorities to perform an assessment of the information that has been collected to meet supervisory needs. However, 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. As regards the information not included in the EBA ITS collected by the ECB, the reporting requirements are periodically discussed in the various networks and groups of the SSM. For example, the STE is reviewed on a yearly basis to take into account changes in activities and risks that would require modifications of the corresponding information collected for Pillar 2 purposes as well as areas entering into the EBA ITS scope.
Assessment of Principle 10	Largely Compliant
Comments	The ITS on supervisory reporting, published by the EBA after approval by the EC, is aimed at monitoring compliance with requirements established by the CRR (mostly Pillar 1 requirements); it represents the sole EU-wide legal framework for supervisory reporting in a number of areas and is a "maximum harmonization" instrument. This means that "with regard to the scope of application of the Implementing Regulation, competent authorities cannot add nor delete data to be reported, nor can they require the reporting of that data in a different format nor in a different (less or more granular) breakdown, nor in a

	combination, other than in accordance with the CRR and with [CRD]," as explained by the EBA. The ECB complements this information, for areas beyond the scope of application of the ITS to address specific and delineated needs. For instance, the STE data collections cover fundamentally some of the data needs for SREP (e.g., assets and liabilities by repricing date, for IRRBB estimation). The legal basis for this form of data collection is Article 10 of SSMR. STE reporting and surveys are necessary to give the ECB some flexibility in addressing its data needs to perform sound supervision. The ECB can also request data in its capacity as central bank, as it does for its ANACREDIT project, a Euro Area-wide collection of granular data on corporate loans. While allowing the ECB some room for flexibly, this provision does not allow the ECB to autonomously and promptly address any substantial data gaps that may emerge in areas already covered by the ITS. Currently, the only way to cover the need for new or more granular standardized data in such areas would be through a revision of the ITS, a much lengthier and more complex process. In addition, the STE data are not subject to the same quality control routines as for ITS reporting, which is likely to lead to lower data quality. The maximum harmonization principle is considered a fundamental safeguard for the development of the single market in the EU, both by creating a level playing field among institutions and by reducing the reporting burden (and, hence, the related costs). As such and taking into account the still existing differences in supervisory approaches across the EU, it is not necessarily fully supporting individual supervisory authorities' interest in nimbly adapting the reporting to dynamically evolving needs. So far, the ECB has, in specific areas, complemented its data collection with tailored additional requests (e.g., the recently introduced supervisory reporting related to NPLs); going forward, the process to amend and integrate the harmonized supervisory reporting should be streamlined and expedited, as to reduce the need for the ECB to keep a host of supplementary data collections in place for long times. In the longer term, the initiatives for BIRD and IReF might contribute to ensuring harmonization of reporting while allowing for more flexibility in its uses: the introduction of a single, common, ultra-granular data source for users' multiple information needs could support streamlining the current reporting requirements and, consequently, reduce the reporting burden on banks while increasing data quality. The ECB should further promote its development and widespread adoption. The EU-wide legislation does not cover the capacity for the supervisor to require a bank to make adjustments to its reporting for capital adequacy or regulatory reporting in order to impose a specific provision if valuations are deemed not sufficiently prudent (EC 3). However, the ECB has the power to influence the provisioning policy of a bank within the limits of accounting standards. The ECB is also entitled 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. In other words, the ECB has the power—for the purposes of own funds calculations (i.e., only for determining the capital ratios for prudential purposes)—to go beyond the accounting treatment when this is considered not prudent. In the EU framework, there is no indication of the appropriate level of the bank's senior management to be held responsible for the accuracy of supervisory returns (EC 8). As regards the EBA ITS data, there is no EU-wide framework for competent authorities to periodically review the information collected from banks and to determine whether it still satisfies supervisory needs. Considering the sizeable currency transformation operated by some internationally active banks, some with considerable presence in non-Euro markets, the ECB should ensure that the ITS include adequately granular and frequent breakdown of those banks' cash flows in material non-Euro currencies and that the JSTs monitor it on a regular basis (see also CP 24). Regular reporting of a maturity ladder with a breakdown also by significant currency started in March 2018.
Principle 11	**Corrective and sanctioning powers of supervisors.** The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
Essential criteria	
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	The ECB is empowered to require banks, financial holding companies or mixed financial holding companies to take necessary measures (See CP 1 EC 3). The main tool used by the ECB are Decisions (legal acts) and operational acts (informal communication. Decisions result from the annual SREP, which is the most used supervisory tool. The ECB supervisory decisions, as defined in Article 2(26) of the SSMFR, must be adopted following the provisions set forth in Article 22 of the SSMR and Articles 25 et seqq. of the SSMFR. ECB supervisory decisions are in writing. According to Article 35 of the SSMFR, the ECB's supervisory decisions can be delivered to SI's governing board. Before making use of supervisory powers, the ECB employs a progressive remedial process. The ECB will employ non-binding routine or ad hoc requests, letters, statements, meetings

	with the management of the credit institution or a letter of intervention (collectively "operational acts") if they will address an issue satisfactorily. If an SI does not comply with the ECB's recommendations, or the seriousness of the problem identified, or deficiency so requires, the process will involve a formal supervisory measure. Such measures require a decision by the Supervisory Board and the Governing Council. The supervisory measure maybe included in the annual SREP decision addressed to the SI or may be in a separate decision. In practice, the SREP decision is the most often used Decisions are followed up by periodical/ad hoc reports only, or more frequent interaction with the SI, including follow-up inspections. The ECB also may seek to impose an enforcement measure to compel the SI to restore compliance, or a sanction, to punish the infringement. Referral to the ECB's Enforcement and Sanctions Division is mandatory if the supervisors have reason to suspect that a breach of a prudential requirement or of an ECB regulation or decision is being or has been committed (See EC4). The decisions on enforcement measures and sanctions are taken by the Supervisory Board and the Governing Council. For LSIs, any material supervisory procedures or draft supervisory decisions should be notified to the ECB.
EC2	The supervisor has available[66] an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory actions, 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.
Description and findings re EC2	The powers of the ECB are laid down in Chapter III of the SSMR (Articles 9 to 18). Apart from the supervisory powers listed in Article 16(2) of the SSMR, the ECB can directly exercise powers conferred on the national authorities by national law transposing Union law directives. It can also require the NCAs, to the extent necessary, and by way of instructions, to make use of their powers, under and in accordance with the conditions of national law, where the SSMR does not confer such powers on the ECB. This is relevant, since the CRD-transposed powers do not cover all the breaches of requirements established by CRR—in that case, the ECB necessarily must resort to instruct NCAs to use purely national powers to deal with the issue. The assessors had access to files when this was the case. The ECB can act in two different ways to address shortcomings: (a) Informal dialogue with the credit institution (or operational acts), which does not require a Supervisory Board and Governing Council decision and is not legally binding; and (b) formal supervisory measures, which require decisions by the Supervisory Board and the Governing Council. These powers include, among 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. The ECB may also impose an

[66] Please refer to Principle 1.

	enforcement measure to compel the SI to restore compliance, or a sanction, to punish the infringement (see EC4).
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	The ECB has broad powers granted by Article 16 of the SSMR. These powers are available not only when the institution is breaching requirements but also when the ECB has evidence that the bank is likely to breach applicable legal requirements specified in Article 4(3) of the SSMR within the next 12 months; or when, based on the SREP, the ECB considers that the arrangements, strategies, processes, and mechanisms implemented by the institution and the own funds and liquidity held by it do not ensure a sound management and coverage of its risks. The ECB's supervisory processes and powers are generally sufficient to resolve issues. In the event an institution remains noncompliant, the ECB may resort to enforcement and sanctions. However, the ECB's enforcement powers are limited and misaligned with supervisory objectives. The ECB may employ non-pecuniary enforcement tools to affirmatively compel supervised entities to comply with applicable supervisory or legal requirements only when they are provided for in national transposition of CRD IV or as purely national measures. Pecuniary penalties are the only enforcement tool directly available to the ECB in every jurisdiction.
EC4	The supervisor has available a broad range of possible measures to address, at an early stage, the scenarios described in EC 2. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank; imposing more stringent prudential limits and requirements; withholding approval of new activities or acquisitions; restricting or suspending payments to shareholders or share repurchases; restricting asset transfers, barring individuals from the banking sector; replacing or restricting the powers of managers, Board members, or controlling owners; facilitating a takeover by or merger with a healthier institution; providing for the interim management of the bank; and revoking or recommending the revocation of the banking license.
Description and findings re EC4	The ECB has at its disposal a broad range of possible measures to address, at an early supervisory stage, deficiencies and weaknesses at SIs, as described in EC 2 above. These measures are comparable to those available to competent authorities pursuant to Articles 103–106 of CRD IV and include the ability to require a SI to take timely corrective action through the ECB Supervisory Board decision process. The formal imposition of sanctions is not expeditious due to the complex legal framework. Internal ECB process improvements should be undertaken even if there are other legal impediments to timely action.

	The ECB can require the SI to take timely corrective action by applying the broad supervisory powers available to the ECB. According to Article 16(2) of the SSMR, the ECB has the power to: • require institutions to hold additional own funds; • require the reinforcement of the arrangements, processes, mechanisms and strategies; • require institutions to present a plan to restore compliance with supervisory requirements; • require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements; • 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; • require the reduction of the risk inherent activities, products or systems of institutions; • require institutions to limit variable remuneration as a percentage of net revenues; • require institutions to use net profits to strengthen own funds; • restrict or prohibit distributions of interest payments by an institution to shareholders, members or holders of Additional Tier 1 instruments; • impose specific liquidity requirements, including restrictions on maturity mismatches between assets and liabilities; • require additional disclosures; • remove at any time members from the management body of credit institutions who do not fulfil the requirements set out in relevant Union law. The ECB has the power to require SIs to take necessary measures at an early stage if a SI is likely to breach prudential requirement within the next 12 months or if sound management and coverage of risks is not ensured (See EC 2 and EC 3). Article 16 of the SSMR also authorizes the ECB to directly exercise all powers conferred on the NCAs by national law transposing Union law directives in order to carry out its supervisory tasks. It also may require a NCA to make use of their national powers, where the SSMR does not confer such powers on the ECB (See EC 2). Thus, the ECB can directly or indirectly apply the powers NCAs have under and in accordance with the conditions set out in national law. Under Article 14(5) of the SSMR, the ECB also has the power to withdraw a credit institution's authorization if circumstances warrant (See CP 5). The ECB can also impose sanctions. The allocation of sanctioning tasks between the ECB and the NCAs vis-à-vis SIs depends on three main elements: (i) type of regulation allegedly infringed (i.e., directly applicable Union law; national law implementing Directives, ECB decisions, or regulations; national law relating to tasks not conferred on the ECB); (ii) entity to be penalized (i.e., supervised entity or natural person); (iii) sanction to be imposed (i.e.,

	pecuniary or non-pecuniary). In general, the ECB can only apply non-pecuniary sanctions and sanction natural persons through an NCA. The table below summarizes the allocation of sanctioning powers between the ECB and the NCAs based on the nature of the infringement:

ECB / NCA SANCTIONING POWERS

Infringement / Sanction		Significant Supervised Entities (SSE)	
		Entities	Natural persons
Directly applicable EU law	Pecuniary	ECB (Art. 18.1 SSMR)	
	Non-pecuniary	**NCA (only at ECB request) (Art. 18.5 SSMR)**	
National law implementing EU Directives	Pecuniary		
	Non-pecuniary		
ECB regulations and decisions	Pecuniary	ECB (Art. 18.7 SSMR)	
	Non-pecuniary	**NCA (only at ECB request) (Art. 18.5 and 18.7 SSMR)***	
National law: non-ECB tasks	Pecuniary	NCA	
	Non-pecuniary		

Where SIs intentionally or negligently breach a requirement under relevant directly applicable Union law in relation to which administrative penalties are available to competent authorities, the ECB may under Article 18(1) of the SSMR impose administrative pecuniary penalties of twice the amount of the profits gained or losses avoided because of the breach where those can be determined or up to 10 percent of the total annual turnover in the proceeding business year. In case of breach of ECB regulations or decisions, the ECB may under Article 18(7) of the SSMR impose fines against supervised entities of the same maximum amount. The ECB has the power to impose periodic penalty payments of up to five percent of the average daily turnover per day of infringement in order to enforce ECB decisions or regulations.

The ECB can 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 (See Article 18(5) of the SSMR, Article 134 of the SSMFR).

Beside the application of these supervisory powers and sanctions, the ECB has the power to impose enforcement measures to compel a SI 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-á-vis the ECB. The allocation of enforcement powers between the ECB and the NCAs is as follow:

<table>
<tr><th colspan="4">ECB ENFORCEMENT POWERS</th></tr>
<tr><td rowspan="2">Enforcement measures</td><td colspan="2">Measures directly available to the ECB</td><td>Measures indirectly available to the ECB</td></tr>
<tr><td><u>Periodic Penalty Payments</u>
(Art. 18(7) SSMR,
Reg. 2532/98,
Art. 129 SSM FR)</td><td><u>Tools qualified as enforcement measures</u>
under the national law transposing relevant Directives
(Art. 9(1) paragraph 2 SSMR)</td><td><u>Pure national enforcement measures</u>
not related to transposition of relevant Directives
(Art. 9(1) paragraph 3 SSMR)</td></tr>
<tr><td>Authority exercising the enforcement measure</td><td colspan="2">ECB</td><td>NCA
(under ECB instruction)</td></tr>
<tr><td>Subject person</td><td colspan="3">Significant Supervised Entities (SSE)
Less Significant Supervised Entities (LSE)
Natural persons</td></tr>
</table>

As regards the types of enforcement measures available, the ECB is empowered to directly impose on SIs periodic penalty payments (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 shall be five percent of the average daily turnover per day of infringement for a maximum period of six months. In addition, according to Article 9(1) paragraph 2 of the SSMR for the exclusive purpose of carrying out its tasks, the ECB shall have all the powers and obligations which NCAs shall have under the relevant Union law. Based on this Article, the ECB may also adopt directly those measures that NCAs shall have under the relevant Union law which are considered as enforcement measures in the national legislation implementing relevant directives. For example, cease-and-desist orders could be included in this category depending on the Member State's implementation of CRD IV.

The ECB provided the assessors with a mapping of national enforcement and sanctioning powers compiled by the NCAs. Unless powers are expressly labeled as enforcement under

	CRD IV transposition, the ECB cannot exercise these directly and needs to instruct NCAs to exercise these pure national powers. For example, in Germany, there are few powers directly available to the ECB as the powers available to BaFin are not considered to be enforcement measures under CRD IV but as administrative measures under German law. Other jurisdictions more closely follow the provisions of CRD IV in terms of the availability and size of pecuniary penalties. Procedural processes vary widely among Member States with regard to assessing penalties against individuals, and some breaches under national law need to observe precise thresholds for trigger. Some national laws also impose procedural processes or approvals before the ECB may exercise a national law tool. Cyprus is an example of where the imposition of national law sanctions requires the agreement of the Minister of Finance. Moreover, differences in national laws governing breaches may result in potentially inconsistent outcomes for similar breaches. This does not foster consistency and a level playing field.
EC5	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.
Description and findings re EC5	The ECB may impose sanctions only on legal entities (SIs), but it does not have the power to directly impose sanctions on natural persons pursuant to recital 53 and Article 18(1) of the SSMR. In contrast, under CRD IV (Article 65 on Administrative penalties and other administrative measures), Member State competent authorities are authorized to impose sanctions on credit institutions as well as to members of management bodies and other individuals. The ECB may, however, require NCAs to open proceedings with a view to taking action to ensure that appropriate national law penalties are imposed for breaches of prudential requirements under Article 18(5) of the SSMR. (Sanctioning powers between ECB and NCAs are discussed in BCP 11 EC 4). Pursuant to Article 134 of the SSMFR, NCAs may impose sanctions upon natural persons belonging to SIs only at the ECB's request and shall inform the ECB of the outcome of the proceedings. NCAs also may ask the ECB to request them to open proceedings to impose a sanction on natural persons belonging to a SI. The level of sanctions has gradually increased since the inception of the SSM. Only four proceedings were initiated in 2015 (3 sanctioning proceedings and 1 enforcement proceeding; 2 sanctioning proceedings were completed in 2015). In 2016, the ECB launched 41 sanctioning proceedings and one enforcement proceeding. The ECB handled 44 proceedings in 2016 (including two ongoing 2015 proceedings), 42 of them regarding sanctions and two related to enforcement measures. Altogether, 30 out of the 42 sanctioning proceedings handled in 2016 relate to suspected breaches of directly applicable EU law (ECB decisions and regulations included). These proceedings concern 26 SIs and relate to the areas of own funds, reporting, public disclosure, liquidity and large exposures. The remaining 12 out of the 42 sanctioning proceedings are related to suspected breaches

	of national law transposing CRD IV provisions and concern SIs or natural persons. These proceedings involved suspected breaches regarding governance, including internal control mechanisms, management body functions and remuneration. During 2016, the ECB also addressed three requests to NCAs to open sanctioning proceedings within the remit of their national competences. The two enforcement proceedings handled in 2016 concerned a suspected breach of national remuneration rules and non-compliance with an ECB supervisory decision (See ECB Annual Report on Supervisory Activities 2016). In addition, the ECB has the competence pursuant to Article 16(2)(m) of the SSMR to remove members of the management body of SIs who do not fulfill the fit-and-proper requirement under its supervisory authorities at any time. The removal powers of NCAs vary under national laws. Some Member States lack the power to remove individual management body members. Others only allow the imposition of penalties upon natural persons. Enforcement proceedings against individuals are brought under national laws, appeals of any such enforcement actions or sanctions are directed to national courts where the ECB may not have legal standing.
EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures, and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	The ECB is empowered by Article 16 of the SSMR to require SIs to take the necessary corrective measures at an early stage. The measures available to the ECB are broad and encompass the actions specified in EC6. They are described in more detail in EC 1, EC 2, and EC 4. In addition to those direct supervisory measures, the ECB can also use the existing purely national structural powers (indirectly exercised by way of instructions pursuant to Article 9(1) 3rd paragraph of the SSMR). The ECB possesses early intervention authorities. An intensive interaction between the ECB and SRB takes place when early intervention measures are planned to be taken by the ECB regarding an institution for which SRB is the resolution authority. Notable differences exist between the scope of the direct supervision of the ECB and the remit of entities falling under the competence of the SRB. The latter has a more extended scope that includes cross-border LSIs not directly supervised by the ECB. Furthermore, there is some overlap between the early intervention powers in the BRRD and the supervisory powers listed in the SSMR, each backed by different procedures (See Commission Staff Working Document https://ec.europa.eu/info/sites/info/files/171011-ssm-review-report-staff-working-document_en.pdf).

EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	The legal framework for crisis management and bank resolution for SIs is established under the BRRD and the SRMR. The framework defines in detail the cooperation arrangements between the ECB and the SRB during the resolution process. If the ECB determines after consulting with the SRB that the institution is failing or likely to fail, or if the ECB receives such a determination from an institution itself, the ECB must notify, inter alia, the SRB. Before it decides that an institution is failing or likely to fail, the SRB must first inform the ECB that it intends to make this determination and allow the ECB three calendar days to make an assessment. The ECB and SRB have signed an MoU, which should ensure early and effective coordination and information sharing. (MoU, between the SRB and the ECB in respect of cooperation and information exchange). At the resolution stage, the BRRD envisages certain tasks to be performed by the supervisor. The ECB will perform these tasks in accordance with the national transposition of the BRRD. For example, in case a bridge institution is set up by the resolution authority, it may submit a request for a temporary exemption of the conditions for authorization. In these cases, the ECB would grant authorization and could become the competent authority for the bridge bank.
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	The ECB is required to take timely supervisory action under Article 16(2) of the SSMR. The assessors saw evidence that the SSM identified deficiencies and initiated timely corrective action through the supervisory process. This is accomplished primarily through progressive remedial measures starting with “operational acts” and culminating in the issuance of formal ECB decisions. The subsequent initiation of formal post-remediation enforcement and sanction actions is less timely. This is due to substantive and procedural legal limitations. With respect to sanctions, the ECB provided the assessors with its June 23, 2016 Guidance for the referral of suspected breaches to the ECB’s independent Enforcement Division. According to this detailed guidance, without prejudice to the adoption of any of the above-mentioned supervisory measures, JSTs and/or other business areas in charge of day-to day supervision must refer to the ECB’s independent investigating unit every identified suspected breach of prudential requirements. Breaches of quantitative prudential requirements do not entail a margin of supervisory judgement and must be referred immediately. The identification of breaches of qualitative prudential requirements may entail a margin of supervisory judgment. Those breaches shall be referred only when, based on expert supervisory judgment, the JST or the relevant business area identified non-

	compliance with supervisory requirements. The ECB's independent investigating unit shall assess the referred breaches and decide whether to open a sanctioning procedure according to the criteria set out in the ex-ante Supervisory Board Guidance. In case the independent investigating unit decides to open a sanctioning procedure, it will consider the distribution of sanctioning powers between the ECB and the NCAs.
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of nonbank related financial entities of its actions and, where appropriate, coordinates its actions with them.
Description and findings re AC2	There is no express provision requiring the ECB to communicate with NCAs or other nonbank EU or national regulatory authorities when taking formal corrective action against a bank that has nonbank related financial entities supervised by it. When the NCA is an integrated supervisory authority for all regulated financial sector entities and sits at the Supervisory Board at the ECB, who approves all supervisory measures, it will be informed. In addition, in this case, the NCA members in the JSTs are generally responsible for the liaison and communication of material issues. This indirect communication process with nonbank national regulators may unnecessarily slow any coordinated response. The ECB is encouraged to develop protocols for communication with insurance and financial market regulators of nonbank entities to coordinate actions, since not all NCAs are integrated supervisors.
Assessment re principle 11	Materially Non-Compliant
Comments	The ECB uses the SREP methodology and its SEPs to identify unsafe or unsound practices at SIs at an early stage. Once deficiencies are identified, a progressive remedial process is followed. Ongoing supervision by the JSTs identifies issues and recommends specific corrective actions within defined time periods to SI management informally and in writing. Article 16.2 of the SSMR lists a broad range of authorities that permit the imposition of both affirmative obligations and significant consequences to correct deficiencies. Written communications from the JSTs are "operational acts." These communications carry significant moral suasion weight even though they are not legally binding at this stage. The ECB's standard practice is to escalate a matter to the ECB Supervisory Board for a formal decision if an SI does not comply with an operational act. The Supervisory Board decision is legally binding upon a SI and is enforceable, as noncompliance constitutes a breach that is subject to sanctions. Assessors saw evidence of this process working effectively in practice. The national laws of several Member States and the SSMR provide a broad range of actions that can be taken by supervisors in their respective responsibilities. Direct enforcement powers and sanctions of the ECB are limited; however, the ECB can make direct use of the enforcement powers available to NCAs, if they derive from the transposition of CRD, and request NCAs to open proceedings with a view to taking action in order to ensure that appropriate penalties are imposed for breaches of national law transposing CRDIV. When

	the powers available to NCAs exist only under purely national law, the ECB can instruct the NCA to use such powers. Assessors had access to evidence of such indirect actions, where the ECB instructed NCAs to apply local sanctioning powers according to the national legislation. The legal framework for enforcement and sanctions, therefore, is complex and contains substantive and procedural gaps that should be addressed to meet CP 11 standards. Assessors note the complex legal enforcement framework may make it operationally difficult and time consuming for the ECB to impose formal enforcement actions and sanctions in some countries, where some powers may not be available. In addition, CRD IV powers do not cover all breaches of the CRR. Some common breaches—such as misreporting of financial statements—are not covered by CRD transposition and therefore cannot be subject to enforcement or sanctioning measures directly by the ECB in all jurisdictions. As noted above, the ECB may impose enforcement measures and sanctions only on legal entities (SIs), but it does not have the power to directly impose enforcement measures and sanctions on natural persons. In contrast, under CRD IV Member State competent authorities are authorized to impose enforcement measures and sanctions on credit institutions as well as to members of management bodies and other individuals. In order to fully ensure deterrence and a level playing field, the ECB's enforcement and sanctioning powers should be fully aligned to its supervisory responsibilities, including the possibility to directly impose sanctions for breaches of national law implementing EU directives and to sanction managers, and its enforcement and sanctioning toolkit should be completed with non-pecuniary measures The current lack of harmonization in the scope and approach to enforcement and sanctions results in similar breaches being addressed asymmetrically. The ECB should have a comparable authority to impose direct enforcement measures and sanctions upon individuals, as is the case with NCAs, and on entities regarding all breaches of the CRR. While the ECB has effectively used its authorities under Article 16.2 to effect necessary remedial measures at SIs, express authority to impose non-pecuniary sanctions, such as enforceable cease and desist orders with affirmative covenants, would provide an additional supervisory tool that could be used in appropriate circumstances. The ECB initiated 44 sanctioning cases since 2015 as of year-end 2016. The ECB should consider measures to reduce the backlog of the 35 remaining sanctioning cases. It is noted that only two matters were brought to a successful conclusion during this period and that only three cases were referred to NCAs to open proceedings under national law. https://www.bankingsupervision.europa.eu/banking/sanctions/html/index.en.html.

	The assessors were shown a detailed schematic of the ECB's enforcement and sanction process. It is complex and may involve a high level of coordination with NCAs. Streamlining the process and procedures could result in a timelier resolution of referred breaches.
Principle 12	**Consolidated supervision.** An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.[67]
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including nonbanking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	The ECB is the competent authority under the CRD and the SSMR to carry out a SREP and to take decisions for SIs. Supervision is conducted at the consolidated, sub-consolidated, and single-entity levels within a group unless an entity has been waived from supervision on an individual basis in accordance with Articles 7, 8, 10 of the CRR. In case of a financial conglomerate, the SREP decisions also take into account the outcome of the supplementary supervision as required by FICOD. This means that the supervisor must understand both the group-wide view as well as gain an understanding of all material activities conducted by the various entities within the group. To achieve this goal in case s where supervision has not been waived, the ECB carries out a SREP. Consolidated supervision generally consists of the following elements: • the day-to-day supervision of each supervised group is carried out by a JST, comprised of staff from both the ECB and NCAs and coordinated by an ECB JST 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 parent companies, banking subsidiaries, and significant branches follows the same supervisory model as consolidated supervision, but with greater involvement by the local JST members. For solo/sub-consolidated supervision of subsidiaries and branches established in non-participating Member States, the model used is based on the supervisory college framework as set out in the CRD. For solo/sub-consolidated supervision of subsidiaries and branches established in third countries (outside the EU), the model is based on MoUs, and if possible on colleges as set out in CRD IV.

[67] Please refer to footnote 19 under Principle 1.

If the parent entity is established in a non-Euro Area Member State or third country, the JSTs conduct sub-consolidated/solo supervision on the entities established in the participating Member-States. For SIs, the JSTs conduct the SREP in accordance with the SSM methodology and ensure compliance with the requirements of CRD IV and the CRR.

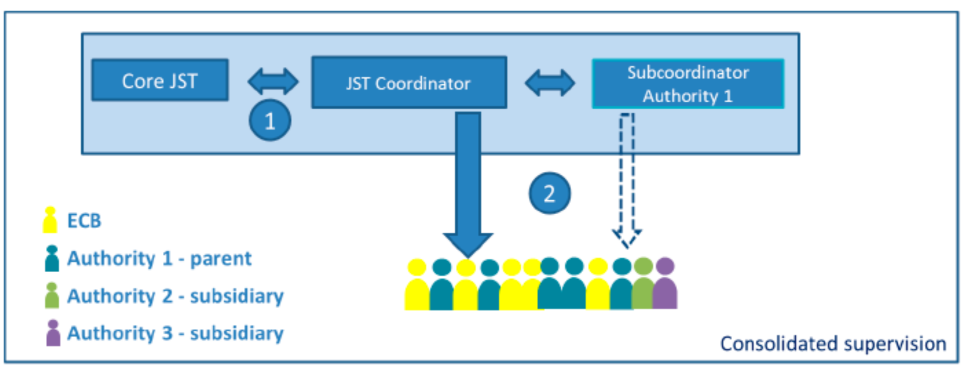
The interaction between consolidated and sub-consolidated/single entity supervision is mainly relevant for large cross-border credit institutions. The model adopted by ECB banking supervision is designed for those institutions but, in principle, can also apply to smaller cross-border groups. For unconsolidated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

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. The SSM Supervisory Manual Chapter 7 on Conglomerates, and relevant supervisory analysis, reviews and other materials were provided to the assessors.

Consolidated supervision

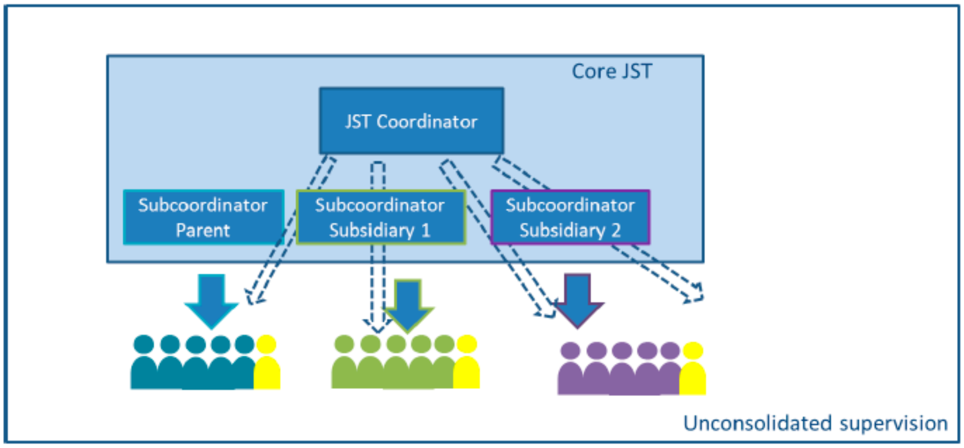
Consolidated supervision builds on the findings of sub-consolidated or single entity (i.e., solo) supervision. The model adopted is depicted schematically in Figure 1 below.

Figure 1. Consolidated Supervision



Consolidated supervision is at the center of SSM supervision. The role of the JST coordinator is pro-active. The JST coordinator utilizes ECB delegated experts and NCA experts directly. He or she can, on his or her own initiative, also direct the sub-coordinator of the parent company to manage or perform specific tasks.

The core JST also 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 respective sub-coordinator, as the competent organizational manager for the parent-company NCA staff in the JST, is involved in discussions on strategic issues related to the supervisory program. The JST coordinator liaises with him or her on important supervisory decisions, such as SREP decisions. The experts working on consolidated supervision are ECB supervisors, supervisors from the previously responsible authority for the parent company, and supervisors responsible for material subsidiaries. In order to successfully avoid competing teams and potential overlap between ECB and NCA supervisors, they are organized as one cross-border team.

Solo/sub-consolidated supervision

The role of the sub-coordinators is more prominent regarding solo and sub-consolidated supervision. The JST coordinators, however, retain the right to have direct contact with the employees working in sub-consolidated or single entity supervision at the national level. Together with their team, they have the main role in the planning for and preparing the necessary supervisory activities. In the case of the parent entity and material subsidiaries, the teams can be supported by ECB staff also working at the national level.

Figure 2: Solo/sub-consolidated supervision

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.

Financial conglomerate

The SREP for a financial conglomerate, established on the basis of the FICOD criteria, includes an assessment of the potential impact of nonbanking activities on the banking part

	of the group, its risk profile of the group, its profitability, and its capital and liquidity position, and assesses the overall situation at the conglomerate level. During the assessment, JSTs need to understand the risks from nonbanking 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 credit institution part of the conglomerate. This assessment, and the issuance of any requirements arising from it, takes place at the end of the process. The conglomerate approach takes into account the different sectoral regulations. In cases where a mixed financial holding company (MFHC) is subject to equivalent provisions under CRD IV and FICOD, there is the option to apply only the provisions of FICOD to the MFHC. Decisions are made on a case-by-case basis (see Articles 4, 108(3) and 120 of CRD IV). Because separate regulatory requirements exist for each sector, groups may have separate risk databases for banking, insurance, and other activities. The lack of common databases may make it more difficult for both management and the JSTs to fully understand the risks to the consolidated group and may impede effective consolidated supervision. Some consolidation of risks is, however, performed at group level and is presented in groups' internal risk dashboards. As coordinator, the ECB may receive the conglomerate's data from the supervised banking entity. If banking, nonbanking and other risks are managed in a fully integrated manner by the supervised institution, the information provided may be used in the assessment. The ECB may also receive information from the competent insurance supervisors. FICOD provides that the competent authorities are responsible for the supervision of regulated entities in a financial conglomerate and the competent authority appointed as the coordinator should share information which is essential or relevant for the exercise of the other authorities' supervisory tasks under the sectoral rules and FICOD. *Supervisory intensity* 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. The axis to bear in mind while mapping the group's perimeter includes, as a minimum, the following: (a) Degree of relevance of the subsidiary/sub-consolidated group: "Relevance" indicates the importance that a given subsidiary/sub-consolidated group has within the significant group it belongs to. There are different quantitative indicators deemed suitable to measure "relevance," such as percentage of total assets, income contribution, contribution to the consolidated capital requirements, risks, etc. Qualitative information may be considered as

	well, as in the case where a local subsidiary manages an important production process or business area within the group (e.g., subsidiaries managing the credit card business or the custodian bank function) or develops complex activities. (b) Degree of significance of the subsidiary/sub-consolidated group: "Significance" indicates the importance that a given subsidiary/sub-consolidated group holds in the local market, 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. (c) Degree of centralization/decentralization of strategy, business, operations, risk governance and controls: Institutions' organization structures exhibit different degrees of centralization or decentralization. Situations may exist where the parent company plays a considerable role in setting strategies, providing binding business guidelines, managing and controlling risks, and providing operational and support services (e.g., IT, accounting, back-up and central processing services, etc.). On the other hand, there are cases where the local subsidiaries/sub-consolidated entities enjoy greater autonomy when following the guidelines and principles issued by the parent company. Therefore, knowing the degree of centralization opted for is of key importance in defining the supervisory model to be adopted on a solo basis. 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. (d) Level of perceived risk: The level of risk of the subsidiary/sub-consolidated group being assessed has to be taken into account in defining the intensity of supervision, based on the principle that entities deemed to be particularly risky within cross-border groups can have potentially destabilizing effects—at least on a reputational level—on the group as a whole. This mapping is an important part of the supervisory planning process and in principle allows for the identification of two subsets of subsidiaries/sub-consolidated groups: • those which are significant and/or relevant and/or more autonomous and/or riskier (material subsidiaries). This subset of entities warrants a level of supervisory intensity comparable to that applied at the consolidated level; • the remaining entities (non-material subsidiaries), for which the supervisory intensity may be lower. The mapping, to be performed along the aforementioned dimensions, is the JST's responsibility supported by DG MS IV and NCAs where needed. An annual review of the mapping is carried out by the JST coordinator, who requests updates from the NCAs.

	The objective of the assessment of business model viability indicators on a consolidated level is to assess viability by means of a quantitative analysis of several risk indicators at the consolidated level, and a comparison to peers. Taken together, these and other indicators should give the analyst a full picture of the real and concrete strategy pursued by the bank and the key metrics regarding profitability at the consolidated level. The consolidated annual accounts of at least the past three years, and the most recent monthly/quarterly management reports for the current year budget (including year-to-date realization) should be used. All available information from FINREP and COREP, data and indicators available in IMAS as well as SNL data will form the starting point of the analysis. A bank should be able to provide detailed bottom-up forecasts of performance for the short-to-medium term (one to three years) and, at least, top-down forecasts for the longer term (two to five years). The assumptions used by the bank to generate forecasts for key drivers should be identified and understood. These are usually found in the bank's strategic assessment and planning documents and Board papers/documents regarding strategic and financial planning. It is necessary to distinguish between assumptions applied at the consolidated level and assumptions applied to business lines. Additional objectives have been established with regard to cross-sector supervision of financial conglomerates, which requires specific institutional arrangements (including at the national level when there is distinct sector supervision). Within the EU, cooperation among sector supervisors is governed by FICOD, which provides the framework for the supplementary supervision of credit institutions, insurance undertakings, and investment firms in a financial conglomerate. This supplementary supervision is understood as supervision that does not substitute the sectorial supervision but builds on it and addresses those risks that stem from the activities of a group in the other financial sectors. Supplementary supervision addresses the "Five Cs": (i) Capital adequacy at group level (i.e., avoidance of "double gearing" across the sectors); (ii) Contagion (i.e., supervising intra-group transactions); (iii) Concentration (i.e., supervising risk concentration across business lines); (iv) Conflict of interest (i.e., issues with respect to corporate governance); (v) Complexity. For cooperation with other authorities please refer also to BCP 3.
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits, and group structure.
Description and findings re EC2	Prudential standards established by the CRR/CRD (Pillar 1 and Pillar 2 requirements) are imposed at the consolidated, sub-consolidated and individual basis. According to the CRR:

	(a)'consolidated situation' means the situation that results from applying the requirements of this Regulation in accordance with Part One, Title II, Chapter 2 to an institution as if that institution formed, together with one or more other entities, a single institution; (b) 'sub-consolidated basis' means on the basis of the consolidated situation of a parent institution, financial holding company or MFHC, excluding a sub-group of entities, or on the basis of the consolidated situation of a parent institution, financial holding company or MFHC that is not the ultimate parent institution, financial holding company, or MFHC. Articles 11, 13, and 14 of the CRR state that parts 2 (Own Funds), 3 (Capital requirements), 4 (Large Exposures), 5 (Exposures to Transferred Risk), 6 (Liquidity), 7 (Leverage), and 8 (Disclosure) are to be complied with on a consolidated basis. For large exposures, Article 11(1) of the CRR stipulates that parent institutions in a Member State of the EU shall comply, to the extent and in the manner prescribed in Article 18 of the CRR, with the large exposures obligations laid down in Part Four of the CRR on the basis of their consolidated situation. According to Article 11(1) of the CRR, the parent undertakings and their subsidiaries set up a proper organizational structure and appropriate internal control mechanisms in order to ensure that the data required for consolidation are duly processed and forwarded. In particular, they ensure that subsidiaries which are not subject to the CRR implement arrangements, processes, and mechanisms to ensure a proper consolidation. With respect to parent financial holding companies, Article 11(2) of the CRR stipulates that institutions controlled by a parent financial holding company or a parent MFHC in a Member State of the EU shall comply, to the extent and in the manner prescribed in Article 18 of the CRR, with the large exposure obligations laid down in Part Four of the CRR on the basis of the consolidated situation of that financial holding company or MFHC. Article 6 of the CRR states that parts 2 (Own Funds), 3 (Capital requirements), 4 (Large Exposures), 5 (Exposures to Transferred Risk), 6 (Liquidity), 7 (Leverage), and 8 (Disclosure) are to be complied with on individual basis, unless waivers under Article 7, 8, or 10 apply. CRR provisions on reporting in Articles 99–100 (reporting on own funds on consolidated basis based on accounting standards), 394 (large exposures), 415–416 (liquidity), 430 (leverage), as specified by the EBA’s ITS on reporting, require that information shall be reported on both a solo and consolidated basis, unless a waiver from reporting on a solo basis under articles 7, 8, or 10 applies. The ECB has adopted Regulation (EU) 2015/534 of March 17, 2015 on reporting of supervisory financial information (See CP 10). The regulation lays down the requirements regarding reporting on supervisory financial information to be submitted to NCAs and the ECB by supervised banks. This reporting includes information on balance sheet items such as financial assets, nonperforming exposures (NPEs), and financial liabilities as well as on

	income and expenses such as impairment due to credit losses. CP 12 EC 1 applies regarding 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. When assessing this information for the banking group, the supervisor 'maps' several components. This model used is complemented by a detailed centrally coordinated planning process that defines the supervisory priorities and the level of involvement of the JSTs, the ECB staff and the level of assistance provided by the NCA within the JSTs for all major supervisory tasks to be carried out (See EC 1). The ECB provided the assessors examples of its consolidated financial review and analysis of banking groups' capital, liquidity, concentrations, exposures to related parties, lending limits, and group structure. The materials included ECB "operational act" onsite inspection letters and subsequent correspondence following up on specified recommendations.
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings re EC3	The ECB has implemented a group-wide supervisory approach when assessing management's oversight of its foreign operations. The supervisor gathers all relevant information concerning the risk management and internal governance on a group-wide level, while risk category specific areas are covered by the related methodological documents on the individual risk categories. The results from those assessments feed into the reliability assessment for capital and liquidity determinations. In the case of home/host relationships, the coordination and cooperation, including exchange of information, is organized through the colleges of supervisors. Additional information on the effectiveness of supervision conducted in the host countries in which its banks have material operation is found in CP 13. The assessors were provided with sample supervisory reviews of the adequacy of SI groups' oversight of their foreign operations. The ECB actively assesses SIs' oversight of foreign operations. Resources and the intensity of supervisory activity are based upon risk and systemic importance (See EC1). The sample of onsite "operational act" letters assessed internal governance, risk management, compliance, internal audit, and financial activities at the entities' foreign operations.

EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct onsite examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	The legal basis for ECB onsite inspections is Article 12 of the SSMR and Title 5 of the SSMFR. The ECB is empowered, based on an ECB decision, to conduct all necessary onsite inspections at the business premises of the legal persons referred to in Article 10(1) of the SSMR and any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating supervisor. Colleges of supervisors are the primary vehicles for cooperation and coordination among the authorities responsible for and involved in the supervision of the different components of cross-border banking groups (see CP 13). The assessors reviewed several agendas and minutes of supervisory college meetings where entities with cross borders operations were discussed with home/host supervisors. Topics discussed included supervisory findings, financial results, organizational changes, business model changes, and substantive international policy issues. The supervisory colleges are maturing.
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 the banking group, and takes appropriate supervisory action.
Description and findings re EC5	The ECB has the authority and responsibility to understand and assess the risks of cross-border companies and subsidiaries (See CP13 EC 1, EC 3, and EC 4). Additional information on the supervision of nonbanking activities within a financial conglomerate is found in EC 2. Information on cooperation and the supervision of parent companies is found in EC 5 and EC 8 of CP 8. The assessors note that the SSM framework requires supervisors to review the activities of companies affiliated with parent companies which may have an impact on the safety and soundness of the group only in the case these are classified as "institutions," i.e., have an investment firm or credit institution license. This EC refers to activities of companies affiliated with parent companies, which may not be supervised entities at all. The lack of authority to review such activities in national law may hinder the ECB's ability to assess whether such parent's activities may have a material impact on the safety and soundness of the bank and the banking group and its ability to take appropriate supervisory action if warranted. The ECB's ability to rely on national law is limited to the extent that not all Member States have enacted laws that permit the NCA to review and limit or restrict a parent company and their affiliates' activities or to require divesture.
EC6	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:

	(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered.
Description and findings re EC6	Article 16(2) of the SSMR grants the ECB supervisory authorities over consolidated entities of a credit institution. It is empowered to ensure compliance with applicable substantive requirements on own funds, securitization, large exposure limits, liquidity, leverage, and reporting and disclosure. It also governs internal governance, including 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 ICAAP, including IRB models. Based upon SREP, the ECB may require an increase in the own funds and liquidity held by a consolidated group to ensure sound management and coverage of its risks. The ECB can exercise, among others, the following powers: 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 (see CP 8, EC3). The ECB's ability to rely on national law is limited to the extent that not all Member States have enacted laws that permit the NCA to limit or restrict a parent company and their affiliates' activities or to require divesture. In addition, the ECB has the power to grant authorization to take up business as a credit institution (licensing); if the applicable national law allows, when issuing the decision, the ECB can limit the range of activities that are conducted and the locations in which they can be conducted within the consolidated group and of individual institutions. The aim of an authorization assessment is 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. The assessment consists of a detailed review and evaluation of the information in the application and other documentation requested by the NCA. Another power of authorization the ECB has regards the use as a remedial measure. An authorization may be withdrawn by the ECB on its own initiative (or on basis of a proposal from the NCA of the participating Member State where the credit institution is established).
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 stand-alone basis and understands its relationship with other members of the group.[68]

[68] Please refer to Principle 16, Additional Criterion 2.

Description and findings re EC7	The ECB, in addition to supervising on a consolidated basis, also supervises on the individual level in the group in order to gain a better understanding of the group dimension. Within the SREP, the various assessments are performed at different frequencies, through MELs which can be fine-tuned by the SEP for each individual institution. This allows the supervisor to assess institutions on a stand-alone basis and these assessments are then consolidated into a single SEP (See CP12 EC1–EC2).
Additional criteria	
AC1	For countries which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit-and-proper standards for owners and senior management of parent companies.
Description and findings re AC1	Only general criteria exist under Article 23 of CRD IV to assess the suitability of a corporate acquirer (See EC 5). There are no express fit-and-proper requirements for owners/senior managers of the corporate/legal person which has acquired the bank unless those persons "will direct the business of the credit institution as a result of the proposed acquisition." Any requirements for non-regulated entity ownership and their managers are defined at national level. Holding companies are not required to be authorized under EU law.
Assessment of Principle 12	Largely Compliant
Comments	The ECB is the consolidated supervisor for all SIs. The ECB utilizes its SREP and SEP programs to monitor consolidated parents and affiliates and applies its prudential standards to all aspects of the business conducted by the banking group worldwide to the extent permitted by law. The assessors note that the lack of integrated data systems and different regulatory reporting requirements between banking and other regulated financial activity may impede effective consolidated supervision (See EC1). The availability of a unique, universal, and permanent identifier for each legal entity client is a fundamental prerequisite for the correct identification of the perimeter of banking group. As recommended by the EBA, competent authorities should request that all institutions under their supervisory remit that are subject to reporting obligations obtain Legal Entity Identifier (LEI) codes for themselves and for all entities within their group on which information is required under their reporting obligations. In an elaboration on a sample of 29 SIs, 6 of these had, on average, two-thirds of the financial entities within their group not identifiable through a LEI. The SSM framework requires supervisors to review the activities of companies affiliated with parent companies which may have an impact on the safety and soundness of the group only in the case these are classified as "institutions," i.e., have an investment firm or credit institution license. The assessors note that a gap may exist with the activities of certain affiliates and parent companies, which may not be supervised entities at all, although CRD (Articles 119(3) and 122) set forth rules on requests on information and inspections for certain unregulated subsidiaries and parents. The lack of authority to review or directly

	regulate such activities in national law may hinder the ECB's ability to assess whether such parent's activities may have a material impact on the safety and soundness of the bank and the banking group and its ability to take appropriate supervisory action if warranted. The ECB's ability to rely on national law is limited to the extent that not all Member States have enacted laws that permit the NCA to review and limit or restrict a parent company and their affiliates' activities or to require divesture. The assessors also note that potential gaps in the ECB's fit-and-proper supervisory authority may exist where there is corporate ownership of the group and there is no governing national law. The ECB is the lead supervisor for 27 financial conglomerates under FICOD. Article 2(15) of Directive 2002/87defines an MFHC as a "parent undertaking, other than a regulated entity, which, <u>together with</u> its subsidiaries (…), constitutes a financial conglomerate." Although a MFHC may be part of the banking consolidation perimeter and subject to banking consolidated supervision, MFHCs do not require authorization from regulators. This may imply a constrained capacity to identify related parties, or nonfinancial entities that may impact conglomerates and as a practical matter include them in the supervisory perimeter. Thresholds for conglomerate definition also are based on fixed percentages of balance sheet and do not include off-balance-sheet assets and provide no supervisory discretion to include other assets or to deem a group a conglomerate based on risk. There is no framework for the resolution of an international conglomerate, which may impede its orderly resolution.
Principle 13	**Home-host relationships.** Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	The ECB is the exclusive competent authority for the supervision of SIs. Rather than establishing colleges of supervisors for Member State NCAs, the SSM has integrated the NCAs into the supervision of SIs through its JSTs. JSTs are set up for all SIs in those EU Member States which participate in the SSM. According to Article 3 of the SSMFR, each JST must be composed of staff members from the ECB and from the NCAs, including NCBs where the NCA is not a central bank but cooperates with the NCB in supervision based on

	national law. The composition of the JSTs integrates pan-European and national perspectives into the supervision of SIs. The ECB establishes colleges of supervisors for subsidiaries of SIs located outside the SSM, with the relevant NCAs and other third-country supervisors to facilitate the exchange of information, to coordinate supervisory activities and to ensure a consistent application of prudential requirements. (The ECB chairs the college of supervisors as consolidating supervisor.) In this case, NCAs participate in the colleges as observers. Supervisory college tasks are performed at least on an annual basis (See Article 116 of CRD IV). The ECB currently participates in 45 supervisory colleges and, as the consolidating supervisor, is responsible for the operation of 26 of these colleges. The ECB's 2017 Report on the SSM noted that supervisory colleges are viewed as particularly important where the ECB is host supervisor for subsidiaries of groups headquartered outside the Euro Area or for non-Euro Area branches that are considered SIs (See CP3). The participation of third-country authorities in EU colleges depends upon the evaluation of the equivalence of their confidentiality regime to the EU confidentiality regime. Under CRD IV, members of the colleges are to reach an agreement on equivalence. The ECB has confirmed its compliance with the EBA Recommendations on the equivalence of confidentiality regimes. The decision on college membership or observer status of supervisory authorities is based on a mapping exercise. This identifies the entities (subsidiaries, branches, other financial sector entities) of a cross-border banking group and it determines and notes the significance of these entities for the local markets and the group. The EBA is invited as a college member. Members of the colleges may include 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 MFHC, and the competent authorities of host Member States where significant branches as referred to in Article 51 of CRD IV 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. Competent authorities of host EU Member States where non-significant branches are established, and third-country supervisory authorities (from countries which are not EU Member States) and other relevant authorities may be invited to participate in the colleges as observers. The ECB invites potential members and observers to the college. Membership and observer status is acquired upon acceptance of the invitation. College members discuss and agree on the scope and level of involvement of observers, if any, in the college. Colleges are structured depending on the size of the banking group and its activities. All college members and observers attend a general or European College, which is the basic form for colleges. If needed, other possible college structures besides the European College are the

	Core College (no third-country supervisors, supervisors of the most important group entities attending), the Crisis Management Group and Cross Border Stability Groups (see EC 5), Resolution Colleges, as well as subgroups depending on the specific needs (for instance, Liquidity Subgroup). A list of the SSM's supervisory colleges was provided to the assessors. The establishment and the operating framework for supervisory colleges are detailed in WCCAs, which specify arrangements for information exchange and cover observers' participation in the college. The ECB establishes regular cooperation with college members that can take the form of meetings (at least annually) or other activities. Sample agendas of European and core supervisory college meetings with relevant Member State and third country supervisors were provided to the assessors. Where the ECB acts as host supervisor, it participates in the college as a member. Depending on the ultimate decision of the home supervisor, the JST's NCAs participate as observers. Finally, NCAs participate in the colleges as observers (Article 9(1) of the SSMFR).
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group[69] and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as MOUs) are in place to enable the exchange of confidential information.
Description and findings re EC2	As a principle, the ECB shares relevant information on SIs on a regular and on an ad hoc basis with other supervisory authorities. This includes, but is not limited to, phone calls, emails, and meetings, and is done in either a bi-lateral or multilateral setting. Colleges of supervisors are an important forum for the exchange of information, as explained below. This principle is applied independently from the role of the ECB as being either home or host supervisor, respectively. In the European context, as required by Article 117 of CRD IV, the ECB cooperates closely with other supervisory authorities and facilitates the sharing of relevant information for the exercise of supervisory tasks. In its capacity as consolidating supervisor for SIs, the ECB established a framework for the exchange of information in going concern and emergency situations governed by a college-specific WCCA (Article 115 of CRD IV). Under the WCCA 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. The authorities supply one another with the necessary information on management and ownership of the

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

	institutions they supervise and additional information that is useful to facilitate their monitoring (Article 55 of CRD IV). Information sharing is particularly relevant 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. Within colleges, the ECB and the members of the college exchange all information necessary to facilitate the exercise and coordination of supervisory activities and the joint decisions on institution-specific prudential requirements (Articles 112 and113 of CRD IV). All essential information is exchanged regardless of whether received from a group entity, a competent or supervisory authority or any other source. This information exchange is adequate, accurate, and timely, thereby enabling and facilitating the efficient, effective, and full performance of the supervisory tasks of the college members. Information sharing is subject to the confidentiality regime of Article 54 of CRD IV, which mandates that the competent authorities receiving confidential information shall only use this information in furtherance of their official duties (e.g., when imposing penalties). The assessors reviewed examples of the ECB's coordinated supervision plans with foreign supervisors. Competent authorities may transmit to monetary authorities and authorities overseeing payment systems information that is related to their role and function. The sharing of information on the liquidity of SIs is particularly important in the case of weak or troubled SIs. The information normally exchanged includes the outcomes of the SREP and a set of commonly agreed indicators. Some NCAs had entered into MoUs with non-SSM Member States and third countries prior to the SSM's creation. In order to ensure continuity with the cooperation framework and supervisory practices before the SSM, the ECB under "step in" arrangements became a principal in the MoUs that individual NCAs already had in place with some third country authorities. As of September 2017, the ECB has become part of the MoUs and similar arrangements that 49 third countries had in place. Executing an MoU can be a lengthy process. The ECB has not finalized agreements with all international supervisors of globally significant banking institutions. Coordination and cooperation with these supervisors only exists under ad hoc arrangements. The ECB should strive to conclude these international MoUs as quickly as possible (See CP 3).
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	Under the WCCA framework, the ECB and the members of the college discuss and agree on the content of the college SEP that contains at least: (i) the areas of joint work identified as a result of the SREP 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 ongoing activities, onsite inspections and internal model investigations; (iii) the respective SEPs 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. As a host supervisor, the ECB shares and discusses its SEP with the home supervisor. Planned activities and onsite missions are discussed on a college level as well as 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 (non-EU), the ECB also manages its relationship with the third-country supervisors/regulators that participate in the colleges as observers (See CP3).
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	In the case of SIs, the ECB has established a college communication policy with the college participants and sets this out in a WCCA. The communication policy includes the scope, frequency, and channels of communication. Under this policy, the ECB 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. 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. As regards information sharing and communication among the involved authorities, the ECB established 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 exchange of information (Article 4 of the CRR). College meetings are held at least annually. For significant banks, semi-annual meetings are routinely scheduled. In addition, the college holds conference calls to exchange the information specified in EC 2. Written information is exchanged via secured emails and secure supervisory college websites.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a

	way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	Within the Euro Area, the framework for cross-border crisis cooperation and coordination among home and host authorities for the management of a cross-border financial crisis has been significantly improved because of the creation of the SSM and the SRM, as well as the adoption of the BRRD. A December 22, 2015 MoU between the ECB and the SRB established a framework for cooperation and information exchange. The ECB also provided evidence that it responded to the SRB consultations on draft group resolution plans pursuant to their MoU. The ECB participates as home or host authority for significant banking groups in supervisory colleges, which provide the framework for cooperation and coordination between competent authorities both in normal times and in crises situations. 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 the planning and coordination of supervisory activities in preparation for and during emergency situations, including the minimum set of information to be exchanged during an emergency, are laid out in WCCAs for each college. These WCCAs 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 the BRRD. With specific reference to cross-border crisis cooperation and coordination, the ECB has concluded and is in the process of negotiating a number of MoU, stepping-in arrangements and other agreements for establishing frameworks for the exchange of information in connection with their respective supervisory responsibilities with foreign authorities (See CP 3). The ECB, together with the competent authorities of subsidiaries and of significant branches, 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 Articles 6 and 8 of the BRRD through a joint decision process. This assessment also involves input from the appropriate resolution authority on potential actions in the recovery plan that may adversely impact the resolvability of the institution. In an emergency, the ECB, when acting as a consolidating supervisor, coordinates the assessment of the emergency in cooperation with the members of the college. The ECB, and the members of the college that supervise group entities that are affected or likely to be affected by the emergency, monitor and exchange information on the implementation

	of the coordinated supervisory response, and coordinate to the extent possible their external communications. Regarding coordination of early intervention measures, 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 notifies the college of any early intervention measures (See, respectively, Articles 27 and 29 of the BRRD). 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. A general principle under the BRRD and CRD IV is that competent and resolution authorities should cooperate with each other to ensure that decisions are made, and actions taken in a coordinated and efficient manner. Once the ECB has determined that the preconditions for early intervention measures have been met in relation to an institution, relevant resolution authorities are notified without delay.[70] Moreover, the ECB should inform relevant resolution authorities about any crisis prevention measures (including for example 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 Article 104 of CRD IV.[71] Furthermore, if an emergency emerges at an institution, the ECB is required to alert the EBA, the NCB and the responsible ministry as soon as practicable and provide these authorities with all information essential for the fulfillment of their tasks.[72] Where the coordinated supervisory response to an emergency is likely to be more efficient by involving the group-level resolution authority, 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 shall consider the involvement of these authorities. The ECB also participates in resolution colleges in accordance with Article 88 of the BRRD. Resolution colleges 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 pursuant to Articles 12 and 13; (c) assessing the resolvability of groups pursuant to Article 16(d) exercising powers to address or remove

[70] Article 27(2) Directive 2014/59/EU (BRRD) and Article 13(1) Regulation 2014/806/EU.

[71] Article 81 (2) Directive 2014/59/EU (BRRD) and Article 13(1) Regulation 2014/806/EU.

[72] See Article 114 in combination with Article 58 (4) and Article 59 of Directive 2013/36/EU (CRD IV).

	impediments to the resolvability of groups pursuant to Article 18; (e) deciding on the need to establish a group resolution scheme (Article 91 or 92); (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 minimum requirements for groups at consolidated and subsidiary level under Article 45. In addition, resolution colleges can be used as a forum to discuss any issues relating to cross-border group resolution. The ECB also participates as home and host authority of banking groups designated as G-SIIs by the Financial Stability Board in numerous institution-specific Crisis Management Groups (CMGs) for the purposes of developing recovery plans and resolution plans for such firms (crisis preparation). Within those CMGs, the ECB has concluded cooperation agreements that govern the activities and information sharing in some CMGs. Cooperation between the ECB and the third countries is based on Article 93 of the BRRD. The Commission may submit to the Council proposals for the negotiation of agreements with one or more third countries regarding the means of cooperation between the resolution authorities and the relevant third-country authorities. The cooperation concerns, inter alia, information sharing for recovery and resolution planning. Further, Article 97 of the BRRD 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 (See also CP 3).
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	The framework for developing resolution plans is established by the BRRD and Regulation 2014/806/EU. In line with this framework, the ECB, as a competent authority, is not responsible for drafting resolution plans. In line with Articles 10 and 12 of the BRRD, the (group) resolution authority oversees drawing up (group) resolution plans, after consulting the competent authority. For SIs within the Banking Union, the SRB as the competent (group) resolution authority draws up the resolution plan and consults with the ECB. The ECB works closely with the nonbanking Union NRAs and the SRB for the development of resolution plans, but the ultimate responsibility in this respect does not rest with the ECB. Importantly, the ECB is required to cooperate with the SRB and the nonbanking Union NRAs in order to provide relevant information to them for the drawing-up of resolution plans. The actual implementation of cooperation and information exchange in this respect with the SRB is set out in the MoU between the SRB and the ECB. In accordance with Article 10 of the BRRD, resolution plans should include, quantified whenever appropriate and possible: (a) a summary of the key elements of the plan; (b) a

	summary of the material changes to the institution that have occurred after the latest resolution information was filed; (c) a demonstration of how critical functions and core business lines could be legally and economically separated, to the extent necessary, from other functions so as to ensure continuity upon the failure of the institution; (d) an estimation of the timeframe for executing each material aspect of the plan; (e) a detailed description of the assessment of resolvability; (f) a description of any measures required pursuant to Article 17 of the BRRD to address or remove impediments to resolvability; (g) a description of the processes for determining the value and marketability of the critical functions, core business lines, and assets of the institution; (h) a detailed description of the arrangements for ensuring that the required information for drawing up resolution plans is up to date and at the disposal of the resolution authorities at all times; (i) an explanation by the resolution authority as to how the resolution options could be financed; (j) a detailed description of the different resolution strategies that could be applied; (k) a description of critical interdependencies; (l) a description of options for preserving access to payments and clearing services and other infrastructures and an assessment of the portability of client positions; (m) an analysis of the impact of the plan on the employees of the institution; (n) a communication plan; (o) the minimum requirement for own funds and eligible liabilities and a deadline to reach that level, where applicable; (p) where applicable, the minimum requirement for own funds and contractual bail-in instruments, and a deadline to reach that level, where applicable; (q) a description of essential operations and systems for maintaining the continuous functioning of the institution's operational processes; and (r) where applicable, any opinion expressed by the institution in relation to the resolution plan. Banking Union parent undertakings shall submit the information that may be required for the drawing up of resolution plans in accordance with Article 11 of the BRRD to the group-level resolution authority, which is responsible for sharing this information. The information provided by the group-level resolution authority to the resolution authorities and competent authorities of subsidiaries, resolution authorities of the jurisdiction in which any significant branches are located, and to the relevant competent authorities, shall include at a minimum all information that is relevant to the subsidiary or significant branch. The information provided to the EBA shall include all information that is relevant to the role of the EBA in relation to the group resolution plans. In the case of information relating to third-country subsidiaries, the group-level resolution authority shall not be obliged to transmit that information without the consent of the relevant third-country supervisory authority or resolution authority. 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, at their discretion, and subject to the necessary confidentiality requirements, involve in the drawing-up and maintenance of group resolution plans 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 line with Article 13) within four months. The ECB participates in the resolution colleges as the competent supervisor. Group resolution plans are reviewed, and where appropriate updated, at least annually, and after any change to the legal or organizational structure, to the business or to the financial position of the group including any group entity, that could have a material effect on or require a change to the plan. With respect to early intervention actions, consultation with the relevant competent authorities and for the provision of relevant information to the resolution authority is required (See EC 5).
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	Under Article 4(2) of the SSMR, the ECB is responsible for the supervision of branches of credit institutions established in EU Member States that do not participate in the SSM. As a host supervisor, the ECB is responsible for assessing the risks, capital adequacy, and liquidity position of its supervised local entities following its own process and methodology for SREP. The ECB, as host supervisor, is also responsible for sharing all relevant and essential information with the home supervisor. Within the EU, the EU-wide application of CRD IV and the 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. This implies, for example, that the ECB may require credit institutions that have branches under its supervision to report periodically to it on their activities (Article 40 of CRD IV). Local subsidiaries of foreign banks need to be authorized by the ECB according to national requirements (See CP 5). Foreign branches, however, are authorized by each country and observe different requirements in different jurisdictions. They are supervised by NCAs under national law. Such branches are not subject to ECB supervision regardless of their size, complexity, or interconnectedness of their operations. The cross-border operations of foreign banks, including through branches, are subject to NCA prudential and supervision requirements. If a foreign bank's operations occur in a subsidiary that meets the definition of a SI it would be supervised by the ECB.
EC8	The home supervisor is given onsite access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	In practice, the ECB as a home supervisor informs the host supervisor individually and via the college about planned activities/visits for the group and individual subsidiaries as

	relevant. This also includes, for instance, intended participation of the home supervisor as an observer or supporting resource in onsite missions conducted by the host supervisor. In the case of foreign subsidiaries and branches of a banking group where the ECB acts as the consolidating supervisor, the ECB is empowered to conduct all necessary onsite inspections at the business premises of the supervised entities based on Article 12 of the SSMR. The ECB as home supervisor carries out onsite inspections after having informed the host supervisory authorities, based on Article 52 of CRD IV. In this respect, when the ECB as home supervisor wishes to check the information concerning an institution situated in another Member State, it may ask the host supervisor to have the check carried out. The host supervisor can (but is not obliged to) allow the home supervisor to carry it out directly. In addition, the ECB can decide to have 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 HoM coming from NCAs or from the ECB's COI Division. Regarding onsite inspections in countries that do not participate in the SSM, or within countries that participate in the SSM but where the ECB acts as host supervisor, the right to inspect branches and subsidiaries would usually be granted based on MoUs (See CP 3). 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 request participation in the onsite inspection. The assessors were provided evidence that host supervisors are informed of inspections.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	The ECB is empowered to authorize credit institutions and withdraw such authorizations (Article 4 para 1(a) of the SSMR). Banking licenses are granted subject to the conditions set out in the relevant national law. Applicants must comply with all conditions. Under EU law, the ECB grants a banking license 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 (Article 13 of CRD IV). The ECB has stated that it does not permit shell banks that only serve as a booking office. Apart from the notification requirements of Article 13 of CRD IV, there are no specific legal requirements that authorize the ECB or NCAs to explicitly prohibit shell banks or the continued operation of shell banks, although it is possible to withdraw the banking license in case of credit institutions that do not make use of the authorization within 12 months or ceases to engage in business for more than 6 months (Article 18(a) CRD). There is also no clear mandate to supervise booking offices in a manner consistent with internationally agreed standards. There are no provisions on booking branches such as those contained in the BCBS 2003 document on shell banks and booking offices (p. 3) and it is unclear whether it is sufficient, in order to avoid the establishment of shell banks, that

	applicants for a banking license guarantee that at least two persons effectively direct the business.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	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). Examples of post-supervisory action notifications where the need for urgency was present were provided to the assessors.
Assessment of Principle 13	Largely Compliant
Comments	The ECB-led supervisory colleges appear to serve their intended purpose in practice. Evidence provided to the assessors shows that they enhance effective oversight by considering the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors in the case of subsidiaries of SIs located within and outside the SSM. The ECB has not finalized agreements with all international supervisors of G-SIBs. Coordination and cooperation with these supervisors exists under ad hoc arrangements. The ECB should strive to conclude international MoUs as quickly as possible given their systemic importance. 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 significantly improved because of the creation of the SSM and the SRM, as well as the adoption of the BRRD. The MoU between the ECB and the SRB established a framework for cooperation and information exchange. Both entities should build on this framework in the planned MoU revision so as to further advance their respective important missions. The spirit of cooperation should become part of the culture of both the ECB and SRB, especially in the advanced planning stage of resolution strategies. Any operational or other issues should be identified and resolved in advance of a cross-border crisis. The ECB's participation as home or host authority for significant banking groups in supervisory colleges fosters coordination between competent authorities in crisis situations. 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 through the supervisory colleges. The specific procedures for the planning and coordination of supervisory activities in preparation for and during emergency situations, including the minimum set of information to be exchanged during an emergency, are laid out in WCCAs for each college. These WCCAs 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. The ECB has stated that it does not permit shell banks that only serve as a booking office. There are no specific legal requirements that authorize the ECB or NCAs to expressly prohibit shell banks or the continued operation of shell banks, although it is possible to withdraw the banking license in case of credit institutions that do not make use of the authorization within 12 months or ceases to engage in business for more than 6 months (Article 18(a) CRD) There is also no clear mandate to supervise booking offices in a manner consistent with internationally agreed standards. There are no provisions on booking branches such as those contained in the BCBS 2003 document on shell banks and booking offices and it is unclear whether it is sufficient, to avoid the establishment of shell banks, that applicants for banking license guarantee that at least two persons effectively direct the business. The ECB should seek express authority to prohibit shell banks or to limit the use of foreign branches as mere booking offices.

B. Prudential Regulations and Requirements

Principle 14	**Corporate governance.** The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management,[73] and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	Article 74 of CRD IV requires that Institutions shall have robust internal governance arrangements including sound remuneration policies and practices. The arrangements, processes and mechanisms shall be proportionate to the nature, scale and complexity inherent in the business model and the institution's activities. The EBA shall issue guidelines on internal governance arrangements. Article 75 of CRD IV also establishes that the EBA shall issue guidelines on sound remuneration policies (see below). Article 76 states that Member States shall ensure that the management body approves and periodically reviews the strategies and policies for taking up, managing, monitoring, and mitigating the risks to which the institution is exposed. The management body shall be actively involved in the management of all material risks. The institution shall establish reporting lines to the management body that cover all material risks and risk management policies and changes thereto. Institutions shall set up an independent risk management function and SIs shall set up a risk committee composed of members of the management

[73] Please refer to footnote 27 under Principle 5.

	body who do not perform any executive function in the institution concerned. The risk committee advises the management body on the institution's overall current and future risk appetite and strategy and assists the management body in overseeing the implementation of that strategy by senior management. Article 88 requires that Member States ensure that the management body defines, oversees and is accountable for the implementation of governance arrangements that ensure effective and prudent management of an institution. Member States shall ensure that the management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies. SIs shall set up a nomination committee composed of members of the management body who do not perform any executive function in the institution concerned. This committee shall identify and recommend, for the approval of the management body or of the general meeting, candidates to fill management body vacancies, evaluate the balance of knowledge, skills, diversity, and experience of the management body and prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected. Article 91 sets out the requirements on the management body collectively and its members. The management body shall always be of sufficiently good repute and possess sufficient knowledge, skills, and experience to perform its duties. The overall composition of the management body shall reflect an adequately broad range of experiences. Article 91 also establishes a requirement on the maximum number of directorships that members of the management body of an SI can hold. Article 92 sets out the requirements on the competent authorities regarding the remuneration policies for institutions and the staff whose professional activities have a material impact on the risk profile of the institution (identified staff). Article 94 sets out requirements for the variable elements of remuneration for identified staff. Article 95 requires that SIs to establish a remuneration committee. The remuneration committee shall be constituted in such a way as to enable it to exercise competent and independent judgment on remuneration policies and practices and the incentives created for managing risk capital and liquidity. The remuneration committee is responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the institution concerned and which are to be taken by the management body. Article 109 specifies to what extent the provisions on internal governance must be met on an individual institution basis, on a consolidated basis, or both. The EBA and the ECB have published additional guidelines, guides and statements on internal governance topics. Relevant documents are summarized below.

	On September 26, 2017, the EBA published revised Guidelines on Internal Governance that will go into force and effect on June 30, 2018 (EBA/GL/2017/11). The Guidelines put more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight, including the role of its committees. They aim at improving the status of the risk management function, enhancing the information flow between the risk management function and the management body, and ensuring effective monitoring of risk governance by supervisors. The 'know-your-structure' and complex structures sections have been strengthened to ensure that the management body is aware of the risks that can be triggered by complex and opaque structures, and to improve transparency. In addition, the framework for business conduct has been further developed and more emphasis is given to the establishment of a risk culture, a code of conduct and the management of conflicts of interest. The current EBA Guidelines on Internal Governance (September 20, 2011) remain in force until their repeal on June 30, 2018. On the same date, the EBA and ESMA joint guidelines on the assessment of the suitability of members of the management body and key function holders will come into force. These guidelines, which were published on September 26, 2017, address the suitability of members of management bodies and key function holders. The Guidelines harmonize and improve suitability assessments within EU financial sectors, and ensure sound governance arrangements in financial institutions in line with CRD IV and the Markets in Financial Instruments Directive (MiFID II). The Guidelines highlight the importance for institutions to consider whether candidates have the knowledge, qualification, and skills necessary to safeguard proper and prudent management of the institution. The Guidelines also foster more diverse management bodies and, therefore, contribute to improved risk oversight and resilience of institutions. The Guidelines specify the notions of (a) sufficient time commitment; (b) adequate collective knowledge, skills and experience; (c) honesty, integrity and independence of mind; (d) adequate human and financial resources for induction and training of members of the management body; and (e) diversity, which is to be considered in the selection process. Additionally, the Guidelines provide further guidance on the scope of assessments to be made, the assessment process for institutions and competent authorities, and related policies. They provide for the heads of internal control functions and the Chief Financial Officer, when they are not members of the management body, to be always considered as key function holders and, therefore, subject to the institution's assessment. On May 15, 2017, the ECB published the ECB Guide to Fit-and-Proper Assessments. The Guide explains how the ECB applies the fit-and-proper assessment criteria, with a view to establishing common supervisory practices for assessing the qualifications, skills, and proper standing of a candidate for a position on a bank's board, e.g., as a chief executive officer or non-executive board member, as well as explaining potential conflicts of interest in more detail. In its fit-and-proper assessments, the ECB applies the relevant EU law and its transposition into the national law of the 19 Euro Area countries. Where EU law leaves room

	for Member States to determine how it is transposed, national differences may continue to exist. While respecting such differences, the Guide aims to harmonize supervisory practices for performing fit-and-proper assessments. The May 2016 ECB Guide on Options and Discretions Available in Union Law (OND) contains additional provisions on internal governance relating to the structure of the Audit and Risk committees and additional non-executive directorships. Chapter 9.3 states that all significant supervised groups should have a separate risk and audit committee at the level of the parent undertaking, or the highest level of consolidation within the participating Member States. At the subsidiary level, the ECB considers that a non-significant institution can combine the risk committee with the audit committee. Chapter 9.4 sets out how the ECB intends to authorize, on a case-by-case basis, members of the management body of a credit institution to hold one additional non-executive directorship, in accordance with Article 91(6) of CRD IV. The provision sets out criteria to be met in making this determination. In June 2016, the ECB published the SSM Supervisory Statement on Governance and Risk Appetite, which summarizes the findings of a 2015 thematic review of internal governance and risk appetite at SI institutions. See EC 2 below for more detail.
EC2	The supervisor regularly assesses a bank’s corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	For SIs, governance is assessed on a continuous basis as part of SREP. The SREP is described in detail in CP 8. “Corporate Governance and Risk Management” is one of the four modules that make-up the SREP and includes (i) internal governance; (ii) risk framework and risk culture; and (iii) risk infrastructure, data and reporting. For the 2017 SREP, two new sub-categories were added on management body and outsourcing. All these SREP sub-categories and categories are rated from 1 to 4. These subcategory ratings flow up into a rating from 1 to 4 assigned for the whole block “Internal Governance and Risk Management.” The ECB is building a database of corporate governance practices for offsite analysis by completing a JST survey of banks’ governance practices and structures.” The tool will provide the JSTs with an overview of the main features of the applicable governance structure in all the 19 SSM countries as well as references to the main national provisions transposing the CRD requirements on governance aspects. The 2015 thematic review identified that most SIs still need to improve their governance and risk appetite frameworks (RAFs) to be in line with international best practices. The thematic review has allowed the ECB to identify follow-up supervisory actions for 2016/2017, as well as areas for forthcoming onsite inspections and aspects to focus on as part of the SREP process. As part of their ongoing supervision, JSTs are following up on the

	implementation of the actions included in the individual follow-up letters sent to banks. The supervisory response included "Standard follow-up" and "Enhanced follow-up" components. In 2017, the Supervisory Board was updated twice on the status of both the "Standard" and "Enhanced" recommendations (in March and June 2017). The "Enhanced follow-up" consists of two deep-dives for a sample of 24 institutions, focused on (i) the board's oversight role on the control functions (risk management, compliance, and internal audit); and (ii) risk appetite limits (assessment of the setting and monitoring of the limits on credit risk for material business lines of the institution); the enhanced follow-up followed the same approach as the 2015 thematic review (compliance check points to be assessment for all the institutions, individual assessments completed by an horizontal approach). Follow-up letters were sent to the 24 institutions in June/July 2017. The Supervisory Board was also provided with the main results of the review in June 2017. The yearly SREP will assess the implementation of all the measures and action plans that institutions have communicated. Governance is a top ECB priority. It will continue to foster consistent and high standards of governance in all institutions. Hence, the ECB will continue promoting dialogue with the boards through regular meetings and using a variety of tools to assess governance, including onsite inspections, documentation analysis, meetings, ongoing "fit-and-proper" assessments, etc. In addition, ECB supervisors may attend parts of board meetings as observers from time to time to see how the board functions and to convey some specific messages. Many of the lessons from the 2015 thematic review are also valid for the LSIs. The ECB is committed to a consistent approach across the SSM in close coordination with the NCAs and in accordance with the principle of proportionality. In the follow-up of the thematic review, the ECB will also continue to build on its policy recommendations and stances and work on the promotion of good practices. The ECB will also continue to play an active role at EU and international levels in the further development of international best practice standards.
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members
Description and findings re EC3	Analysis of the processes for nominating and appointing management body members is broadly encompassed by the ECB's SREP methodology for determining quantitative capital, liquidity and other supervisory measures. The SREP's Internal Governance and Risk Management block includes a sub-section on "Organizational Structure." This assessment focuses on the composition and functionality of the Board and the management body as well as in the evaluation of the different Board committees, particularly the (separate) Audit,

	Risk and Remuneration Committees, as well as the nomination, human resources, governance, ethics, and compliance committees, if established. This assessment is also measured against legislative requirements, EBA guidelines on the suitability of members of management bodies and international best practices and the conclusions from the June 2016 SSM Supervisory Statement on Governance and Risk Appetite (See EC 1). The thematic review is an example of the ECB's horizontal process for assessing board composition and effectiveness. Onsite supervisory procedures also require an assessment of internal governance.
EC4	Board members are suitably qualified, effective, and exercise their "duty of care" and "duty of loyalty."[74]
Description and findings re EC 4	The ECB carries out the fit-and-proper assessment of the suitability of members of management bodies of significant credit institutions and of key function holders (whenever national law permits this assessment), having regard to Articles 4(1)(e) and 16(2)(m) of the SSMR and Article 93 of the SSMFR. In the ECB's internal procedures, this topic is addressed every time there is an appointment of a new board member and of key function holders (where applicable) and in the assessment of internal governance in the SREP, and more specifically in the part on organizational structure and governance. For the countries that assess key function holders, these persons should be identified, and their qualifications and experience ascertained in the context of their competence in their position. Managers should be of good repute and have appropriate professional expertise and experience in a diversity of relevant areas, to ensure that collectively they can make sound, objective and independent decisions and judgments. Fit-and-proper suitability requirements are covered by Article 91 of CRD IV. This Article, however, does not provide any details on the different criteria, and remains silent as to the type of supervisory procedures that should be followed (e.g., the choice between *ex ante* supervisory approval of an appointment or *ex post* notification of an appointment to the supervisor). Consequently, when taking fit-and-proper decisions, the ECB applies the substantive fit-and-proper requirements laid down in the binding national law which implements Article 91 of CRD IV. Given that Article 91 is clearly a minimum harmonization provision, this transposition has been dealt with in different ways in the 19 Euro Area countries. Some countries also have gone beyond what is required by Article 91. The ECB published its Guide to Fit-and-proper Assessments in May 2017. The assessment of management boards is an ongoing process under the Guide's Principle 6—Interaction with

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

	ongoing supervision. The fit-and-proper assessment feeds into the ongoing supervision of the governance of an institution, especially regarding the composition and functioning of the management body. A fit-and-proper assessment may lead to a decision that needs to be followed up in ongoing supervision, while ongoing supervision in turn may provide input for a fit-and-proper assessment (especially regarding the collective suitability or independence of mind criteria) or lead to the reassessment of members of the management body.
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite[75] and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	In 2015, the ECB conducted a thematic review of governance and risk appetite. The governance and risk appetite thematic review was a significant step by the ECB and signaled to Sis the importance of internal governance and risk management and the central role boards play. The ECB horizontally assessed the adequacy of risk appetite in the context of strategic decision discussions; conflicts of interest policies; internal processes for communicating conflict of interest policies to staff; the board's understanding of the relationship between the risk appetite statement and the business strategy; the frequency of board reviews of risk appetite compliance; board and senior management clarity of understanding on which business lines pose the greater risk; and whether board/management assesses employee morale. The reviews supplemented the standard ongoing review of governance and risk management under pillar 2 of SREP (See CP8 EC3). The thematic reviews were intensive and intrusive. The ECB's findings highlighted deficiencies in corporate governance concerning qualifications and involvement of the supervisory board in oversight of management and made recommendations for strengthening internal audit reporting to the supervisory board of the institution The thematic review also involved a more in-depth assessment of selected SIs' understanding and implementation of the RAF as an integral part of its strategic discussions and decisions, as measured against international best practices. This standard was expressed in the June 2016 SSM Supervisory Statement on Governance and Risk Appetite. It states that the ECB expects boards to take a more active role both in the definition of the RAF and in its monitoring. A sound risk culture is a key part of a well-designed RAF. Risk appetite statements also are expected to be used to promote robust discussions on risk and strategic issues not only at the board but also within the risk management and internal audit functions. The ECB's SREP and its actual ongoing supervisory practices appropriately emphasize sound internal governance and risk management (See CP 8 Supervisory Approach and CP 9

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

	Supervisory techniques and tools). Supervisory documents the ECB provided to the assessors demonstrate appropriate attention is given to these matters.
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit-and-proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	A component of the 2015 thematic review was management board/executive board composition. The review assessed whether SIs maintained proper distinctions between the three management functions (managing the institution's activities, overseeing the institution's activities and setting the institution's general policy and strategy); whether members of the management board have the necessary experience, competencies, and integrity to manage the businesses and people under their supervision; and whether members of the management board are selected through an appropriate nomination or recruitment process which takes into account the qualifications required for the position in question. The ECB's recommendations asked SIs to improve the design and implementation of a succession plan for the management body; the process for selecting members of the management body; and enhancing the management body's capacity to independently challenge senior management as part of its supervisory and oversight function.
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	The ECB assesses whether a SI's management body actively oversees the design and operation of the remuneration system through Pillar 2 of the SREP and its ongoing supervision program. Under applicable ECB explanatory guides and EBA Guidelines a SI's compensation system and incentive structure should promote good performance, convey acceptable risk-taking behavior, and reinforce the bank's operating and risk culture. Compensation practices are part of a sound RAF. The institution's board is responsible for the overall oversight of the compensation system for the entire bank and must regularly monitor and review (at least annually) outcomes to ensure that the bank-wide compensation system is operating as intended and supports a sound risk culture. Furthermore, the ECB expects SIs to have a supervisory board-level remuneration committee to oversee the compensation system's design and operation on behalf of the board of directors. The remuneration committee should be constituted in a way that enables it to exercise competent and independent judgment on compensation policies and practices and the incentives created for managing risk, capital and liquidity. The ECB through the SREP regularly assesses whether a SI's management body actively oversees the design and operation of the remuneration system. The ECB applies the governing legal requirements and guidelines on remuneration in the context of SREP's

	internal governance subcomponents and as part of the SEP process. SIs are required to have compensation committees and to adhere to applicable requirements. The adoption of best practices, beyond legal minimums, is encouraged. Weaknesses are identified, and corrective action is expected. The 2016 SREP contained a new sub-category on remuneration policies and practices to be consistent with the approach contained in the EBA Guidelines. In addition, all JSTs were required to return a survey on the assessment of SIs' remuneration policies and practices in October 2016, in order to assess the SIs degree of compliance with the EBA's November 26, 2015 recommendations on Remuneration Policies and Practices[76] and the CRD IV requirements on remuneration as established in national legislation.
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	The EBA's 2017 Guidelines on Internal Governance (EBA/GL/2017/11), Chapter 6.3, generally provides that institutions should avoid setting up complex and potentially non-transparent structures that have no clear economic rationale or legal purpose or raise concerns that the structures might be used for a purpose connected with financial crime. It also states that when setting them up, the management body should understand such structures and their purpose, and the particular risks associated with them and ensure that internal controls are in place. These structures should be approved and maintained only when their purpose has been clearly defined and understood, and when the management body is satisfied that all material risks, including reputational risks, have been identified, that all risks can be managed effectively and appropriately reported, and that effective oversight has been ensured. The more complex and opaque the organizational and operational structure, and the greater the risks, the more intensive the oversight of the structure should be. The ECB assesses corporate and risk culture through the internal governance component of the SREP process and onsite inspections under the SEP. The EBA's October 30, 2017 revised draft Guidelines on Common Procedures (EBA/BS/2017/319rev1) directs competent authorities to assess whether the management body knows and understands the operational structure of the institution and the associated risks of complex structures. The Guidelines state that in setting own funds requirements, competent authorities should consider the risk arising from deficiencies in internal governance, including internal control, arrangements, and other deficiencies. The Guidelines also provide additional direction and considerations to competent authorities for assessing internal governance and institution-wide controls.

[76]https://www.bankingsupervision.europa.eu/banking/letterstobanks/shared/pdf/2015/151126_letter_variable_remuneration_policy.en.pdf?08e3df5728e6df4dcfa23e0d207c589a

	The ECB ensures that banks maintain detailed records on organizational structure and these are discussed with the management board. The information was shared with the assessors, including disclosing the data systems and the ability to massage the data and drill down on to determine affiliates.
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	The ECB has the power to remove members of the management boards of SIs who do not fulfill the requirements set out in relevant legislation. Article 16(2)(m) of the SSMR states that the ECB has the power to remove members at any time from the management body of credit institutions who do not fulfil the requirements set out in all relevant Union law, the national law transposing the Directives and the relevant national legislation. In practice, therefore, the ECB has the power to reassess the members of the management body of credit institutions and to potentially take a supervisory decision addressed to the institution to remove a member of the management body who no longer fulfills the suitability requirements. The ECB uses its supervisory process to identify weaknesses in management bodies and to recommend changes. The fit-and-proper authorization process is used to effect necessary changes.
Additional criteria	
AC1	Laws, regulations, or the supervisor require banks to notify the supervisor as soon as they become aware of any material and bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	Article 71 of CRD IV does not specifically require institutions to report breaches, but sets out arrangements to facilitate such reporting, such as rules to protect employees (from liability) who report. Article 71(1) states that competent authorities shall establish effective and reliable mechanisms to encourage reporting of potential or actual breaches of national provisions transposing this Directive. Article 94(1) of the SSMFR states that a significant supervised entity shall inform the relevant NCA of any new facts that may affect an initial assessment of suitability or any other issue that 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. The relevant NCA shall notify the ECB of such new facts or issues without undue delay. Article 94(2) continues that the ECB may initiate a new assessment based on the new facts or issues referred in paragraph 1 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 shall then decide on the appropriate action in accordance with the relevant Union law and national law and shall inform the relevant NCA of such action without undue delay. The ECB provided sample examples of where notifications occurred.

Assessment of Principle 14	Compliant
Comments	Credit institutions supervised by the ECB operate under a corporate governance legal structure that is governed by disparate national law requirements[77] supplemented by EBA Guidelines and ECB explanatory Guides as well as other best practice standards. The ECB has established clear regulatory expectations, which have been reinforced by horizontal reviews and ongoing supervision. A major emphasis has been on improving the qualifications and effectiveness of management bodies in developing and monitoring the institution's RAF and its role as a credible challenge to operating management. The ECB uses its supervisory process to identify weaknesses in management bodies and to recommend and effect changes. The ECB through the SREP regularly assesses whether a SI's management body actively oversees the design and operation of the remuneration system. The SI's compensation system and incentive structure should promote good performance, convey acceptable risk-taking behavior, and reinforce the bank's operating and risk culture. The ECB applies the governing legal requirements and guidelines on remuneration in the context of SREP's internal governance subcomponents and as part of the SEP process. SIs are required to have compensation committees and to adhere to applicable requirements. The adoption of best practices, beyond legal minimums, is encouraged. The ECB's in-depth onsite 2015 thematic review of Governance and Risk Appetite and its subsequent follow-up program provided a horizontal baseline view of industry practice. Assessors had access to anonymized files and noted that supervisory letters and directives appropriately draw attention to internal governance and RAF deficiencies. The letters are comprehensive. They also identify material weaknesses in the level and quality of supervisory data being reported to the management board and its audit and risk committees. The potential for conflicts of interests and weak governance was noted where the presence of dominant individual board members, lack of a direct reporting line for the internal audit function to the management board, and quality of board debate existed. The ECB also should be granted greater legal discretion to object to persons whose prior work experience and relationships may have made them not fully independent from management. Corrective action plans were closely monitored by the ECB. The recommendations of the thematic review and agreed action deadlines are improving standards at individually assessed SIs. The published summary of these reviews also informs NCAs and LSIs as to internal governance best practices. Work in this area is fully integrated into the SREP process's internal governance component and is continually assessed in ongoing SEPs.

[77] For example, Germany has a two tier (dual) board structure; Italy has not yet implemented CRD IV provisions on fit-and-proper.

	The ECB has a process for the assessment of "Fitness and Propriety" of management body members. The fit-and-proper authorization process is used to effect necessary changes in SIs' management bodies and key function holders. The legal framework, has been harmonized to the extent possible. However, the ECB's dependence on national law for its fit-and-proper assessment makes the process very complex, time consuming as it applies to all SIs, including non-material subsidiaries) and not fully harmonized. The recent approval by the Supervisory Board of the Delegation framework have reduced the board's burden of directly approving thousands of fit-and-proper determinations. However, it has not reduced the intensity or level of review. It is anticipated that risk-based assessment process (the alternative fit-and-proper process) would improve efficiency and timeliness. Further harmonization of national law along international best practice principles may be warranted as national law substantive and procedural practices vary among member states. Since the ECB's generally supervises at the consolidated level, internal governance standards for Financial Conglomerates (FCs) could be enhanced as only general risk considerations are outlined in the SSM Supervisory Manual.
Principle 15	**Risk management process.** The supervisor determines that banks[78] have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate[79] all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.[80]
Essential criteria	
EC1	The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that: (a) a sound risk management culture is established throughout the bank;

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

[79] 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.

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

	(b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	Art. 73 CRD requires banks 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 (ICAAP). Article 74 of CRD IV requires banks 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. The governance arrangements, risk management processes, and internal control mechanisms must be comprehensive and proportionate to the nature, scale, and complexity of the risks inherent in the business model and the institution's activities. Article 76 of CRD, on the treatment of risks, requires Member States to ensure that banks' management bodies approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks to which the institution is or might be exposed, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle. Member States must also ensure that the management body devotes sufficient time to consideration of risk issues. According to Article 123(2) of CRD IV, competent authorities shall require institutions to have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures in order to identify, measure, monitor and control transactions with their parent mixed-activity holding company and its subsidiaries appropriately. In some national jurisdictions, laws, regulations or administrative circulars set specific requirements on banks' risk governance and management, such as 'MaRisk' in Germany, Law 10/2014 and Circular 4/2004 in Spain, the CBI corporate governance code in Ireland, Circular 285/2013 in Italy, Banco de Portugal Notice. 5/2008, the Regulation on Internal Governance Arrangements, the Management body and the Internal Capital Adequacy Assessment Process for Banks and Savings banks in Slovenia.

A specific assessment on banks' risk management strategies is part of the overall assessment of internal governance of the SREP (explained in more detail in BCP 14).

The ECB determines whether banks have appropriate risk management strategies. To do so, element 2 of the SSM SREP methodology (internal governance and risk management assessment) serves as an overall review of the institution's operational and organizational structure, overall risk control and risk management framework and the technical architecture supporting the risk management framework and practice. The assessment covers three main aspects:

(i) the institution's internal governance framework (including key control functions such as risk management, internal auditing, compliance);

(ii) its risk management framework and risk culture; and

(iii) its risk infrastructure, internal data and reporting.

This element takes a wide perspective with a view to assessing a bank's overall organizational competence and capacity. This does not include the detailed assessment of the controls for specific risks to capital and to liquidity and funding, which is conducted for each specific risk category; the risk control framework at the risk category level is expected to be consistent with the firm-wide governance and risk management control framework.

The internal governance and risk management assessment is conducted in three phases:

Table 2. Internal Governance and Risk Management Assessment Process

Phase 1	Information gathering and preliminary analysis, mainly based on information provided by entity itself.
Phase 2	Compliance check of CRD articles relating to internal governance and risk management.
Phase 3	Supervisory Assessment including: • Internal Governance Assessment (Organization Structure, Internal Audit, Risk Management, and Compliance Function Assessment) • RAF and Risk Culture • Risk Infrastructure, Data Aggregation, and Reporting

The SSM SREP assesses both the adequacy and appropriateness of an institution's internal governance/risk management (IG) and that of the risk management and control (RC) that are in place at the risk factor level. This includes assessing how institutions monitor their risk exposures; identify the measures that need to be taken; and assess the adequacy of their internal policies, organization, and limits. Category-specific risk control arrangements that are assessed need to be consistent with the general internal governance/risk management at the level of the institution.

The next sections describe the more specific items to be considered by supervisors.

The Board and risk management

The management body in its management function will carry out periodic evaluations of the adequacy of the risk management function, possibly on the basis of the work performed by the internal audit department. Taking into account the size and complexity of the institution, the management body in its supervisory function should appoint a risk committee from among its own members to assist it with regard to all risk management issues. Senior management should ensure that the institution has an adequate independent risk management function that acts consistently along the lines defined by the management body in its management function. It should keep the management body in its management and supervisory function regularly and event-driven informed about risk management activities and controls. With due consideration to the proportionality principle, an institution can create specialized committees allowing it to gain a proper grasp of the risks resulting from its business activities.

The risk management function

The risk management function is defined as an independent function within the organization that supports the management body in designing and ensuring the adequate implementation of any strategies, processes, and procedures which may be required in order to ensure, in accordance with the institution's risk appetite, that any risks to which the institution is—or could be—exposed, and any interdependencies between these risks, at both individual and aggregate levels, are constantly identified, monitored, controlled, and reported. It also ensures that, where possible, mitigation measures are taken to ensure that such risks do not exceed the institution's risk appetite.

Governance of the risk management function

The responsibilities of the risk committee include the drawing-up of risk management policies and the definition of the institution's risk appetite for presentation to and approval by the management body in its supervisory function. Documents validated by the management body in its management function must clearly reflect the institution's risk management policies, in particular the existence of limits in relation to its risk strategy. Status and organization of the risk management function.

The risk management function should have the independence, proficiency and resources needed in order to fulfil its duties properly. In particular, SIs must appoint a Chief Risk Officer (CRO) at management committee level with distinct responsibility for risk management. Under the leadership of the CRO, the risk management function should, as a minimum, be responsible for designing the RAF and for monitoring the institution's compliance with it on an ongoing basis. While formal reporting lines may vary across institutions, the CRO should report and have direct access to the management body or the risk committee without impediment.

Some internal governance arrangements may involve the appointment of Chief Governance Risk Officer and Chief Credit and Market Risk Officer rather than one individual carrying out

	the role of CRO. Such arrangements may allow risk management oversight at a more granular level within the bank and are not necessarily considered a negative factor in the assessment. While no single risk management organizational model applies to all institutions (e.g., a centralized versus decentralized function), the structure should in all cases guarantee that the risk management function is sufficiently independent from the institution's commercial interests and risk-taking units and that it is up-to-date on market practices and commercial realities. Within a group there may be a number of organizational models for the risk management function (e.g., centralized versus decentralized). Nevertheless, each unit belonging to the group is expected to have an in-depth understanding of its risk profile and the resources and systems that are used to manage it. If a decentralized model is used, the group must take steps to develop a consolidated approach to its risk management. This guarantees an exhaustive overview of its risk profile, including interdependencies, so that there are no areas of risk that are not properly identified, monitored, and controlled. **Operation of the risk management function** The risk management function must have the appropriate human resources (competence and staffing) and technical resources to allow it to fulfil its duties. The risk assessment should seek to understand and assess the processes for identifying, measuring, monitoring, and supervising risks and identify what risk management tools are available. The function should develop policies, procedures, and methodologies to adequately identify and measure risks. On that basis, indicators and reporting documents should be designed. Special attention should be paid to new activities, especially when they are developed outside of the institution's traditional framework. To carry out adequate risk management, reliable risk management tools that can be based upon equally reliable data must be available. Furthermore, the monitoring and supervision of risks must be an integral part of the institution's culture and values. The "risk" dimension must be clearly taken into account in all of the institution's processes and developments. This awareness should be regularly tested. In this respect, in order for the institution to evaluate the adequacy of the risk control measures in place, it must define clearly the roles and responsibilities in this area and must put in place a structured CSA (control self-assessment) process. Risk management should be included in the audit universe of all the institution's functions and business activities and should thus be covered by regular internal audits. In addition, the "risk" aspect should be taken into account when the various internal audits are carried out outside the risk management function. It should be stressed that supervisors should satisfy themselves that the risk management framework passes the "use test," i.e., that it is not merely viewed as a regulatory compliance exercise.

	The management body in its supervisory function defines the risk management policies and determines the acceptable levels of risks that can be incurred, including under stress conditions. This process should include the whole range of risks to which the institution is exposed; it should not be confined to credit, market, liquidity, and operational risks, but should also include concentration, reputational, compliance, litigation and strategic risks, and all other risks that are material for the institution. In this context, JSTs should also consider whether potential findings and deficiencies stemming from the assessment of recovery plans should be considered as a symptom of weaknesses on institution-wide controls and reflected in the risk management assessment (i.e., issues detected in the related escalation process). In performing a risk management function assessment, a JST should be aware that a sound and consistent risk culture is one of the key elements of effective risk management. Implementing appropriate standards for professional and responsible behavior throughout the institution should help reduce the risks to which an institution is exposed. Reports by the risk management function that identify new risks or pre-existing risks that have not been managed must give rise to an adequate review of the internal controls and of risk mitigation measures in place. Reports regarding such risks need to be submitted to the management body. **Assessment of the risk management function** When assessing institutions on their risk management framework as a whole (and not per risk), JSTs assess whether the overall risk management framework is appropriate to both the scale and complexity of the institution. A JST should also look at whether the risk management function ensures that it is adequately staffed and sufficiently independent both in terms of quality and quantity of human resources that are allocated to the function, and if it maintains links with operational lines. As discussed above, the CRO is also assessed. The criteria are, among others, whether the CRO has the necessary experience and skill, bears the responsibility for risk management and is able to give the risk perspective significant weight within the institution with regard to significant business decisions. The management body must regularly evaluate (at least once a year) the adequacy of the risk management function, which has to report directly to the management body in its management function and must have access to the management body in its supervisory function. The risk management function's processes and internal controls, the quality of the reports it submits to the management body, and risk mitigation measures must also be periodically audited by independent auditors who are trained and competent in risk management. The management body in its supervisory function (or Board) must approve and regularly update the (group) risk strategy, the (group) business strategy, the RAF, capital plan, and internal capital allocation. In order to assess whether the Board of the institution recognizes the uncertainties attached to risk measurement, the JST needs to verify whether the bank

	establishes and maintains policies and processes for considering valuation adjustments for uncertainties. As noted in CP 14, an in-depth thematic review of Governance and Risk Appetite was conducted in 2015 across all SIs in the Euro Area. As a result of the review, in 2016 the ECB issued follow-up letters for all the institutions, listing concrete recommendations. The SSM has published expectations on the overall management framework and the duties of the different functions in the context of the internal process of allocating capital and liquidity: in January 2016, a letter was sent by the Chair of the ECB's Supervisory Board to the management of all SIs, detailing the ECB's supervisory expectations for banks' ICAAP and ILAAP. The letter covers, inter alia, aspects of governance, risk identification, inter-risk diversification, and stress testing. In recognition of the considerable room for improvement in banks' practices in this area, a second letter was sent in February 2017 to introduce two draft SSM Guides on ICAAP and ILAAP, as a first step in a multi-year project to develop comprehensive guidance for SIs on these themes. The Guides elaborate on the content of the first letter, providing a more structured and detailed description of the principles that should inform the two processes. The guides will be subject to a public consultation in the first half of 2018 and then implemented for SREP 2019. The overall framework does not explicitly address the important aspect of Board and senior management awareness of the uncertainties attached to risk measurement; this aspect has been touched—and addressed, when needed—within the 2015 thematic review and, as regards being informed on data inaccuracies and model limitations, in the thematic review on risk data aggregation (BCBS 239). In some cases, it was observed that the Board spent an inadequate amount of time on risk appetite and internal models. Generally, JSTs can get a sense of the Board 's awareness of such uncertainties through access to Board meeting minutes or direct participation in their meetings.
EC2	The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate: (a) to provide a comprehensive "bank-wide" view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank's risk management process.
Description and findings re EC2	See EC 1. The ECB requires banks to have comprehensive risk management policies and processes regarding all material risks.

	As part of the SREP assessment, JSTs are asked to assess whether the management body approves and regularly updates the institution's policies for taking up, managing, monitoring and mitigating the risks to which the institution is or might be exposed, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle. These themes are also typically discussed with the bank's top management (CEO, CFO, CRO, etc.) during periodical meetings. Reports by the risk management function that identify new risks or pre-existing risks that have not been managed must give rise to an adequate review of the internal controls and of risk mitigation measures in place. Reports regarding such risks need to be submitted to the management body. An important step on this review is the assessment of the RAF, to understand its use in strategic decision-making processes, considering that: (1) a bank's overall risk profile is ultimately driven by its RAF and its implementation; and (2) the RAF should link risks undertaken with the bank's risk capacity and strategic objectives. The management body should establish structures to ensure a high level of accountability and the translation of the RAF into clear incentives and constraints for business lines. It should also cover activities, operations and systems that fall within its risk landscape but are outside its direct control, including subsidiaries and third-party outsourcing suppliers. Dedicated SSM expectations on the RAF should also be considered as published in the SSM Supervisory Statement on Governance and Risk Appetite in June 2016, an outcome of the 2015 thematic review on this topic. From the processes perspective, supervisors must check if those implemented by the bank are adequate, especially considering the risk management function and the business lines, assessing their capability to provide a comprehensive "bank-wide" view of risk across all material risk types (including risk profile and systemic importance of the bank and risks arising from the macroeconomic environment). In performing a risk management function assessment, a JST should be aware that a sound and consistent risk culture is one of the key elements of effective risk management. Implementing appropriate standards for professional and responsible behaviour throughout the institution should help reduce the risks to which an institution is exposed. In this context, the JST should understand if the management body in its management function carries out periodic evaluations of the adequacy of the risk management function, possibly on the basis of the work performed by the internal audit department. Risk management should also be included in the audit universe of all the institution's functions and business activities and should thus be covered by regular internal audits. Regarding the business lines—the first line of defence—the JSTs must assess crucial aspects, for example, if the business lines managers ensure alignment between the

	approved risk appetite and decision-making processes of their business units and legal entities or if the business units actively monitor risk limits. Risk management tools start from the Risk Appetite Statement, which should explicitly set the boundaries within which the bank's management is expected to operate to achieve the bank's strategic business objectives. Again, a common risk language across the bank, expressed through qualitative statements and appropriately selected risk metrics, facilitates the acceptance and effective monitoring of the implementation of the RAF. Risk limits are important, but not the only relevant safeguard: while risk limits are essential for setting operational boundaries, they are not by themselves sufficient to ensure that the bank operates within its RAF. The provision of positive incentives, such as career advancement and compensation, for individuals who demonstrate strong risk management abilities helps promote a risk culture consistent with the RAF. Similar to the Risk Appetite Statement, risk limits should also be allocated on a bank-wide level as well as on a business line/product, division, or subsidiary level. It is critical for the risk limit setting exercise to consider not only individual risk types but also correlation and compounding effects between individual risks. By their nature, risk limits must be closely related to a bank's capital and liquidity plans and based on forward-looking assumptions. The assessors were able to observe the modus operandi of ECB offsite and onsite supervisors in the assessment of banks' risks through access to anonymized documents, such as SREP reports, internal monitoring reports and presentations, reports from (offsite) deep dives and (onsite) inspections on credit and market risk, follow-up letters to institutions, and ECB decisions.
EC3	The supervisor determines that risk management strategies, policies, processes and limits are: (a) properly documented; (b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank. The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank's Board where necessary.
Description and findings re EC3	**Risk management strategies, policies, processes, and limits should be properly documented** All necessary internal documents describing the bank's risk management framework should be requested by the supervisor in order to assess this framework. These documents include identification of structures concerning the risk management framework as well as the description of the strategy, policies, processes, and tools for managing risks. Furthermore, there should be adequate documentation and formalisation of the operation in place that

	can prove the establishment and on-going monitoring of risk appetite as well as material changes to existing risk appetite levels and regulatory expectations regarding risk appetite. To determine whether the risk management strategies, actions etc. are properly documented, the supervisor assesses the Risk Appetite Statement. It is by means of this Statement that a bank identifies material risks under normal and stressed conditions and sets out a clear and unambiguous view and intended actions about those risks, in line with its business strategy. In particular, it includes quantitative limits and more general qualitative statements that clearly outline motivations for taking on or avoiding certain types of risks, products, or regions. In the supervisory perspective, JSTs should assess if the Risk Appetite Statement is simple enough to be easily communicated and understood and, at the same time, sophisticated enough to be useful. It can be expressed through a series of documents. If that is the case, the supervisor will need to establish whether the Statement is coherent and comprehensive enough to enable the Board to form a view of the bank's risk appetite easily. The institution-wide Risk Appetite Statement is often the first step, but it must not be the last. An effective Statement should, at the least, be allocated to various business lines, divisions, and subsidiaries and closely aligned with their business plans. To accommodate this, the Statement must include quantitative metrics that can be easily aggregated and attributed to different business lines, divisions, or subsidiaries. **Risk management strategies, policies, processes, and limits should be regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles, and market and macroeconomic conditions** When assessing the RAF, an important question that needs to be assessed by JSTs is whether there are appropriate mechanisms in place to ensure that the risk appetite, risk management strategy, and business strategy are effectively aligned and embedded in decision-making and operations at all appropriate levels of the institution. This means that the mechanisms in place must be regularly reviewed and adjusted appropriately. Furthermore, the sets of limits in place (per risk category) in the organization must be consistent with the risk management strategy and risk appetite of the institution. JSTs need to assess how often risk management strategies are updated (per risk). When assessing the risk management and controls within the institution, it is important that the evaluation state whether there are any exceptions to the policies made, that such exceptions are identifiable and well recorded by the institution, and that issues related to them are being managed.

	Risk management strategies, policies, processes, and limits should be communicated Through the evaluation of the risk management framework and risk culture, JSTs assess the quality of the procedures in place to assist the Board and senior management in setting and communicating the institution's risk appetite and in monitoring compliance with these decisions. The level of communication with supervisors and general awareness and transparency of risk should be taken into consideration, as banks that have a very open communication strategy are likely to better manage their risk profiles. The Board and senior management should assess whether the institution's risk assessment framework as well as the business strategy are clearly understood and embraced by management and relevant staff and are effectively embedded in the decision-making and operation of the business. Open communication as well as collaboration should be promoted constantly in order to ensure that each employee's view is valued and the institution works together to strengthen risk-related decision-making. Communication is not only assessed with regard to the various levels of management; both vertical and horizontal communication and cooperation should be adequate in order to ensure effective sharing of information.
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 SSM SREP methodology, SI supervisors assess whether the senior management and the Board have both the knowledge and the information necessary to provide adequate oversight and fulfill their tasks within the institution and, therefore, are able to understand the nature and level of the risks that are being taken by the institution. These criteria are focused on risk management information: there should be adequate documentation and information on the operation of the Board specifically with regard to the establishment and on-going monitoring of risk appetite as well as material changes to existing risk appetite levels and regulatory expectations regarding risk appetite. This is also the case for management and business lines, as they will need to approve and periodically review the strategies and policies regarding to the risks to which they are exposed. Supervisors can assess the quality of a particular RAF by, for example, discussing with the Board and senior management how the institution's business strategy is related to the RAF, as well as how the risk appetite has had an impact on the institution's decisions. This includes reviewing other material, such as strategy and planning documents and Board reports, in the context of how the Board determines, implements, and monitors its risk appetite, so as to ensure that risk-taking is aligned with the Board-approved Risk Appetite Statement.

	As regards the management body's awareness of and responsibility for the relationship of risks to capital and liquidity, SI supervisors are requested to annually review and evaluate a range of relating key aspects listed in dedicated guidance on ICAAP and ILAAP. Among others, this guidance refers to the management board's and senior management's role in approving ICAAP/ILAAP structures, control environment, documentation, outcomes, and the definition of capital and liquidity adequacy. Supervisors need to judge what role the ICAAP/ILAAP plays in the management body and senior management decision making and capital planning, strategy and risk appetite setting. Furthermore, supervisors assess to what extent the ICAAP/ILAAP assumptions and methodology are understood and discussed. The assessment about the implementation of risk reporting entails analysis of whether the bank ensures that its IT strategy includes ways to improve risk data aggregation capabilities and risk reporting practices and to remedy any shortcomings, and whether the bank's senior management identifies data critical to risk data aggregation and IT infrastructure initiatives through its strategic IT planning process, and supports these initiatives through the allocation of appropriate levels of financial and human resources. JSTs should put themselves the following questions: - Does senior management ensure that the bank's IT strategy includes ways to improve risk data aggregation capabilities and risk reporting practices and to remedy any shortcomings without delay? - Does the bank's data architecture and IT infrastructure fully support its risk data aggregation and risk reporting practices not only in normal times but also during times of stress or crisis? ECB banking supervision has conducted a thematic review on BCBS 239 "Principles for effective risk data aggregation and risk reporting," as part of the SSM priorities for 2016–17, to assess compliance with the BCBS principles. As part of this activity, the ECB conducted 'fire drills' aimed at verifying the ability of banks to collect and aggregate the requested information; highlighting gaps and shortcomings in the data extraction and aggregation process; and raising the board's and senior management's awareness of the limitations in their ability to obtain an accurate and complete picture of the risks incurred by their institution.
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	ICAAP and ILAAP are reviewed and evaluated as part of the SREP on an annual basis. The results of this SREP assessment feed into the SI SREP assessment and they are used for determining pillar 2 capital and liquidity requirements for SIs.

	As noted in EC 1, in January 2016 the Chair of the ECB's Supervisory Board wrote to the management of all SIs, detailing the ECB's supervisory expectations on the banks' ICAAP and ILAAP processes. The letter covers, inter alia, the aspects of governance, risk identification, inter-risk diversification, and stress testing. In recognition of the considerable room for improvement in banks' practices in this area, a second letter was sent in February 2017 to introduce two draft SSM Guides on ICAAP and ILAAP, as a first step in a multi-year project to develop comprehensive guidance on these themes for SIs. The Guides elaborate on the content of the first letter, providing a more structured and detailed description of the principles that should inform the two processes. The SREP methodology foresees an intensive assessment of the reliability of institutions' ICAAP and ILAAP using, among others, information on ICAAP/ILAAP which is collected annually for all SIs. Unreliable ICAAPs (weak or inadequate) may impact on the Element 2 score. For the ICAAP reliability assessment, supervisors assess institutions' methodology and processes alongside dedicated assessment guidance, which comprises a questionnaire and a template for documentation of the assessment results. In addition, supervisors are provided with risk quantification proxy tools for the major risk categories, which the supervisors should use when entering a dialogue about the reliability of institutions' ICAAPs (see also BCP 16). The assessment of the ICAAP is, however, not limited to the quantitative part, i.e., assumptions and mathematics for producing figures. The following factors are considered equally important in the qualitative assessment of the ICAAP governance: management board responsibility, use of ICAAP for decision making, setting the RAF and the strategies, etc. The approach for assessing liquidity adequacy is similar to the ICAAP assessment approach, with the caveat that there are currently no supervisory quantification proxies to provide a quantification range for the ILAAP. Conceptually liquidity and funding requirements cannot simply be added: they should be viewed together for a comprehensive picture. Both capital and liquidity adequacy are also assessed under stressed circumstances.
EC6	Where banks use models to measure components of risk, the supervisor determines that: (a) banks comply with supervisory standards on their use; (b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and (c) banks perform regular and independent validation and testing of the models The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.

Description and findings re EC6	The SSMR confers specific tasks on the ECB including to ensure compliance with prudential requirements on credit institutions in the area of own funds and to carry out supervisory reviews. To this end, the SSMR provides that: • the ECB shall have the relevant supervisory powers, and in particular it may, on the basis of a formal decision and "subject to prior notification to the national competent authority concerned, conduct all necessary onsite inspections at the business premises" of the credit institution and that, "where the proper conduct and efficiency of the inspection so require, the ECB may carry out the onsite inspection without prior announcement to those legal persons" (Article 12(1)); • the inspectors authorised by the ECB to conduct an onsite inspection "shall have the right to (a) require the submission of documents; (b) examine the books and records of the persons referred to in Article 10(1) and take copies or extracts from such books and records; (c) obtain written or oral explanations from any person referred to in Article 10(1); (d) interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation" (Article 11(1)); and • if an onsite inspection "requires authorisation by a judicial authority according to national rules, such authorisation shall be applied for" in compliance with specific rules (Article 13). In the SREP process, ECB banking supervision assesses the adequacy of internal governance and risk management. Where banks use models to measure components of risk, the ECB determines whether the bank has established procedures and controls for the use of risk assessment methodologies. If so, JSTs are asked to describe the system in detail on basis of several questions in phases 2 (an automated rating process that serves as an anchor point) and 3 (a supervisory assessment that relies on the JST's expert judgment) of the risk control assessment. Furthermore, these models will be assessed on whether they are integrated into daily risk management and if they serve to identify, measure, and report the risks as well as setting limits. In answering the phase 3 questions, JSTs need to identify if the institution performs testing of the model, i.e., through stress testing and back testing, if the models are adequate, and if staff can use them effectively. In order for the ECB to assess whether the model outputs by banks appear reasonable as a reflection of the risk assumed, the Risk Analysis Division of DG MS IV enables JSTs to benchmark the institution against other peer groups and supports JSTs in their ad hoc analyses. This enables an early engagement to identify and rectify possible deficiencies and remediation of issues. Models used by SIs under Pillar I are monitored with the involvement of the JST and/or the Internal Model Division (INM). ECB banking supervision is currently working on a TRIM exercise, whose overall objective is to enhance the credibility and to confirm the adequacy and appropriateness of approved Pillar I internal models for credit, market, and CCR of all SIs using internal models within the SSM, with a view to ensure compliance with regulatory requirements and to harmonise

	practices. TRIM is an SSM-wide project jointly performed by the ECB and NCAs, with consultancy support, and is planned to run for three years. The preparatory phase was completed in Q1.2017 and is followed by targeted onsite investigations for credit, market, and CCR models, which started in Q2.2017 and will continue until 2019. Model experts from INM Division and respective colleagues from NCAs have initiated a project directed at the ongoing monitoring of credit and operational risk models for all institutions in the SSM. The objective of the project is (1) to promote a standardised reporting of institutions' validation results to the ECB based on a common set of statistical metrics and (2) to provide JSTs with effective tools for the prioritisation and execution of ongoing model monitoring tasks. The validation reporting is considered to be supplementary to and will not replace the existing internal validation activities performed by the institutions in accordance with regulatory requirements. A one-year pilot phase was launched in April 2017 with a selected number of participating institutions from the target group in order to analyse and refine the metrics used and to establish a framework for supplementary validation reporting for the future. The assessors had the opportunity to see a few anonymized reports from internal model investigations and the related follow-up letters; the evidence shows the thoroughness of the SSM internal model assessment process.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing, and reporting on the size, composition, and quality of exposures on a bank-wide basis across all risk types, products, and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	In order to assess the information systems of the institution, JSTs are required to examine data aggregation and reporting of the credit institutions within Element 2 of the SREP, which covers the risk infrastructure. This assessment can also be carried out by making occasional requests for information on selected risk issues with short deadlines to test the capability of the banks to aggregate risk data rapidly and produce risk reports. In this context, the risk management function is also expected to have technical resources to understand and assess the processes for identifying, measuring, monitoring, and supervising risks. An adequate risk management should be based on reliable risk management tools and reliable and available data. Hence, a bank should design, build, and maintain a data architecture and IT infrastructure that fully support its risk data aggregation capabilities and risk reporting practices not only in normal times but also during times of stress or crisis. Senior management should ensure that the bank's IT strategy includes ways to improve risk data aggregation capabilities and risk reporting practices and to remedy any shortcomings. Senior management should also identify data critical to risk data aggregation and IT

	infrastructure initiatives through its strategic IT planning process, and support these initiatives through the allocation of appropriate levels of financial and human resources. The implementation of highly developed risk data infrastructures requires more automation and fewer manual workarounds, two important conditions that can improve the accuracy and timeliness of risk data aggregation. While some manual interventions might be necessary, a move toward more automation and fewer manual processes increases senior decision-makers' ability to rely on risk information. As soon as it is practically possible, disparate IT systems acquired through a new business or mergers and acquisitions activity should be integrated with bank-wide systems and infrastructure. Business line management and senior IT managers should make it a priority to develop an integration plan consistent with the goal of providing accurate and comprehensive risk reporting to senior decision-makers. If integration is not seen as a priority, critical risk data may sit in legacy systems and be treated separately from, and inconsistently with, the existing bank-wide risk metrics reviewed by the senior leadership team. A bank's risk infrastructure framework should include service-level agreements for both outsourced and in-house risk data-related processes, and policies on data confidentiality, integrity, and availability. The information systems, IT infrastructure, and processes in place should provide adequate, reliable, timely, and comprehensive information to the Board and senior management for risk identification and monitoring purposes. Reporting within the institution is also assessed by JSTs: risk management reports should accurately and clearly present aggregated risk data to reflect risk in a precise manner while covering all material risk areas within the organization. When reviewing a bank's reporting capability, JSTs should expect reports to be consistent with the size and complexity of the bank's operations and risk profile, as well as the requirements of the recipients. Reports should be regularly validated and reconciled and amended to reflect changes in the bank's portfolio, organization, and activities. In order to be useful and easy to understand, reports should communicate information in a clear and concise manner while remaining comprehensive enough to facilitate informed decision-making, and should be tailored to the needs of the recipients. Reports should be distributed to the relevant parties while ensuring confidentiality. Ultimately, the Board and senior management will set the frequency of risk management report production and distribution. Such frequency should reflect the needs of recipients, the nature of the risk reported and the speed at which the risk could change. In determining reporting frequency, the Board and senior management should align the report production

	and decision-making processes across the bank, supporting sound risk management and effective and efficient decision-making. During times of stress/crisis the bank should be able to quickly increase the frequency of the report production process without significantly changing its infrastructure or reducing the quality/granularity of the information. When looking at the reporting system, an important aspect is to assess whether the IT infrastructure is adequate for the institution. In the context of the risk management process, to ensure appropriate and effective reports to the bank's Board and senior management, it is essential to incentivise active promotion and communication of the RAF throughout an organization (this is the key link between the RAF assessment and the bank's risk culture). Correct information is the pillar for developing a RAF and facilitating discussion at high level about the risks faced. This is the reason why, similarly, the RAF is critically linked to a bank's IT and reporting capability: an effective RAF must enable the bank to easily obtain key information on its risk capacity, risk appetite, risk limits, and risk profile across business lines and subsidiaries. To achieve this objective, the RAF should strongly influence the development of IT and management information systems (MIS). Typically, such systems should be able to produce management information reports on a quarterly, monthly, weekly, or even a daily or intraday basis if that is appropriate for the type of risk. These reports play a critical role in preventing business decisions that would unknowingly put the bank beyond its current risk appetite. The adequacy of the MIS is assessed by determining whether the MIS allow an accurate, timely identification, aggregation, monitoring, and reporting of the (various) risk exposures. Preliminary findings from the thematic review on BCBS 239 principles show the importance of assigning responsibility for data quality assurance at a sufficiently high managerial level and how the appointment of a Chief Data Officer (CDO) with adequate responsibilities and resources can represent good practice in this direction. The assessors were shown the conclusions of two anonymized reports from onsite inspections on internal and external reporting quality, as an example of the attention assigned to this topic by JSTs (the units requesting inspections) and the professional competence of the onsite teams in conducting the investigation.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products,[81] material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model, and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these

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

	risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	In order to determine whether a bank's Board and management understand the risks, supervisors must first of all assess whether the management function has the appropriate human resources (competence and staffing) and technical resources to allow it to fulfil its duties. The risk assessment should seek to understand and assess the processes for identifying, measuring, monitoring, and supervising risks and identify what risk management tools are available. The function should develop policies, procedures and methodologies to adequately identify and measure risks. On that basis, indicators and reporting documents should be designed. Special attention should be paid to new activities, especially when they are developed outside of the institution's traditional framework. Reports by the risk management function that identify new risks or pre-existing risks that have not been managed must give rise to an adequate review of the internal controls and of risk mitigation measures in place. Reports regarding such risks need to be submitted to the management body. The supervisor will focus on assessing, firstly, whether the overall risk management framework is appropriate to the scale and complexity of the institution and, secondly, whether the (group) risk strategy, (group) business strategy, RAF, capital plan and internal capital allocation are approved and regularly updated so that possible changes in activities go through the management functions.
EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the banks' Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	Article 76(5) of CRD IV requires Member States to ensure that: • institutions have a risk management function independent from the operational functions and which shall have sufficient authority, stature, resources, and access to the management body; • the risk management function ensures that all material risks are identified, measured, and properly reported; • the risk management function is actively involved in elaborating the institution's risk strategy and in all material risk management decisions and can deliver a complete view of the whole range of risks of the institution; • the risk management function, where necessary, can report directly to the management body in its supervisory function, independent from senior

	management, and can raise concerns and warn that body, where appropriate, where specific risk developments affect or may affect the institution, without prejudice to the responsibilities of the management body in its supervisory and/or managerial functions; • the head of the risk management function shall be an independent senior manager with distinct responsibility for the risk management function. The EBA's SREP guidelines require competent authorities to assess whether the institution has established an effective independent internal audit function that, inter alia, adequately covers all necessary areas in the risk-based audit plan, including the areas of risk management, internal controls, ICAAP, and ILAAP (Paragraph 105e). The supervisor determines whether the risk management function in place has the appropriate human resources (competence and staffing) and technical resources to allow it to fulfil its duties. A strong and well-functioning management team is essential to overall performance and resilience. In order to determine whether risk management is performing its duties in a well-functioning and effective way, the different levels of management are assessed accordingly as well as the communication between the different levels. For supervisors, meetings with banks and their key functions holders (e.g., CRO) can be a useful tool to assess the risk management process according to these criteria. Furthermore, the Board must also ensure that an adequate control framework, which includes risk control, compliance, and internal audit functions, as well as appropriate frameworks for financial reporting/accounting, key appointments planning, is in place. There must be cohesive and effective cooperation between the management body and the horizontal functions (compliance, audit, and risk). Within the framework of their duties and responsibilities, the management body in its supervisory function and the management body in its management function must take any steps necessary to ensure that the institution always has an adequate internal audit function, which would therefore be able to audit the risk management function. The supervisor will need to assess the reporting lines within the institution, for example whether the CRO or equivalent reports (and has direct access) to the management body and the risk committee. The supervisor assesses whether there is a clear segregation between the risk-taking and the risk-management functions, per risk category.
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a CRO or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval

	of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	Article 76(5) of CRD IV requires that "The head of the risk management function shall not be removed without prior approval of the management body in its supervisory function and shall be able to have direct access to the management body in its supervisory function where necessary." The EBA's SREP guidelines require competent authorities to assess whether the institution has a CRO with a sufficient mandate and independence from risk-taking, and exclusive responsibility for the risk control function and the monitoring of the risk management framework (Paragraph 104f). The ECB requires SIs to appoint a CRO at management committee level with distinct responsibility for risk management. Under the leadership of the CRO, the risk management function should be, as a minimum, responsible for designing the RAF and for monitoring the institution's compliance with it on an ongoing basis. Some internal governance arrangements may involve the appointment of Chief Governance Risk Officer and Chief Credit and Market Risk Officer rather than one individual carrying out the role of CRO. Such an arrangement may allow risk management oversight at a more granular level within the bank and is not necessarily considered a negative factor in the JST's assessment. When assessing the bank's CRO, JSTs do not only look at the CRO's experience and skills, but also whether (s)he bears exclusive responsibility for risk management and, given his or her personal skills and status within the institution, whether (s)he is able to give the risk perspective significant weight in all significant business decisions. At EU-wide level there is no requirement that the removal of CROs must be discussed with the supervisor nor that such a removal must be disclosed publicly; the assessors could not verify whether either or both of these requirements are envisaged in national laws or regulation in individual Member States.
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, IRRBB, and operational risk.
Description and findings re EC11	CRD IV addresses all risks that can be classified as material for almost all institutions: credit risk (Article 79), market risk (Article 83), interest rate risk Article 84), operational risk (Article 85), and liquidity risk (Article 86). Standards on these risks are then issued at national level, as part of the transposition of the Directive into the legal framework of each Member State; consequently, there is room for a non-harmonized codification of these standards, in terms of both legal instruments (guidelines, circulars, regulations, primary, or secondary legislation) and content.

	The EBA's SREP guidelines provide a set of recommendations for supervisory assessment related to risk management of the specific risk categories listed in this EC. ECB banking supervision has published its supervisory expectations on ICAAP and ILAAP as well as a number of other documents that provide indications on its expectations regarding the management of different categories of risk. The TRIM guide, for example, contains indications relevant for banks with approved internal models, while the NPL guidance provides indications on the management of problem loans applicable to all banks. However, these documents neither cover the whole spectrum of risks listed in this EC, nor ensure that banks can be held to comply with them, given the potential overriding by national (binding) legal provisions. As explained by the ECB in the introduction to the NPL guidance, "This guidance does not intend to substitute or supersede any applicable regulatory or accounting requirement or guidance from existing EU regulations or directives and their national transpositions or equivalent, or guidelines issued by the EBA. Instead, the guidance is a supervisory tool with the aim of clarifying the supervisory expectations regarding NPL identification, management, measurement and write-offs in areas where existing regulations, directives or guidelines are silent or lack specificity. Where binding laws, accounting rules and national regulations on the same topic exist, banks should comply with those."
EC12	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	Each institution or group has to maintain a recovery plan that includes measures to restore its financial situation following deterioration. In particular, in line with Articles 5 and 7 of the BRRD, the ECB requests each bank under its direct supervision to draw up and maintain recovery plans that include a range of recovery options, as well as the appropriate conditions and procedures to ensure their timely implementation. Recovery plans should also contemplate a range of scenarios of severe macroeconomic and financial stress relevant to the institution's specific conditions, including system-wide stress events, and include a framework of indicators that identify the trigger levels for deciding about taking appropriate recovery actions and their monitoring. Details on the design and content of recovery plans are laid down in Annex 1 of the BRRD, and guidelines and technical advice have been issued by the EBA (Guidelines on the range of scenarios to be used in recovery plans; Guidelines on the minimum list of qualitative and quantitative recovery plan indicators; Commission Regulation 2016/778; Guidelines on the application of simplified

	obligations) and on its own initiative (Recommendation on coverage of entities in group recovery plans). In line with Article 5 of the BRRD, the ECB requires banks under its direct supervision to update their recovery plans at least annually or after a change to their legal or organizational structure, their business or their financial situation, which could have a material effect on, or necessitates a change to, the recovery plan. The ECB can require more frequent updates if other significant changes occur. For 2016 and 2017, the ECB has approved a timeline for requesting and assessing recovery plans from banks under its direct supervision. In line with Articles 6 and 8 of the BRRD, the ECB is responsible for reviewing a recovery plan within six months of its submission. The assessment is focused on whether the implementation of the arrangements proposed in the plan is reasonably likely to maintain or restore the viability and financial position of the institution or of the group; and whether the plan and specific options within the plan are reasonably likely to be implemented quickly and effectively in situations of financial stress and avoiding to the maximum extent possible any significant adverse effect on the financial system, including in scenarios that would lead other institutions to implement recovery plans within the same period. When assessing the appropriateness of the recovery plans, the ECB takes into consideration the appropriateness of the institution's capital and funding structure to the complexity of the organizational structure and the risk profile of the institution. In addition, recovery plans are considered to be a governance arrangement within the meaning of Article 74 of CRD IV and are also included in the SREP. In particular, in line with the final EBA guidelines on common procedures and methodologies for the SREP, when assessing internal governance and institution-wide controls, the ECB takes into account any findings and deficiencies identified in the assessment of recovery plans. Similarly, findings from the assessment of SREP elements, including internal governance and institution-wide control arrangements, inform the assessment of recovery plans. The operationalization of the assessment process for group plans depends on whether the institution has subsidiaries outside participating Member States. In particular, if the institution has no such subsidiaries, the assessment of the recovery plan is performed by the JSTs. Alternatively, if the group does have such subsidiaries, the recovery plan is reviewed by the relevant supervisory college through a joint decision process in line with Article 8 of the BRRD (both in cases where the ECB is home or host supervisor). Where the ECB is the only supervisor or the home supervisor for the EU group, the JSTs communicate to the institution any recommendations or changes to be included in the plan. The assessment of recovery plans also involves input from the resolution authority. In particular, the ECB provides the recovery plan to the SRB, which examines it with a view to

	identifying any actions that may adversely impact the resolvability of the institution. The SRB can make recommendations to the ECB with regard to those matters. Where the ECB concludes that there are material deficiencies in the recovery plan, or material impediments to its implementation, it notifies the institution of its assessment and requires the institution to submit, within two months (which could be extended by one month), a revised plan demonstrating how those deficiencies or impediments are addressed. Where the ECB does not consider the deficiencies and impediments to have been adequately addressed by the revised plan, it may direct the institution to make specific changes to the plan. If the institution fails to submit a revised recovery plan, or if the ECB determines that the revised recovery plan does not adequately remedy the deficiencies or potential impediments identified in its original assessment, and it is not possible to adequately remedy the deficiencies or impediments through a direction to make specific changes to the plan, the ECB shall require the institution to identify within a reasonable timeframe changes it can make to its business in order to address the deficiencies in or impediments to the implementation of the recovery plan. If the institution fails to identify such changes within the timeframe set by the ECB, or if the ECB assesses that the actions proposed by the institution would not adequately address the deficiencies or impediments, the ECB can direct the institution to take any measures it considers to be necessary and proportionate, taking into account the seriousness of the deficiencies and impediments and the effect of the measures on the institution’s business. The above escalation procedure is operationalized through a flow chart that includes the interaction between banks and the ECB and the internal ECB processes for the assessment of recovery plans. In addition to recovery plans, the ECB has put in place additional contingency arrangements in order to ensure that banks can adequately address risks that may materialize in stress conditions and could pose a serious risk to their viability. In particular, in line with Article 85 of CRD IV, the ECB requests the institutions under its direct supervision to have in place contingency and business continuity plans that ensure that an institution is able to operate on an ongoing basis and limit losses in the event of severe business disruption. Moreover, in line with Article 86(10) of CRD IV, the ECB requires the institutions under its direct supervision to develop effective liquidity contingency plans in order to ensure that institutions have in place robust policies, processes, and systems for managing and monitoring liquidity risk. These plans should be proportionate to the complexity, risk profile, and scope of operation of the institutions. Within the SREP, the ECB regularly carries out a comprehensive assessment of the overall liquidity risk management by institutions (Article 98(2) of CRD IV), including the effectiveness of their contingency plans. The assessors were able to briefly analyze two anonymized decisions on recovery plans, accompanied by detailed assessments of the plans.

EC13	The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program: (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. The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process.
Description and findings re EC13	Article 86(9) of CRD IV requires competent authorities to ensure that institutions consider the potential impact of institution-specific, market-wide, and combined alternative scenarios for liquidity risk, possibly considering different time periods and varying degrees of stress conditions. According to Article. 98(1e) of CRD IV, the SREP should also consider the exposure to, measurement and management of liquidity risk by institutions, including the development of alternative scenario analyses, the management of risk mitigants (in particular the level, composition and quality of liquidity buffers) and effective contingency plans. Article 177 of the CRR sets the requirements for stress tests used by IRB banks in the assessment of capital adequacy. Article 221 of the CRR requires banks using the Internal Models Approach for master netting agreements to frequently conduct a rigorous program of stress testing, and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets. Article 290 of the CRR sets stress testing requirements for banks using the internal model method for counterparty credit risk. Article 302 requires banks to assess, through appropriate scenario analysis and stress testing, whether the level of own funds held against exposures to a central counterparty adequately relates to the inherent risks of those exposures. Article 368 sets stress-testing requirements for banks using internal models for market risk, while Article 407 sets stress-testing requirements for banks investing in securitization positions.

	In line with EBA guideline 2014/13 and EBA guideline 2010/32 on stress testing, institutions need to develop their own stress-testing programs and demonstrate to supervisors how they use the outcomes for risk management and internal liquidity adequacy assessment purposes. However, the EBA stress-testing guidelines do not cover all the elements of this EC; a broader coverage of this EC is provided by some national laws or regulations (e.g., in Germany, Spain, Latvia, Portugal). The reliability of banks' ICAAP and ILAAP is assessed in accordance with the SSM's SREP methodology; the supervisor challenges the banks' internal assessment of their capital and liquidity needs. In assessing the use of stress testing by the bank, JSTs verify in particular whether the tests are conducted regularly, if they are reported to the board, if the tests are frequent, if the outcome of the testing is integrated in the overall risk management framework (for capital and liquidity), if assumptions and scenarios are regularly reviewed and updated, if different horizons are implemented for liquidity stress tests (institution-specific, market-wide, and possible combinations) and if the stress testing has an impact on individual level as well as on the group-wide position. Another factor that is assessed by the supervisors is the management of capital and liquidity positions, namely by documenting the procedures, the reports, and limits (see also EC 3 and EC 4).
EC14	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement, and new product approval process for all significant business activities.
Description and findings re EC14	According to Article 92(2a) of CRD IV, banks' remuneration policies must be consistent with and promote sound and effective risk management and not encourage risk-taking that exceeds the level of tolerated risk of the institution. According to Article 94(1b) of CRD IV, the assessment of performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period that takes account of the underlying business cycle of the credit institution and its business risks; in addition, the allocation of the variable remuneration components within the institution shall also take into account all types of current and future risks (Article 94(1k)). As part of the qualitative assessment of liquidity risk within the SREP, JSTs question how the transfer pricing system is embedded in institutions' governance and internal reporting, including product approval processes. Within its "SSM supervisory statement on governance and risk appetite" (June 2016), the ECB has made explicit its supervisory expectations regarding the RAF, clarifying, in particular, how RAFs should be used to guide behavior towards risk awareness: variable remuneration should be linked and conditioned to some risk factors, both ex ante (key risk-related performance indicators used as an input to calculate variable remuneration) and ex

	post ("malus" provisions in the event of non-compliance with key risk indicators). Recommendations emerging from the thematic review address in particular the need to strengthen the link between risk and remuneration in line with Article 94 CRD IV, improving the implementation of risk indicators in the calculation of remuneration, the transparency of the remuneration system and its ability to be understood by the employees." In the EU-wide framework there is no explicit requirement for banks to appropriately account for risks (including liquidity impacts) in their new product approval process. The assessors received an anonymized presentation of the main findings and recommendations of a deep dive on transfer pricing conducted by a JST.
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	As part of developing a supervisory view on bank-specific factors, the SREP also entails the assessment of other material risks such as reputational and strategic risks, based on a "holistic approach" to risks: the SSM SREP allows JSTs to take into account the specific features of an institution or the specific developments it could be faced with. JSTs need to include any other risk types (beyond those explicitly considered in the SREP methodology) that are material to the supervised institution in their risk assessment. In defining the risk management policies and determining the acceptable levels of risk, the management body in its supervisory function is expected to include the whole range of risks to which the institution is exposed, including strategic and reputational risk. The strategy concerning reputational risk is also overseen by the risk committee, as it needs to be consistent with the stated risk appetite. Reputational risk is considered a sub-category of operational risk in the SREP methodology and is taken into consideration also in business model analysis for its impact on business model viability.
Assessment of Principle 15	Largely Compliant
Comments	CRD IV addresses all the main risk categories that are likely to be material for almost all institutions, such as credit risk, market risk, interest rate risk, operational risk, and liquidity risk. Standards on these risks are then issued at national level, as part of the transposition of the Directive into the legal framework of each Member State; consequently, there is room for a non-harmonized codification of these standards, in terms of both legal instruments (guidelines, circulars, regulations, primary or secondary legislation) and content.

	ECB banking supervision has published a number of other documents that provide indications about its expectations regarding the management of different categories of risk; however, these documents neither cover the whole spectrum of risks listed in this CP, nor ensure that banks can be held to comply with them, given the potential overriding by national (binding) legal provisions. As explained by the ECB in the introduction to the NPL guidance, "Where binding laws, accounting rules and national regulations on the same topic exist, banks should comply with those." In addition, there are some elements of this CP that are not covered at all at EU level and that might also be missing in some (or most) national legal frameworks, such as: • the need for Board and senior management awareness of the uncertainties attached to risk measurement (EC 1 and 4); • the requirement for the removal of CROs to be discussed with the supervisor and for such a removal to be disclosed publicly (EC 10); • certain requirements on stress testing, such as the need for stress testing programs to actively involve the Board and senior management and to be appropriately documented and regularly maintained and updated (EC 13); and • the requirement for banks to appropriately account for risks (including liquidity impacts) in their new product approval process (EC 14). The practice of supervision within the SSM demonstrates how JSTs, onsite inspection teams and internal model investigation teams strive to overcome any gap in the regulatory framework by correctly adopting an extensive interpretation of their role in ensuring sound management and coverage of risks by banks. However, a more complete and harmonized regulatory framework on risk management would mitigate the risk of unnecessary distractions in the performance of supervisory tasks caused by the need to deal with an incomplete and heterogeneous set of rules; it would also facilitate banks' understanding of supervisory expectations and possibly improve the quality of the supervisory dialogue. This situation would require two different kind of interventions: first, the responsibility to define the standards on the different categories of risk should be assigned to competent authorities (e.g., by moving to the CRR the CRD IV Articles from 79 to 87); secondly, the ECB should issue a comprehensive document on risk management that collects, structures, and reorganizes all existing guidelines, letters and other documents issued so far and completes them with further indications on areas not covered yet. While only the first type of intervention would guarantee full harmonization of supervisory standards on risk management in the SSM through binding legal instruments, the second could still prove useful in setting the direction of and providing clarity about the supervisory expectations of the ECB.

Principle 16	**Capital adequacy.**[82] The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC 1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	The CRR establishes the requirements for calculating prescribed capital requirements (Part Three, Articles 92–386), including thresholds by reference to which a bank might be subject to supervisory action and which banks are required to satisfy at all times (Article 92(1)). Part Two of the CRR defines the components of capital following the Basel-based capital tier structure, which reflects varying degrees of loss absorption capacity, and the deduction requirements. These provisions are supplemented and further specified by Delegated Regulations (EU) No. 241/2014, 2015/850, and 2015/923 (including the RTS on own funds Parts 1 to 4), and by delegated acts of the EU Commission. Also, Article 54 of the CRR provides for the write-down or conversion of Additional Tier 1 instruments when the Common Equity Tier 1 (CET1) ratio of a bank falls below 5.125 percent. These requirements are directly applicable by the ECB to supervised banks, based on its supervisory powers under Article 16(2) of the SSMR (which largely reflect the provisions of Article 104 of CRD IV). CRD IV gives Member Stares some discretion on the application of macroprudential buffers and other measures to address systemic or macroprudential risks as set out in the CRR and CRD IV, for which each Member State determines a designated authority. For SSM members, the ECB is empowered to apply higher requirements for capital buffers or more stringent macroprudential measures (Article 5(2) of the SSMR). The CRR establishes the following minimum capital requirements thresholds: CET1 capital 4.5 percent, Tier 1 capital (including additional Tier 1) 6 percent, and total capital (including Tier 2 capital) 8 percent, capital conservation buffer by CET1 capital 2.5 percent; it also requires that other buffers (such as the G-SIB buffer and capital conservation buffer) be

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

	covered by CET1 capital. The ECB's Supervisory Board has issued a decision that Pillar 2 capital add-ons shall be solely composed of CET1.
EC2	At least for internationally active banks,[83] the definitions of capital, risk coverage, method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	The CRR and accompanying EU Regulations apply to all institutions captured by Article 4(1)(3) of the CRR, which includes the internationally active banks within the EU but is not restricted to them. The provisions regarding capital adequacy in the CRR and CRD IV are based on the currently applicable Basel standards, including the definition of own funds, the risk coverage, the method of calculation and thresholds for the prescribed requirements. 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.[84] National discretions with regard to capital definition and regulatory requirements can be found in the transitional provisions of Article 481 pp. of the CRR. Some Member States have exercised some of these discretions. For example, in one Euro Area country the discretion for qualifying holdings in Article 89 paragraph 3 of the CRR has been implemented via a general decree. The assessors could not determine that for internationally active banks, capital requirements are not less than the applicable Basel standards. For example, the ECB's explanatory memorandum on the "Public Consultation on a draft Regulation and Guide of the ECB on the exercise of options and discretions available in Union law" states that the full deduction of insurance holdings would have had a significant impact on major bank led

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

[84] The EU Standardized Approach and the Internal Ratings-Based approach for credit risk diverged in the permanent partial use exemptions for various types of credit exposures in the IRB Approach for credit risk. Concessionary risk weights were extended to small- and medium-sized enterprise (SME) exposures for customers located in both the EU and abroad. The splitting of residential mortgage loans into lending qualifying for a 35 percent risk weight and lending not qualifying for this preferential treatment, as permitted under EU law, did not meet the Standardized Approach for credit risk. The treatment of CCR deviated with respect to the credit valuation adjustment (CVA) exemptions provided for various obligor exposures. Other cited deviations included the treatment of investments in the capital instruments of insurance company subsidiaries in the definition of the capital component of the Basel framework, and in the credit risk components. Eight of the 14 components assessed were compliant with the Basel framework, and four components (definition of capital and calculation of minimum requirements, Standardized Approach for credit risk, credit risk (securitization framework) and Standardized Measurement Method for market risk) were deemed largely compliant; one component (IRB approach for credit risk) was materially non-compliant; while the CCR component was rated non-compliant.

	conglomerates in the SSM. It would have resulted in a 100 bp on average drop in CET1 ratios from 11.41 percent to 10.41.[85]
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions)[86] entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	The minimum capital requirements prescribed by the CRR already consider whether risks have been adequately transferred or mitigated through transactions (e.g., securitization transactions) and impose specific capital charges on all risk exposures to the extent covered by the Basel standards for Pillar 1 capital requirements, including for securitizations, except for the differences identified by the EU RCAP. According to Articles 97–98 of CRD IV, to the extent risks and elements of risk are not already covered by the CRR or the requirements for capital buffers, the ECB must consider the individual risk profile of an institution, as identified in the SREP or the review of the permission to use internal approaches and establish capital requirements in excess of the CRR and buffer requirements (See CP8). The ECB's application of SREP methodology has resulted in the imposition of additional own funds requirements based upon SIs' risk profiles. The assessors saw examples of this in practice. The tool has been used effectively. Article 104 (1)(a) and (2) of CRD IV empowers competent authorities inter alia to require institutions to hold own funds in excess of the requirements set out in Chapter 4 of Title VII (Capital Buffers) and relating to elements of risks and risks not covered by Article 1. Mandatory reasons for a capital add-on are, for example, that risks are not covered by the minimum capital requirements of the CRR, the institution's risk bearing capacity is insufficient, it is likely that although the institution is complying with the regulatory requirements risks are underestimated, or the institution has no sound business organization. Regarding securitized transactions, the ECB decides, on a case-by-case basis, when the possible reduction in risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties. The ECB issued detailed guidance for JSTs on how the assessment of significant risk transfer shall be performed, building on EBA guidelines[87] and the relevant CRR articles.

[85] https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/pub_con_explanatory_memorandum_options_discretions.en.pdf?1183efa255688975eba286a469c36e51

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

[87] ECB public guidance on the recognition of significant credit risk transfer https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_significant_risk_transfer.en.pdf?ddd450f00db7a92d5be25a0ad26e6990 and EBA Guidelines 2014/05 on Significant Credit Risk Transfer relating to Articles 243 and

(continued)

EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks[88] in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	The minimum capital requirements prescribed by the CRR already reflect major parts of the risk profile of institutions (See EC3). Furthermore, with the CRR the Pillar 1 requirements were fully harmonized across the EU, leaving, in principle, no room for diverging requirements at the level of the individual Member States. However, the CRR contains a few exemptions from this strict rule. According to Article 124(2), the competent authority may, based on financial stability considerations, set higher risk weights for exposures secured by immovable properties where these are no longer appropriately based on the loss experience or forward-looking immovable properties market developments. Similarly, according to Article 164(5), the competent authority may, where appropriate on the basis of financial stability considerations, set higher minimum values of exposure weighted average LGD for exposures secured by immovable property in their territory. Member States may set higher capital requirements for addressing macroprudential or systemic risk identified at the level of a Member State (Article 458). To the extent risks and elements of risk are not already covered by the CRR or the requirements for capital buffers, competent authorities are obliged to reflect the individual risk profile of an institution, as identified in the SREP (Pillar 2 under Basel standards) or the review of the permission to use internal approaches, by requiring own funds in excess of the CRR and the buffer requirements for risk and elements of risks not covered by the CRR. For SSM Member States, these supervisory powers are given to the ECB by Article 16 of the SSMR and are given to the NCAs in these States for their responsibilities for LSIs under Article 6(4) of the SSMR. The ECB's Guide on National Options and Discretions under Union Law (March 16, 2016) harmonizes the exercise of capital-related options and discretions by Member States for SIs supervised by the ECB. The build-up of leverage by an institution is already, to a certain extent, constrained by non-zero capital requirements according to the CRR and CRD IV. In addition, Article 98(6) of CRD IV requires supervisors to consider in the SREP in particular the risk of excessive leverage (Article 4(1)94 of the CRR), and the exposure of institutions to the risk of excessive

Article 244 of Regulation 575/2013, 7 July 2014 https://www.eba.europa.eu/documents/10180/749215/EBA-GL-2014-05+Guidelines+on+Significant+Risk+Transfer.pdf

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

	leverage as reflected by indicators of excessive leverage, including the leverage ratio determined in accordance with Article 429 of the CRR. This allows the competent authorities to use their powers for reflecting the individual risk profile of an institution under the SREP to establish higher requirements for constraining leverage where excessive. Leverage is taken into account in the SSM SREP methodology for the determination of the overall SREP score of the institution and the supervisory measures, including capital measures, adopted as a result of the SREP. As for the Basel framework, the leverage ratio still is under investigation at the EU level and institutions only have, for the time being, to calculate and report the leverage ratio to their competent authority (Articles 429 and 430 of the CRR), as well as to disclose the leverage ratio (Article 451(1) of the CRR), and must consider the leverage ratio as one of the indicators for the identification, management and monitoring of the risk of excessive leverage (Article 87(1) of CRD IV). The European Commission has published a legislative initiative to introduce a binding leverage ratio requirement for all institutions subject to CRD IV. The leverage ratio requirement complements the current requirements on supervisory monitoring of the risk of excessive leverage in CRD IV and the CRR requirements to calculate the leverage ratio, to report it to supervisors and, since January 2015, to disclose it publicly.
EC5	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: (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	The CRR requires prior permission by the competent authority before an institution uses internal assessments of risk as inputs into the calculation of regulatory capital requirements (Articles 143, 221, 225, 259, 283, 312, 363, 377 of the CRR) and sets out the requirements that need to be met for permission by the competent authority.

	(a) The requirements of the CRR and accompanying EU regulations are based on the rigorous qualification standards set by the current Basel standards. For details and differences see the 2014 EU RCAP report. For entities 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) of the SSMR and in accordance with the acts referred to in the first subparagraph of Article 4(3) of the SSMR. The assessors were provided samples of the ECB's independent review and validation of SIs' internal capital models and examples of required modifications and conditions that were imposed. The ECB bases its decisions on internal models for credit, market, operational and counterparty risk, beyond the requirements in Part Three of the CRR (Capital Requirements) and relevant RTS adopted by the Commission, on Guidelines issued by the EBA, which further specify CRR provisions on a more technical level. These guidelines are non-binding, but subject to a requirement that the competent authority state the reasons where it decides to not comply with these guidelines. Relevant EBA/CEBS Guidelines with which the ECB complies are: Guidelines on the implementation, validation and assessment of AMA and IRB Approaches (CEBS GL 10), Guidelines on stressed Value-at-Risk (stressed VaR) (EBA/GL/2012/2), and Guidelines on the Incremental Default and Migration Risk Charge (IRC) (EBA/GL/2012/3). The RTS on assessment methodology for AMA and IRB approaches have replaced the CEBS Guidelines (CEBS GL-10) on the implementation, validation and assessment of the AMA and IRB) approaches, in the context of the methodology used by competent authorities in assessing the compliance of an institution with the requirements to use these approaches. Although not endorsed yet by the Commission, the final draft has been published by the EBA. For CCR and Credit Valuation Adjustment (CVA) there are neither mandates for RTS in the CRR nor in EBA Guidelines. For those risk types, internal ECB banking supervision guidelines have been published. Relevant internal model investigation assessment topics have been collected already (see below). Typically, approvals of models and material changes to them (collectively called "internal model investigations") are granted based on an onsite investigation by a project team. An internal model investigation has five phases: a preparatory pre-application phase, the investigation phase in which the actual assessment is performed, the reporting phase, followed by a draft and final decision process phase. Ensuring consistency in supervisory standards across all SSM Member States was a primary objective for the creation of the SSM. Therefore, after the initial assessment of the (onsite) expert project team the draft assessment report is reviewed for consistency and adherence to standards. It is performed by the NCA and the ECB's Internal Model Division in an integrated way. Chapter 8 of the

	SSM Supervisory Manual describes the processes for the approval of internal models and material changes to them in more detail. The ECB is conducting a TRIM in 2017–2019 to collect information and to assess current model practices including deviations from the principles stated in the ECB Guide for General Topics. SIs with deviations will be required submit a corrective action plan. The ECB has planned about 200 TRIM missions. A group of SSM model experts has produced a practical guide to internal model investigations for the fieldwork of an internal model investigation ("Onsite model investigations" in the SSM Supervisory Manual). It explains the process in detail and provides a standard for models assessment reports. Moreover, for each risk category (credit, CCR/CVA, market, and operational risk), it presents the five most useful inspection topics based on expert judgment to be covered during internal model investigations. This list will be expanded in the future if it is deemed necessary, especially if a need for harmonization of some given topics emerges from the consistency reviews of the model assessment reports performed by ECB. For each of these topics, the recommended inspection methodologies contain the following items: the inspection objectives, the potential risks, the expected controls from the banks, and the inspection techniques to achieve the objectives. The HoM (see point c) should use expert judgment to assess if other topics should be investigated in detail or if other inspection techniques are more appropriate. (b) Cessation of the use of internal models for determining the regulatory capital requirements is subject to prior approval by the competent authorities (Articles 149, 225(1), 259(5), 283(5), and 313 of the CRR)). Any material change to an approved internal model needs prior permission by the competent authority, according to Article 143(3) of the CRR for IRB approaches, Article 312 of the CRR for AMA approaches, and Article 363(3) of the CRR for Internal Models-based Approaches (IMA) for market risk. Similarly, cessation of the use of an internal model and thereby reversion to a standardized (less sophisticated) approach requires permission by the competent authority according to Article 149 of the CRR for IRB approaches, Article 283(5) of the CRR for Internal Model Method (IMM) approaches, and Article 313 of the CRR for AMA approaches. For IMA, a reversion to a standardized approach is considered a material change. Permission to use an Advanced-CVA model is linked to the permission for using IMAS for specific interest rate risk and the IMM approach according to Article 383(1) of the CRR. As for the IMM method and Advanced-CVA models, there are no provisions in the CRR concerning material changes; SSM guidelines for assessing the materiality of model changes have been published. (c) Within the SEP planning cycles for SIs, the resources and planned tasks are matched, based on the assumed internal model approvals expected to occur within the planning cycle timeframe while allowing for regular updates of tasks. For the purpose of assessing

	internal models, a pool of suitable experts is assembled. This pool comprises permanent members of the JSTs, experts from the ECB's horizontal functions, and model experts from the NCAs. The JST coordinator appoints a project manager from JST members; a HoM drawn from that pool is also appointed if an onsite investigation is needed. In response to the assessors' questions, ECB senior staff stated that they had sufficient quantity and quality of staff to conduct model reviews and that the planning process was effective from an operational standpoint. The JST updates the SEP accordingly as soon as possible. In addition, a project team will be assigned to assist the project manager and/or the HoM with the tasks. The project team can be staffed from various sources, including from the expert pool. The Internal Models Division is entitled to nominate a project team member from within its own ranks. In specific cases, the Internal Models Division may reject candidates for the project team. When selecting a project manager, due consideration is given to expertise in the subject area, as well as experience with model approval projects among peers of the institution being assessed. (d) For cases of non-compliance with the requirements for using internal models for calculating the regulatory capital requirements, Article 101(4) of CRD IV requires the competent authorities to require the institution to either demonstrate that the effect is immaterial or to present a plan for the timely restoration of compliance. For SIs, these supervisory powers are given to the ECB by Article 16 of the SSMR. (e) Where deficiencies are revealed in the assessment of an internal model, approval for model use is either not granted at all or is subject to terms and conditions as part of the supervisory decision issued by ECB. Its power to impose terms and conditions on its approvals for prudential measures derives from Article 16(1) of the SSMR. Article 16(2) gives a non-exhaustive list of concrete powers. The ECB has the power to revoke approvals. It assesses internal models through its supervisory activities, including its review of internal model investigations and its TRIM horizontal (See CP8 EC3). The assessors saw examples where additional actions were prescribed in connection with an approval. The use of internal models, including terms and conditions for their use, is monitored on an ongoing basis by the ECB. The SSM Supervisory Manual describes the process in detail in the section "Ongoing model monitoring." The assessors were provided copies of model approval decisions and sample model assessment reports.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).[89] The supervisor has the power to require banks:

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

	(a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	In accordance with Article 16(2)(a) of the SSMR, the ECB has the power to require institutions to hold own funds in excess of Pillar 1 requirements set out in the CRR. In practice, these requirements are defined at least once a year in the context of the SREP. The SSM SREP methodology (see CP 9 for further detail) anticipates the adverse effects of possible events and changes in market conditions by adopting a forward-looking view in the assessment of the risks to which institutions are exposed. In particular, Element 3-Block 3 of the SSM SREP methodology is aimed at assessing the adequacy of institutions capital under stressed assumptions. This assessment is used to quantify the capital needs of the institution to cover the risks to its capital, and will be one of the key factors—other factors include the business model and the degree of leverage—taken into account to determine the level of capital imposed by the supervisor in excess of Pillar 1 requirements. This will ensure that the institution holds enough capital even in times of stress. In addition, institutions have to develop recovery plans that should be commensurate with and proportionate to the risk profile of the bank. The assessors note that the ECB appropriately applies the SREP in determining Pillar 2 capital requirements.
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	As explained in EC 2, the CRR and accompanying EU Regulations, as well as the specifications to the CRR and the transposition of CRD IV in the Member States, apply to all institutions within the meaning of Article 4(3) of the CRR. Thus, consistency with the principles of the applicable Basel standards is the same as indicated for EC 2. In particular, it is affected by the findings of the EU RCAP.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.[90]
Description and findings re AC2	CRD IV and the CRR are applied both on a stand-alone and consolidated basis, with few exceptions (Articles 6 and 7 of the CRR), subject to conditions aimed at ensuring an adequate distribution of capital between parent and subsidiaries. However, the competent authority may waive the capital adequacy requirements for the individual basis, for the parent institution and/or for the subsidiaries in the country (Articles 7(1) and 7(3) of the CRR) provided there is no material practical or legal impediment to the prompt transfer of own funds or repayment of liabilities.

[90] Please refer to Principle 12, Essential Criterion 7.

	The ECB has adopted a "Guide on options and discretions available in Union law"[91] (March 16, 2016) that further specifies the principles for granting the waivers under the CRR waiver conditions. A list of waivers from 2015–2017 was provided for assessor review.
Assessment of Principle 16	Materially Non-Compliant
Comments	The compliance of EU legislation with the Basel capital framework has been assessed by the Basel Committee under its RCAP in 2014 (Assessment of Basel III regulations—EU). The assessment found that the implementation of the Basel framework in the EU was "materially non-compliant." The EU framework was found "compliant" in terms of scope of application, transitional arrangements, capital buffers, internal models approach for market risk, operational risk, supervisory review process, and disclosure requirements. It was rated "largely compliant" for definition of capital, standardized approach for credit risk, securitization framework, standardized approach for market risk. A "materially non-compliant" rating was assigned for the IRB approach for credit risk and a "non-compliant" rating was assigned for the CCR framework. The ECB can require banks to hold capital in excess of the minima under Pillar 2 through the SREP process. Leverage is also specifically taken into account in the SREP methodology. The ECB's Guide on options and discretions (OND Guide) harmonizes the exercise of capital-related options and discretions for SIs. Some of the deviations cited in the RCAP, such as the non-deduction of insurance holdings, are material and continue to be authorized by the ECB OND Guide (See EC2). The ECB did harmonize the phase-in of various deductions from CET1 for which various approaches had been allowed. In addition, it also applies the waivers granted under Article 7 of the CRR. The ECB should monitor the effects of deviations from the Basel capital and liquidity requirements. The ECB also should continue to require the consistent application of capital internal model requirements, including permanent partial use provisions.
Principle 17	**Credit risk.**[92] The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk[93] (including counterparty credit risk)[94] on a timely basis. The full credit lifecycle is covered including

[91] https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/reporting/ecb_guide_options_discretions.en.pdf?59277660d00228705435a3ab8627afe7 and https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ond_part2_guide.en.pdf?75f59e5d10361493f8b5428622183cd0

[92] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

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

[94] CCR includes credit risk exposures arising from OTC derivative and other financial instruments.

	credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations, or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration, and monitoring.
Description and findings re EC1	Article 79 of CRD IV requires competent authorities to ensure that: (a) credit-granting is based on sound and well-defined criteria and that the process for approving, amending, renewing, and re-financing credits is clearly established; (b) institutions have internal methodologies that enable them to assess the credit risk of exposures to individual obligors, securities or securitization positions, and credit risk at the portfolio level; (c) the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems; and (d) diversification of credit portfolios is adequate given an institution's target markets and overall credit strategy. The EBA SREP guidelines describe how supervisors are expected to conduct their assessment of banks' credit risk management and controls (paragraphs 179 to 195). Paragraph 183 specifies that "Competent authorities should assess whether the institution has an appropriate framework for identifying, understanding, measuring, monitoring and reporting credit risk, in line with the institution's size and complexity…" At EU-wide level there are no further or more specific descriptions of supervisory expectations for banks' credit risk management, as detailed in this EC; however, the legislation or regulation of some Member States provide more explicit indications (e.g., Belgium, Germany, Spain, Ireland, Italy).
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming,[95] identifying, measuring, evaluating, monitoring, reporting, and controlling or mitigating credit risk (including CCR and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.

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

Description and findings re EC2	The EBA SREP guidelines (paragraph 180) require the supervisors to verify whether: • the management body clearly expresses the credit risk strategy and appetite as well as the process for their review; • senior management properly implements and monitors the credit risk strategy approved by the management body. See also EC 1. The assessors were shown a monitoring report prepared by a JST for reviewing, inter alia, the internal governance of a bank on credit risk, including the role of the management and supervisory bodies in defining and approving the credit risk management strategy, the implementation of the strategy by the senior management under the direction and oversight of the management body, and the main policies and processes in place for credit risk management.
EC3	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including: (a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower’s ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank’s Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank’s risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (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 (g) effective controls (including in respect of the quality, reliability, and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.

Description and findings re EC3	(a) Article 79(b) of CRD IV requires institutions to have internal methodologies for credit risk assessment that do not rely solely or mechanistically on external credit ratings for the assessment of an obligor's or financial instrument's creditworthiness. The EBA SREP guidelines recommend that supervisors verify that policies and procedures are sound and consistent with the credit risk strategy (paragraph 182c). However, there are no specific indications about the documentation of the strategy. (b) Article 79(a) of CRD IV also requires institutions 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. The EBA SREP guidelines cover, inter alia, credit-granting processes (paragraph 182.c) and require that there are clear lines of responsibility for taking on, measuring, monitoring, managing, and reporting credit risk (paragraph 181.a). (c) The EBA SREP guidelines cover, inter alia, the criteria for the review of borrowers' creditworthiness (paragraph 182.c) and require supervisors to verify that the bank can detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities with regard, inter alia, to collateral coverage, contractual terms and agreements, and covenants (paragraph 184). Supervisors should also assess the level and quality of credit risk mitigation (paragraphs 171–174). There is no mention of the need for policies and processes that include the review of the performance of underlying assets in the case of securitization exposures. (d) The EBA SREP guidelines recommend that supervisors consider whether the data, information systems and analytical techniques are appropriate to enable the institution to fulfill supervisory reporting requirements, and to detect, measure and regularly monitor the credit risk inherent in all on- and off-balance-sheet activities (paragraph 184); and to assess whether the institution has implemented regular reporting of credit risk exposures, including the outcome of stress testing, to the management body, senior management and the relevant credit risk managers (paragraph 191). (e) The EBA SREP guidelines recommend that supervisors verify that policies and procedures are sound and consistent with the credit risk strategy, and cover, inter alia, credit limits (paragraph 182.c); that such policies are adequate for the nature and complexity of the institution's organization and activities, and enable a clear understanding of the credit risk inherent to the different products and activities under the scope of the institution (paragraphs. 182.d and 193.a) and are clearly formalized, communicated, and applied consistently across the institution (paragraph 182.e). (f) The EBA SREP guidelines recommend that supervisors verify that the bank has appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures and limits are reported in a timely manner to the appropriate level of management for action (paragraph 192.c).

	(g) For IRB banks, the EBA SREP guidelines recommend that supervisors assess whether the internal validation process is sound and effective in challenging model assumptions and identifying any potential shortcomings with respect to credit risk modelling, credit risk quantification, and the credit risk management system (paragraph 195); more generally, the risk of losses relating to the development, implementation or improper use of any other models by the institution for decision-making (e.g., product pricing, monitoring of risk limits, etc.) is addressed within the assessment of operational risk (paragraph 235). There are no indications about the use of other models (e.g., internal models not approved for regulatory purposes). The assessors reviewed some examples of internal model investigations of IRB systems and of an onsite inspection on the quality of credit risk information.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	The EBA SREP guidelines require supervisors to assess the appropriateness of systems to measure credit risk, in particular that these systems provide a sound and prudent estimation of credit risk at borrower/transaction and portfolio level (paragraph 186). They also require supervisors to assess the risk management of foreign exchange lending risk, measurement and control frameworks, policies and procedures and whether the bank periodically reviews the hedging status of borrowers (paragraph 159.b). The assessors got evidence of onsite inspections specifically addressing shortcomings in banks' assessment of their borrowers' situation, including by not capturing their whole indebtedness.
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	The EBA's revised Guidelines on Internal Governance require that the "management body should have a written policy on managing conflicts of interests for its members" (paragraph 12(6)). Within the assessment of the overall internal governance framework, the EBA SREP guidelines require supervisors to assess whether the bank can demonstrate that it has in place policies to identify and avoid conflicts of interest (paragraph 85). In the EU framework there is no explicit requirement for banks to make credit decisions on an arm's-length basis; however, in some jurisdictions (e.g., Germany, Spain, Ireland), this principle is enshrined in legislation or regulation.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.

Description and findings re EC6	Except for the rules on large exposures, there is no specific requirement, at EU-wide level, for a bank's Board or senior management to approve credit risk exposures exceeding a specific threshold. In some jurisdictions, a Board or senior management decision is required for the approval of credit transactions exceeding given thresholds (e.g., Austria, Germany, Latvia).
EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling, and reporting on credit risk.
Description and findings re EC7	Article 4 of CRD IV requires Member States to ensure that supervisory authorities are able to obtain the information needed to assess the compliance of banks and banking groups with the requirements of the Directive and of the CRR (paragraph 3), that banks and banking groups provide the supervisory authorities with such information (paragraph 5) and register all their transactions and document systems and processes in such a manner that supervisors are able to check compliance (paragraph 6). Article10 of the SSMR states that the ECB may require institutions to provide all information that is necessary for it to conduct its supervisory tasks. Central credit registries are available in some Member States. The ECB has launched in 2016 a project to create a database (Analytical Credit Datasets or AnaCredit) for the collection of loan-to-loan information on banks' credit exposures to all legal entities (including SMEs) in the Euro Area. Starting from November 2018 (with reference to September 2018 data) AnaCredit will collect, on a monthly basis, entity identifiers and several data attributes from banks (both SIs and LSIs, with some exemptions for the smallest ones). The initiative is in line with those for BIRD and IReF (see CP 10) in aiming at a single data source for credit risk from which all relevant information (on performing and NPLs) can be extracted; in the long term this could contribute to streamlining aggregate reporting requirements, reducing the reporting burden on banks. Together with the security-by-security data available in another database (Security Holding Statistics), AnaCredit will provide a comprehensive picture of all legal entities' indebtedness in the Euro area. Future developments could lead to an extension of the database in terms of scope (loans to households), reporting entities (nonbank lenders), and data attributes (risk-weight, LGD, etc.). While the registry has been created primarily to satisfy the information needs for monetary policy, it lends itself to extremely useful and powerful uses for supervisory purposes: a more detailed view of banks' loan portfolios, the possibility to segment the portfolios according to different criteria and to perform drill-downs from high-level harmonized reports into granular data, the monitoring of banks' progress in reducing NPLs

	and granting forbearance, the availability of early warning signals on the indebtedness of specific borrowers and groups of connected borrowers, inputs for the scoping and preparation of onsite missions and for the subsequent follow-up.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	The EBA SREP guidelines require supervisors to assess whether the institution has undertaken stress testing to understand the impact of adverse events on its credit risk exposures and on the adequacy of its credit risk provisioning (paragraph 189). The EBA Guidelines on Stress Testing (GL32) provide a starting point for the design of stress tests, which can be followed by banks and used by supervisors in their interaction with banks on this subject.
Assessment of Principle 17	Largely Compliant
Comment	CRD IV and the EBA SREP guidelines set some requirements on banks' credit risk management, but not all those envisaged by this CP. The SSM Supervisory Manual complements the framework for supervision of credit risk by providing a series of investigative suggestions for onsite inspections, broadly covering the lifecycle of the lending activity, from granting loans to foreclosing collateral. However, these suggestions are meant for onsite activity and for the use of examiners, and are not shared with the generality of the supervised entities, hence, they cannot be considered either (binding) regulatory requirements or (non-binding) supervisory expectations. Credit risk represents one of the sub-elements of the capital element in the RAS. Information on credit risk is extracted primarily from harmonized reports, complemented by recently introduced more ad-hoc reports (e.g., on NPLs) and, for some jurisdictions, by data extracted from the national credit registers. From the end of 2018 these will be further complemented with the collection of loan-to-loan information on banks' credit exposures to all legal entities (including SMEs) in the Euro Area (AnaCredit database). All banks (both SIs and LSIs, with some exemptions for the smallest ones) will report, on a monthly basis, a number of entity identifiers and data attributes for all their loans to legal entities above a fix threshold (EUR 25,000). The database will work as a single data source for credit risk from which all relevant information (on performing and NPLs) can be extracted; in the long term this could contribute to streamlining aggregate reporting requirements, reducing the reporting burden on banks. Together with the security-by-security data available in another database (Security Holding Statistics), AnaCredit will provide a comprehensive picture of all legal entities' indebtedness in the Euro area. These data can lend themselves to extremely useful and powerful uses for supervisory purposes, such as the monitoring of banks' progress in reducing NPLs and granting forbearance and the availability of early warning signals on the indebtedness of specific borrowers and groups of connected borrowers.

	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, though some or all these elements are required by some national laws/regulations (EC 6).
Principle 18	**Problem assets, provisions and reserves.**[96] The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.[97]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations, or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	Article 79(c) of CRD IV requires competent authorities to "ensure that the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems." The EBA SREP Guidelines require competent authorities "to assess whether the institution has appropriate policies for the identification, management, measurement, and controls of credit risk." Some of the elements to take into account when assessing those policies and procedures are: • the policies are clearly formalized, communicated and applied consistently across the institutions (paragraph 182(e)); • the management body approves the policies for managing, measuring, and controlling credit risk (paragraph 182(a)); • the policies and procedures cover all the main business and processes relevant to managing, measuring, and controlling credit risk, including credit-risk measurement and credit-risk management (paragraph 182(c)). In some national jurisdictions, law or regulation contains provisions that qualify in more detail the requirements and criteria for the assessment of banks' policies and processes for identifying and managing problem assets. However, they are not in contradiction with the March 2017 ECB Guidance to banks on NPLs. Section 3 of the Guidance (NPL governance

[96] Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

[97] 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).

	and operations) covers supervisory expectations in this regard: the steering and decision-making; the operating model; the control framework; the monitoring activities; the early warning mechanisms; and supervisory reporting. In the context of implementation of IFRS 9, the EBA is completing the transposition of the BCBS "Guidance on credit risk and accounting for expected credit losses" (December 2015) that will be applicable to credit risk and to expected credit losses (ECL) under IFRS 9 in the SSM. JSTs regularly draft credit risk monitoring reports that contain a section on the risk management of the bank, including an analysis of the content of policies and controls in place for the management of problem loans. The onsite instructions in the SSM Supervisory Manual treat in detail the content of inspections on credit risk. One of the main goals of the inspection is to assess the quality of the exposures of the bank and the robustness of the provisioning policies, as observed by the assessors in some anonymized examples. In the past two years there have been approximately 120 onsite inspections of SIs for credit risk.
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes.
Description and findings re EC2	The EBA SREP Guidelines requires competent authorities to: • assess whether the institution has an appropriate framework for identifying, understanding, measuring, monitoring and reporting credit risk (paragraph 183) • consider whether the data, information systems and analytical techniques are appropriate to enable the institution to detect, measure and regularly monitor the credit risk (paragraph 184); and • ensure that such systems and methodologies enable the institution to differentiate between different levels of borrowers and determine the level of provision and CVAs required to cover expected and incurred losses (paragraph 186). In addition, the ECB guidance on NPLs establishes concrete supervisory expectations for the recognition of NPLs (section 5) and the impairment measure (section 6). The assessors found evidence of supervisory action—through regular monitoring, deep dives, onsite inspection, and follow-ups—aimed at verifying the adequacy of banks' policies and processes in this area.

	The ECB can use (and has sometimes used) external experts in a supporting role for onsite inspections on credit risk.
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures.[98]
Description and findings re EC3	The EBA SREP guidelines require competent authorities to consider whether the data, information systems and analytical techniques are appropriate to detect, measure, and monitor credit risk inherent in all on- and off-balance-sheet activities (paragraph 184). The definition of NPE and forborne assets in the EBA ITS on supervisory reporting includes off-balance sheet items, and particularly loan commitments and financial guarantees provided.
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	The EBA SREP guidelines require supervisors to assess whether the systems and methodologies to measure credit risk at borrower/transaction and portfolio level enable the institution to determine the level of provision and CVAs required to cover expected and incurred losses (paragraph 186.e). Additionally, section 6 of the ECB guidance on NPLs establishes supervisory expectations regarding impairment measurement and write-offs: • Sections 6.2 and 6.3 are devoted to the methodologies and processes for appropriate provisioning; for the collective estimation of allowances, banks should take into account all relevant factors that have a bearing on loss rates, including (but not limited to) macroeconomic variables (e.g., GDP, unemployment, property prices) and changes in international, national, and local economic and business conditions; • Section 6.5 is devoted to NPL write-offs while Section 6.6 is specifically devoted to the timeliness of provisioning and write-offs. The indications of the NPL guidance should be followed by more detailed and explicit supervisory expectations on the criteria banks should adopt for NPL write-offs.
EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material

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

	circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing, or reclassification of loans).
Description and findings re EC5	Article 79(c) of CRD IV requires competent authorities to ensure that the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems. The EBA SREP Guidelines require competent authorities to assess whether the institution has defined and implemented continuous and effective monitoring of credit risk exposure with specific indicators and relevant triggers to provide effective early warning alerts (paragraph 190). In addition, section 3 of the ECB guidance on NPLs is devoted to the governance and operations of NPLs including: • early warning mechanisms (section 3.6): "In order to monitor performing loans and prevent the deterioration of credit quality, all banks should implement adequate internal procedures and reporting to identify and manage potential nonperforming clients at a very early stage;" • monitoring of NPLs (section 3.5): "A related framework of key performance indicators needs to be developed to allow the management body and other relevant managers to measure progress;" and • customer engagement and cash collections (section 3.5.2). The classification of exposures in arrears is regulated by the EBA ITS on Supervisory Reporting. FINREP template F18 classifies the exposures in different buckets depending on the number of days in arrears (less than 30; between 30 and 60; between 60 and 90; and more than 90, which is considered nonperforming). The EBA SREP Guidelines require competent authorities, when assessing portfolio credit quality, to pay particular attention to the adequacy of the classification of the credit exposures and assess the impact of potential misclassification (paragraph 165) and to assess whether the level of loan loss provisions and CVAs are appropriate for the quality of the exposures and, where relevant, for the level of collateral (paragraph 175). The SSM Supervisory Manual details the criteria and procedures to be followed for credit file reviews during onsite inspections. The assessors got access to reports from onsite inspections on credit risk based on credit file reviews and relative follow-up letters.
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	Supervisory reporting obligations are established in the EBA ITS on Supervisory Reporting, which has a specific template for NPEs (F18) and forborne exposures (F19) to be reported quarterly.

	Regarding the classification of assets, SIs are encouraged under section 5 of the ECB guidance on NPLs to use the classification as defined by the EBA ITS on Supervisory Reporting (templates F18 and F19) also for risk management purposes. Section 6 of the ECB guidance on NPLs states the supervisory expectations for the calculation of provisioning levels. Section 6.7.2 highlights that "Banks should maintain internal supporting documentation, which may be made available for review by supervisory authorities upon request." SIs identified by the ECB guidance on NPLs as "High NPL banks" are required to report their NPL strategy—including the operational plan—to their JSTs in the first quarter of each calendar year, and a standard template summarizing the quantitative targets and the level of progress made in the past 12 months against plan. The follow-up and monitoring of banks' NPL reduction plans is intense and it is producing positive results in terms of banks' increased proactivity in addressing their issues. In some jurisdictions (e.g., Germany, Austria, Spain, Italy), supervisors can rely on additional, detailed credit information drawn from national central credit registries that provide loan-by-loan information according to different data models and subject to different reporting thresholds.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	For relevant indications from the EBA SREP Guidelines see EC 5. The ECB's supervisory powers in this area are established by Article 104 of CRD IV and Article 16(2)(d) of the SSMR; they include the power to require institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements. The ECB does not have the power in all cases to require banks to adjust their classifications of individual assets; asset reclassifications can be required there were the NCA has also accounting powers in relation to banks (like in Spain); otherwise, the adjustment can be required only for the purpose of capital requirement calculations. The European Commission has clarified that that power stated in Article 16(2)(d) of the SSMR "allows the ECB 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" (EC, Report on the SSM, October 2017). This should be sufficient for the ECB to impose

	capital deductions when a bank is considered under provisioned and it does not follow up by increasing its provisions accordingly, although an explicit granting of these powers by the EU legislation would represent a firmer legal basis. In terms of asset classification, the clarification means that the ECB can require a bank to reclassify an exposure when it is deemed defaulted (as defined by Article 178 CRR, i.e., 90 days past due or belonging to an 'unlikely to pay' obligor), not necessarily when it is considered nonperforming (as defined by the ITS on Forbearance and NPEs): currently the latter is, in fact, a wider concept, encompassing the former. The ECB has expressed its expectation that banks should use the NPE concept for all purposes and the EBA is working at a regulation that will clarify the 'default' concept, by more closely aligning it with the 'NPE' one and providing indications on how to identify 'unlikely to pay' obligors. This should give the supervisors a more solid footing on which to base their requests for banks to reclassify their exposures. But for the time being—until the EBA regulation is issued and enters into force—the ECB cannot impose a reclassification as NPL in those cases where an exposure does not fully meet all the conditions to be considered defaulted. The guidance on NPLs constitutes ECB banking supervision's expectations including all the elements of the management of problem assets. It is not binding in nature, but banks should explain and substantiate any deviations upon supervisory request and non-compliance may trigger supervisory measures.
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives, and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.
Description and findings re EC8	Part II, Chapter 4 of the CRR on credit risk mitigation (Articles 192–217) establishes requirements on risk mitigants. The EBA SREP Guidelines require competent authorities to: • assess whether the institution has appropriate policies for the identification, management, measurement, and controls of credit risk, including the criteria for assessing collateral evaluation and frequency for its review (paragraph 182c); and • assess the appropriateness of the bank's information systems and analytical techniques also with regard to the collateral coverage (including netting agreements) and eligibility of this coverage (paragraph 184c). Supervisory expectations are stated in section 7 of the ECB guidance on NPLs, specifically for real estate collateral. The guidance covers aspects such as: the governance, procedures, and controls in the collateral valuation; the frequency of the valuations; and the

	methodology for valuation of collateral. Immovable property collateral should be valued according to European and international standards.
EC9	Laws, regulations or the supervisor establish criteria for assets to be: (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).
Description and findings re EC9	(a) The definition of problem asset can be found in two different sources: • Article 178 of the CRR provides the definition of default, which is used by IRB banks for capital requirement calculation purposes; and • the EBA ITS on Supervisory Reporting introduces the definition of nonperforming exposure, used for supervisory reporting (instructions for template F18 in Annex V). The definition of nonperforming exposure (NPE) is a concept potentially broader than the concept of default. However, as stated in section 5.5.1 of the ECB guidance on NPLs, practice shows that some institutions have tried to align the implementation of the default definition with the NPE definition in order to streamline processes and unify definitions. The ECB guidance (section 5.1) encourages SIs to use the NPE definition in their internal risk management and public financial reporting, and not only for supervisory reporting purposes. As of June 2017, almost half of the SIs showed a high degree of convergence, with no difference between the reported NPLs and defaulted loans. Additionally, the ECB guidance (section 1.3) covers not only NPEs, but also foreclosed assets and certain performing exposures such as “watch-list” and performing forborne exposures. (b) The reclassification of an asset as performing is also regulated by two different sources: • Article 178(5) of the CRR for capital requirement calculations of IRB banks (“If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure. Where the definition of default is subsequently triggered, another default would be deemed to have occurred”); and • the EBA ITS on Supervisory Reporting (instructions for template F18 in Annex V). The CRR is unspecific as regards the discontinuation of the default status (Article 178.5) The criteria for discontinuation of the qualification of nonperforming and forborne exposures are to be applied by institutions for supervisory reporting on top of the criteria they already apply for the discontinuation of the quality of defaulted exposure, as per Article 178 of the CRR.

	In accordance with paragraph 176 of Annex V of the EBA ITS on Supervisory Reporting, forborne exposure can be performing or nonperforming. Specific requirements in paragraph 157 for reclassifying nonperforming forborne exposures comprise the completion of a "cure period" of one year from the date the forbearance measures were extended and a requirement for the debtor's behavior to demonstrate that concerns regarding full repayment no longer exist. Institutions are required to perform a financial analysis of the debtor to establish the absence of such concerns. The EBA ITS establishes: "Exposures shall be considered to have ceased being nonperforming when all of the following conditions are met: (a) the exposure meets the exit criteria applied by the reporting institution for the discontinuation of the impairment and default classification; (b) the situation of the debtor has improved to the extent that full repayment, according to the original or when applicable the modified conditions, is likely to be made; (c) the debtor does not have any amount past-due by more than 90 days. An exposure shall remain classified as nonperforming while those conditions are not met, even though the exposure has already met the discontinuation criteria applied by the reporting institution for the impairment and default classification according to the applicable accounting framework and Article 178 of CRR respectively." The ECB guidance on NPLs (Section 5) also provides guidance on the classification of forborne performing and NPEs.
EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	Section 3.2 of the ECB guidance on NPLs requires the management body of the bank to approve and monitor the institution's strategy regarding NPLs. For that purpose, and according to section 3.5 of the same guidance, "A framework of key performance indicators needs to be developed to allow the management body and other relevant managers to measure progress." Those indicators are to be monitored on a periodic basis. As mentioned above, the guidance applies to NPEs more broadly, not only loans. Section 3.5 also identifies a minimum set of indicators, which should cover, among others: NPL ratios and coverage; NPL flows and default rates; customer engagement and cash collection; forbearance activity; and liquidation activity.
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	The classification of exposures as nonperforming shall be done on an individual basis or for the overall exposure to a given debtor, following the definition in the EBA ITS on Supervisory Reporting (instructions for table F18 in Annex V).

	According to IAS 39, exposures that are individually significant should be subject to individual assessment of impairment, while for exposures that are not individually significant the impairment assessment and loss allowance estimation can be performed either on an individual or collective basis. The ECB guidance on NPLs discusses individual provisioning in Section 6.2.1, which also establishes that: "Banks are expected to clearly define, in their internal policy, the criteria to make these decisions according to the principles presented in this guidance."
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	Article 81 of CRD IV, on concentration risk in the review process, expects 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." Within the ECB, horizontal functions have the responsibility to identify key risks for SIs. In this regard, there is a process to identify key risks for the Euro Area and adapt supervisory planning and activities to these (e.g., by carrying out horizontal in-depth reviews across affected banks). This includes a task force specifically charged with the analysis of NPEs. However, aggregated system-wide data based on bank-specific reporting is limited and most information is collected on an ad hoc basis. Aggregate concentrations and problem asset information are not available for all banks. Problem assets (watch list) are collected for FINREP reporting banks but no breakdowns by severity.
Assessment of Principle 18	Largely Compliant
Comments	The supervisory activity on problems assets and provisioning in the SSM has progressed significantly since the issuance, by the ECB, of its guidance on NPLs. This has allowed the SSM to tackle with more determination the long-term issue of extremely high NPL ratios in certain banks. The guidance is a non-binding instrument that sets supervisory expectations for how the NPL issue should be addressed by banks in terms of governance, operations, classification (of forbearance and nonperforming status), provisioning, write-off, and collateral valuation. Banks with a high level of NPLs are requested to define an NPL strategy and are subject to ad hoc reporting requests. The follow-up and monitoring of banks' NPL reduction plans is

	intense and it is producing positive results in terms of banks' increased proactivity in addressing their issues, as seen by the assessors in the monitoring reports examined. The guidance fills a number of pre-existent gaps in the EU-wide framework, characterized by scant requirements or guidance on asset classification and provisioning. However, because of its non-binding nature, the guidance cannot override national provisions on the same topics, where these are contained in laws or regulations. Based on the review of a large (though incomplete) synopsis of national legal frameworks, the assessors think that, even if in some jurisdictions there can be more detailed requirements and criteria for the assessment of banks' policies and processes for identifying and managing problem assets, these do not appear to be in contradiction with the indications provided by the guidance. While the guidance focuses specifically on the banks' legacy NPLs, an addendum published for consultation in October 2017 proposes to introduce quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for NPEs and would be applied to the flow of (new) NPLs. Deviations from the ECB's expectation would trigger a supervisory dialogue and could ultimately, but not necessarily, result in the adoption of Pillar II measures. It can be seen as a welcome 'bridge' solution towards the similar—but Pillar I—prudential backstops that the European Commission plans to introduce with the revision of CRD/CRR, as they would apply only to loans granted after the entry into force of the revision (probably in a few years time) once they become nonperforming (as opposed to new NPLs), the prudential backstops are likely to produce tangible results only in a relative distant future. The European Commission has clarified the ECB's power 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. While this is a welcome clarification, an explicit granting of these powers by the EU legislation would represent a firmer legal basis. The ECB must then make use of this power to foster the convergence of banks' provisions (especially in 'high-NPL' banks) towards more realistic levels, so as to facilitate the mobilization of burdensome stocks of legacy NPLs (through sales, securitizations, etc.). However, the ECB cannot impose a reclassification as NPL in those cases where an exposure does not fully meet all the conditions necessary to be considered defaulted. The indications of the NPL guidance on write-offs should be followed by more detailed and explicit supervisory expectations on the criteria banks should adopt for the write-off of their NPLs. The onsite activity on problem loans and provisioning is underpinned by a structured methodology that includes detailed indications on credit file reviews. This will soon be

	accompanied by statistical procedures for the extrapolation to the portfolio of the results obtained from samples of loan files, thus amplifying the impact that onsite missions can have on banks' provisioning. Notwithstanding the high quality and experience of ECB inspectors, their limited number constrains their direct participation in onsite missions (less than 10 percent of missions' staffing), thus requiring a substantial support (and effort) from NCA inspectors, who are also in charge of the inspections on LSIs. The overstretching of onsite resources across the SSM could weaken the capacity to maintain pressure on banks for decisive action on NPLs.
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report, and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.[99]
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk.[100] Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	Article 393 of the CRR requires that institutions have adequate procedures and internal control mechanisms for identifying, managing, monitoring, reporting, and recording large exposures (i.e., exposures equal or in excess of 10 percent of eligible capital. According to Article 389 of the CRR, an "exposure" means any asset or off-balance sheet item. Following Article 390 (4) and (5) of the CRR, these exposures are to be calculated by adding exposures of the trading and non-trading books, and the exposure to a group of connected clients shall be calculated by adding exposures to individual clients in the group. Articles 76 and 81 of CRD IV requires competent authorities to address and control concentration risk, including by means of written policies and procedures. Article 81 generally states that NCAs "shall ensure that the concentration risk arising from exposures to each counterparty, including central counterparties, groups of connected counterparties, and counterparties in the same economic sector, geographic region or from the same activity or commodity, the application of credit risk mitigation techniques, and including in particular risks associated with large indirect credit exposures such as a single collateral issuer, is addressed and controlled including by means of written policies and procedures." This definition does not fully cover the forms of concentration detailed in the footnote to

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

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

	this CP ("also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies"); however, a more encompassing definition of concentration risk can be found in some national frameworks (e.g., in Germany).
	
	Paragraph 34 of CEBS Guideline GL31 clarifies that "risk drivers which could be a source of concentration risk should be identified" by banks, covering "all risk concentrations which are significant to the institution […], including on- and off- balance sheet positions and committed and uncommitted exposures, and extending across risk types, business lines, and entities."
	
	Paragraph 186 of the EBA SREP guidelines specifically requires competent authorities to ensure that an institution's systems and methodologies "identify and measure credit concentration risks (single-name, sectoral, geographical, etc.)"; and paragraph 184 states 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."
	
	The ECB requires SIs to have a concise and practical definition of what constitutes a credit concentration. The definition should encompass the different types of credit concentration, including exposures to the same counterparties, exposures to groups of connected counterparties, exposures to counterparties in the same economic sector, geographical concentrations of asset exposure, and concentrations in a particular commodity or currency, as well as large indirect credit exposures (e.g., to a single collateral issuer). The definition should also cover the application of credit risk mitigation techniques to the credit concentrations.
	
	JSTs must, first of all, assess and monitor compliance with the large exposures regime on a continuous basis (Part Four, Articles 387–403 of the CRR) and should take immediate action if the regulatory limits are breached (Article 395).
	
	JSTs should then pay close attention to the following types of credit risk concentration:
	• Concentrated exposures to the same counterparties:
	    o a first indication of this aspect is provided by compliance with the large exposures regime on an individual and aggregate basis; these factors were considered in Phase 2 for the scoring system in SREP;
	    o the weight and evolution of the largest 10, 20, or 50 exposures depending on the characteristics of the institution;
	    o the Herfindahl index for the total loan portfolio when available to evaluate the share of each borrower in the total portfolio;

	o single-name concentration: the granularity adjustment is used for assessing, also in comparison with peers, the percentage capital add-on needed to cover this aspect. • Concentrated exposures to the same sectors: excessive concentration in one sector (real estate, agriculture, etc.) should be monitored closely. For this purpose, the JST should use the Herfindahl index based on data aggregated by NACE (Statistical Classification of Economic Activities in the EU) sector. • Concentrated exposures to specific products, e.g., credit cards or consumer loans, causing dependence on certain business lines, and concentrated exposures to specific collateral. • Concentrated exposures to specific geographical regions/countries. These should be taken into account when assessing credit risk, linking these results to the macroeconomic analysis. In case of large banking groups with important international activities, the geographical diversification benefits may be thoroughly analyzed and could lead to a positive adjustment of the score. To allow the JSTs to perform a comprehensive analysis, the following indicators could be used: o breakdown of loans and advances and debt securities by country and type of counterparty; o breakdown of NPEs by country and type of counterparty; o breakdown of forborne exposures by country and type of counterparty. Concentration risk in specific sectors (e.g., shipping) or towards specific counterparties (e.g., central counterparties) can be analyzed more deeply via detailed requests to the banks and/or formal/informal JST networks (when common to different SIs). The assessors received a presentation showing how a JST would address the concentration risk of a supervised entity, from the information requested for monitoring and analysis to the follow-up to supervisory letters centered on findings on large exposures and concentration risk. In particular, the presentation provided examples of: • supervisors requiring and assessing management of concentration risk other than credit risk (e.g., concentration in particular asset classes, products, collateral, or currencies); • the board being required to have adequate knowledge of a bank's concentration risk; • thresholds for acceptable concentrations of risk adopted by a bank; • more detailed information on the classification by sector requested from banks; • internal aggregate/individual limits on material exposures to shadow banking entities adopted by banks; and

	• analysis of concentration risk in ICAAPs and the use of supervisory proxies to challenge a bank's estimates.
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure[101] to single counterparties or groups of connected counterparties.
Description and findings re EC2	Article 393 of the CRR requires institutions to have in place 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. Additionally, institutions must have adequate information systems to comply with EU reporting requirements set down in Article 394 of the CRR. The EBA Guidelines on Internal Governance (GL 44) stipulate that institutions shall have effective and reliable information and communication systems covering all their significant activities (section 30(1)). Information systems, including those that hold and use data in electronic form, should be secure, independently monitored and supported by adequate contingency arrangements. An institution should comply with generally accepted IT Standards when implementing IT systems (section 30(2)). The EBA SREP guidelines recommend (paragraph 184) that: "competent authorities should consider whether the data, information systems and analytical techniques are appropriate to enable the institution 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." Point (b) also mentions "credit exposures (irrespective of their nature) of borrowers and, where relevant, of groups of connected borrowers. The ECB requires SIs to have data architecture and IT infrastructure that fully support their risk data aggregation and risk reporting practices not only in normal times but also during times of stress or crisis; banks are also required to be able to generate and aggregate up-to-date risk data in a timely manner to meet all risk management reporting requirements including ad-hoc risk-management reporting requests, both from supervisors and internally. The data should be of sufficient granularity to enable identification of business lines, legal entities, asset types, industries, geographical regions, or other segments relevant for the risk in question, so as to give the bank the ability to identify and report risk exposures, concentrations and emerging risks. A bank's risk infrastructure must enable it to collect up-to-date risk data in a timely manner while also respecting the principles of accuracy and integrity, completeness and adaptability.

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

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	Article 393 of the CRR requires all banks to "have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying, managing, monitoring, reporting and recording all large exposures [i.e., those exceeding 10 percent of a bank's eligible capital] and subsequent changes to them." The CEBS Guidelines on the management of concentration risk under the supervisory review process (GL31) require 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. The EBA SREP guidelines recommend that competent authorities "assess whether the institution has a sound, clearly formulated and documented credit risk strategy, approved by the management body. For this assessment, competent authorities should take into account: "whether this strategy supports risk-based decision-making, reflecting aspects that may include, for example, exposure type (commercial, consumer, real estate, sovereign), economic sector, geographical location, currency and maturity, including concentration tolerances" (paragraph 180). ECB banking supervision expects a bank's management body in its supervisory function to define the risk management policies and determine the acceptable levels of risks that can be incurred. This process should include the whole range of risks to which the institution is exposed; it should not be confined to credit, market, liquidity, and operational risks, but should also notably include concentration risks and all other risks that are material for the institution. In addition, when assessing credit risk controls, supervisors have to check whether a set of limits regarding credit risk is clearly established and periodically reviewed. As stated in EC1, the assessors were shown how a JST would review the thresholds for acceptable concentrations of risk adopted by a bank (included internal aggregate/individual limits to material exposures to shadow banking entities) and analyze concentration risk in ICAAP, using supervisory proxies to challenge a bank's estimates. The JST reviews the Board's minutes to verify that the RAF and the actual materiality of risk get discussed. The

	assessors were also provided an example of a JST asking a bank to introduce limits by commodity.
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	Article 394 of the CRR sets out reporting requirements for large exposures and certain largest exposures. These include the identification of a client or a group of connected clients, the value of the exposure before credit risk mitigation, types of credit protection, and expected run-off of the exposure. An institution reports to the supervisor all exposures to a counterparty or a group of connected counterparties reaching or exceeding the threshold of 10 percent of its eligible capital. In addition, Regulation (EU) No 680/2014 on supervisory reporting and subsequent amendments, Annex VIII and IX, developed common reporting templates and instructions in relation to large exposures, which need to be submitted quarterly. The annexes include identification of the counterparty by general sector (government, credit institutions, households), and statistical sectoral codes for individual counterparties that are nonfinancial corporations. For geographical location, the place of residence of the individual counterparty is used. In the SSM, the concentration risk template of the STE requests the 100 largest loans overall and 100 largest loans to nonfinancial corporations. This data also comprises information on counterparty categories reported according to the FINREP counterparty breakdown. More detailed information on the classification by sector may be requested, to complement the quarterly information in FINREP and COREP available to the supervisors.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	Article 4 (1) (39) of the CRR explicitly defines conditions under which counterparties, owing to control or economic connections, must be treated as a group of connected counterparties. According to this definition, two or more natural or legal persons are regarded as a group of connected clients constituting a single risk (i) if one of them has directly or indirectly control over the other or others, or (ii) if—without any such control—they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would also be likely to encounter funding or repayment difficulties. For the further definition of the control criterion, the CRR refers to the accounting framework, i.e., the European Directive on the preparation of consolidated financial statements, which includes detailed criteria for determining a relationship of control. Regarding the second criteria, i.e., economic interdependence, the EBA 2009 Guidelines on connected clients give further detailed guidance to institutions on how to apply this criterion. The guidelines will be replaced from January 2019 by the new EBA Guidelines on the treatment of connected clients, which provide institutions with criteria to identify all possible connections among their clients, in particular when control relationships or

	economic dependency should lead to the grouping of clients because they constitute a single risk. As for all EBA guidelines, each competent authority will have to implement the guidelines and communicate to the EBA whether they comply with the guidelines or explain the reasons for not complying. 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. However, the institution can challenge the supervisor's opinion before court. For the supervisor to verify the definition of a group of connected counterparties adopted by a bank, it needs to receive the list of counterparties that, according to the bank, belong to that group of connected clients; the counterparties must be coded unambiguously, so as to allow the supervisor to compare them with external sources and with the mapping of the same group of counterparties by other banks. COREP template C27.00, which all SIs need to report quarterly, contains such a list for a bank's large exposures, together with a number of attributes, including a code (generally based on the national reporting system), the counterpart's LEI, and the type, sector and residence of the counterparty. This should, in principle, allow offsite verification of the accuracy of the identification of groups of connected clients by a bank. To ensure that LEIs are appropriately used in supervisory reporting, the ECB provides instructions to NCAs on how to collect and update the identifiers (as part of a larger collection of attributes for supervised entities, the 'Master Data'). NCAs then engage all credit institutions (including SIs established in their country) to ensure that the necessary information is provided. However, an elaboration of a sample of 29 SIs conducted by an IMF team showed that for 12 of these SIs an average of 30 percent of the entities with exposures exceeding 1 percent of eligible capital lacked a LEI code.
EC6	Laws, regulations or the supervisor set prudent and appropriate[102] 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 CCR exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	The definition of exposure for large exposures purposes is set out in Article 389 of the CRR and includes both on-balance sheet assets and off-balance sheet items. According to Article 392 of the CRR, an institution's exposure to a client or group of connected clients shall be considered as large exposure where its value is equal to or exceeds 10 percent of its eligible capital. In accordance with Article 395 (1) of the CRR, an institution shall not incur an exposure to a client or group of connected clients the value of which exceeds 25 percent of

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

	its eligible capital. If the client is a credit institution or investment firm, the limit is 25 percent of its eligible capital or EUR 150 million, whichever is higher. As for Article 11 (1) (parent institution) and (2) (parent financial holding) of the CRR, the rules on large exposure limits also apply to consolidation at group level. If, in an exceptional case, exposures exceed these limits, the competent authorities may, where the circumstances warrant it, allow the institution a limited period of time in which to comply with the limit. According to Article 394 (1) of the CRR, an institution has to report information about every large exposure, such as the identification of the client or the group of connected clients to which an institution has a large exposure, to the competent authorities. Regulation (EU) No. 680/2014 of April 16, 2014 lays down detailed templates for the remittance of large exposure reports on a solo or consolidated basis. Article 393 of the CRR 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 EBA Guidelines (2015) on limits on exposures to shadow banking entities that carry out banking activities outside a regulated framework inter alia specify: • the effective processes and control mechanisms that credit institutions should use as part of their internal processes and policies to identify, manage, control, and mitigate concentration risks arising from exposures to shadow banking entities; and • the process through which credit institutions should set internal aggregate limits as well as individual limits to material exposures to shadow banking entities. Institutions that cannot meet the requirements regarding internal control (processes, control mechanism and oversight) must apply the limit of 25 percent of its eligible capital (the fall-back approach). In addition, even if institutions meet the requirements on internal control, they should apply the fall-back approach to those exposures to shadow banking entities for which they do not have enough data to set an appropriate limit.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	The CEBS Guidelines on the management of concentration risk under the supervisory review process (GL31) specifically address concentration risk within stress testing. The CEBS Guidelines on stress testing (GL32) also cover concentration risk (in particular in Annex VII). The EBA SREP guidelines require that the results of stress tests be used to identify credit concentrations (paragraph 178).

	In the SSM SREP methodology, the inclusion of the impact of concentration on banks' stress testing is part of the assessment of banks' ICAAP, and in particular Block 3 (assessment of capital quantification under stress). In this context, banks' ICAAP stressed estimated figures are assessed taking into account concentration risk. To that purpose, the ECB relies on supervisory proxies dedicated to concentration risk (for single-name, sectorial, and geographical concentrations) which are tools used by supervisors to challenge banks' ICAAP stressed figures.
Additional criteria	
AC1	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) 10 percent or more of a bank's capital is defined as a large exposure; and (b) 25 percent of a bank's capital is the limit for an individual large exposure to a private sector nonbank counterparty or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.
Description and findings re AC1	The definition of large exposures and the correspondent limits given in Articles 392 and 395 of the CRR are in accordance with these provisions. However, certain exemptions available to Member States under the CRR can weaken these limits, such as: • Article 400(2) a: covered bonds. • Article 400(2) b: certain claims on regional governments/local authorities that attract a 20 per cent risk weight. • Article 400(2) d: exposures within groups/network of mutual/cooperative banks. • Article 400(2) e: promotional loans and guarantees. • Article 400(2) i: 50 percent of low/medium risk off-balance sheet commitments and 80 percent of legal guarantees within mutual guarantee schemes. • Article 400(2) j: legally required guarantees in mortgage loans. • Article 400(2) k: exposures to recognised exchanges. These exemptions are neither temporary nor necessarily related only to very small or specialized banks. In addition, there is no stricter large exposure limits for G-SIBs as per the Basel large exposures framework. Under Article 395(1) of the CRR, small credit institutions and investment firms (those for whom EUR 150 million is more than 25 percent of their eligible capital) are exempted from some elements of the large exposures requirements. For such institutions, large exposures

	to other credit institutions may be up to 100 percent of their eligible capital or EUR 150 million, whichever is the higher. In its Regulation of March 14, 2016 on the exercise of options and discretions available in Union law, the ECB has decided to harmonize some of the options under the CRR. It introduced a 20 percent floor for exposures under Article 400(2) a and 400(2) b. It also decided to exercise the option for full exemption for the others. For the exercise of exemptions under Article 400(2) d, the waiver in relation to intra-group exposures is be allowed in full provided that that meets consolidated supervisory requirements under the CRR and FICOD or their equivalent standards in third-country jurisdictions (criteria are provided in an annex of the Regulation). Nevertheless, a transitional rule in the CRR allows Member States to adopt their own policy on these waivers until 2028 (Article 493(3)). From the point in time when the Member State discretion is exercised, the ECB policy does not apply. More generally, the ECB decided that irrespective of the prior national treatment, the limit on the value of a large exposure within the meaning of Article 395(1) of the CRR shall not be lower than EUR 150 million.
Assessment of Principle 19	Largely Compliant
Comments	The CRR sets the large exposures regime and determines the limits to be observed. While the framework is broadly aligned with the Basel 2014 large exposures framework (which will take effect from January 1, 2019 and will be applicable to internationally active banks, regardless of size), there are gaps. Some exceptions under Article 400(1) of the CRR seem to go beyond the Basel framework and weaken the limit, such as for some off-balance sheet contingent facilities (which, in the Basel framework, are subject to a 10 percent CCF floor) and the definition of eligible capital: as defined by Article 3(71) CRR, it includes “Tier 2 capital (…) that is equal to or less than one third of Tier 1 capital” in addition to Tier 1 capital, which is the only eligible in the Basel framework. In addition, exemptions under national discretion provided by Article 400(2) may not be compliant with the Basel regime: for instance, the Basel regime establishes that a covered bond meeting certain conditions can be assigned an exposure value of no less than 20 percent of the nominal value of a bank’s covered bond holdings. The eligible covered bonds under Article 129 seem to be broader than those under paragraph 70 of the Basel framework, as underlying assets in the EU can be exposures to banks, and maritime liens on ships. The national discretion provided under Article 400(2) does not mention the 20 percent floor; nevertheless, the ECB, exercising the discretion, has imposed a 20 percent floor to the exceptions under Articles 400(2) a and 400(2) b. On the other hand, the ECB decided to exercise full exemption for all other options under Article 400(2), so Member States that had no exemption or partial exemptions will have a less conservative framework. Several Member States have expressed their national discretion option under Article 493(3) and therefore can exercise the discretion until 2029.

	Finally, there is no stricter large exposure limit for G-SIBs, as envisaged by the Basel framework. As the Basel framework is not yet in force, these gaps do not represent, at the moment, a violation of international standards; however, by weakening the limits, they represent a violation of AC 1. Supervisors should address the potential consequences of these deviations from the international standard in their risk assessments, closely monitoring the risk concentrations that they could incentivize. An adequate monitoring of large exposures rests on regular reporting accompanied by a correct identification of the entities that belong to the same group of connected clients; while banks in the EU are required to report quarterly the lists of such entities, the incomplete reporting of legal entity identifiers by some institutions compromises the possibility of effective offsite verification of how groups of obligors are defined. The EU-wide framework does not cover concentration risk in the broader sense of this CP: in general, the ECB focuses on concentration as part of credit risk, thus not explicitly considering concentration risk derived from sources different from credit (e.g., markets). In addition, there is no requirement that all material concentrations be regularly reviewed and reported to a bank's supervisory board (EC 3). However, the evidence provided by the ECB shows that JSTs are able, when needed, to go beyond the limits of how concentration risk is defined in the EU-wide framework, conducting the necessary deep dives, asking for supplementary information, and requiring the banks' management to address the observed risk concentrations. While the ECB internal procedures for credit concentration are aligned with the CP, the expectations of the supervisor with respect to concentration risk management are not clearly and publicly communicated to the banks.
Principle 20	**Transactions with related parties.** In order to prevent abuses arising in transactions with related parties[103] and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties[104] on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes.

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

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

Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties." This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	There is no directly applicable EU-wide framework for exposures to related parties. Definitions of the term "related parties" and restrictions for credits to related parties can be found in the national legislation of some Euro Area Member States, such as Belgium, Cyprus, Finland, Germany, Estonia, Greece, Italy, Latvia, Malta, Portugal, Slovakia, and Spain. Based on advice from the European Commission, the ECB considers itself directly responsible for exercising the powers related to related parties granted under these national laws, as such powers fall under the ECB's tasks and underpin a prudential function; it has communicated such determination to all significant supervised entities. Some of the definitions of "related party" under national laws are broadly in line with the definition provided in this CP; however, they differ widely across SSM Member States. Credits to related parties may also be assessed as part of the suitability assessment of members of management bodies since they may jeopardize the members' independence (which is one of the assessment criteria under Article 91 CRD IV).
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties.[105]
Description and findings re EC2	National provisions in some Euro Area Member States provide—or empower the competent supervisor to ensure—that certain transactions not be undertaken under more favorable terms (e.g., preferential interests or favorable contractual clauses) than those with non-related parties. For instance, credit institutions in Germany, Italy, Slovenia, and Malta are required to enter any transactions with related parties on an arm's-length basis, monitor these transactions, and take appropriate steps to control or mitigate the risks. The assessors had access to material related to an onsite inspection whose findings (and related action points) included the deficiency of the bank's internal process to ensure that related parties were not treated on more favorable terms than non-related ones.
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.

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

Description and findings re EC3	The laws of some Euro Area Member States set limits for transactions with related parties. The upper amount is either a general amount for credit to related parties (e.g., Portugal), which can be a percentage or a numeric value, or an amount for the approval of individual credits to related parties (e.g., Spain, Ireland). There is no EU-wide requirement 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 assessors observed that one finding in an onsite inspection concerned the criteria adopted by a bank to identify those transactions that had to be approved by an appropriate committee of directors. The assessors also found evidence of a specific policy, implemented by a bank at the JST's request, which prevents the participation of Board members in decision-making on transactions for which they have a conflict of interest.
EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	Apart from the general powers granted to it by the SSMR (e.g., the power to require a bank to reinforce its arrangements, processes, mechanisms, and strategies), the ECB's powers to determine the existence of policies and processes concerning credits to related parties depend on existing national laws.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	Some national laws empower the respective competent authorities to impose upper limits on loans to related parties, as defined in each national law, on a case-by-case basis. In other Member States, the upper limit is defined by law and any credit beyond that limit requires prior approval by the competent supervisory authority (e.g., Spain). Depending on national law, the ECB is directly competent to authorize credit exceeding a limit defined by law (e.g., in Spain), to set—on a general or case-by-case basis—limits for exposures to related parties (e.g., in Portugal, Cyprus, Malta, Ireland, Estonia), or to deduct such exposures from capital when assessing capital adequacy (e.g., in Germany).
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related

	party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	See EC 1. The assessors found evidence of a specific document, to be implemented by a bank at the JST's request, detailing a policy for the identification of related parties and relevant transactions, for the reporting on such transactions to the Board and senior management, and for the management of any breaches of the policy.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties.
Description and findings re EC7	There is no EU-wide reporting requirement for transactions with related parties, except for FINREP, which follows the accounting standards and hence does not meet the requirements of this CP as regards the definition of related parties and of the relevant transactions. Some national laws require regular reporting to the competent authority on exposures, for instance on a quarterly basis.
Assessment of Principle 20	Materially Non-Compliant
Comments	There is no EU-wide framework for exposures to related parties; some, though not all the Member States in the Banking Union have laws and/or regulations in place that provide definitions of related parties and, in certain cases, prescribe limits for such transactions. As described above, assessors saw evidence that some JSTs actively discuss related party risk in individual cases, but there is no common approach to the supervision of related party risk for SIs in the SSM. Related party lending and, more generally, all forms of transactions with related parties (including those within different entities of the same banking group) are often one of the main factors behind the deterioration of the financial situation of a bank. As such, they need to be addressed decisively, leveraging on: a regulatory framework that ensures the identification of related parties and relevant transactions according to definitions at least as encompassing as those provided by this CP; adequate reporting on aggregated related party transactions, based on such definitions; and powers to require that banks put adequate safeguards in place to limit their transactions with related parties, prevent them to be approved under preferential terms, and prevent their beneficiaries to take part in the approval of such transactions. Having a common, harmonized framework within the EU (or, at least, the Euro Area) would represent a solid base for supervisors to do their job in monitoring transactions with related parties, assessing how banks equip themselves to track, monitor, and manage them, intervening with supervisory and/or enforcement actions when needed.
Principle 21	**Country and transfer risks.** The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report, and control or mitigate

	country risk[106] and transfer risk[107] in their international lending and investment activities on a timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting, and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored, and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	Country and transfer risk are not specifically mentioned in CRD IV/CRR. In the EBA SREP Guidelines, country risk is treated as a subcategory of Credit Risk (paragraph 154). Similarly, the SSM SREP methodology, based on the EBA SREP Guidelines, covers country risk as a credit risk subcategory and provides indications for JSTs on how to assess it directly, rather than what to expect in terms of banks' policies and processes. Specific requirements on the measurement and management of country risk are available in a few national frameworks (e.g., in Ireland, the central bank's Country Risk Policy is largely based on this CP). The SREP methodology requires that national regulations be taken into account in its Phase 3 assessment. The assessors were shown the activity conducted by a JST on the country risk of a SI with significant cross-border exposures within and outside the Euro Area. It showed the attention paid by the JST to, inter alia, the policies and processes for country risk adopted by the banking group, the information available to the senior management, the limits by country introduced at group level, and the country risk perspective in the strategic and business plans.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.

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

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

Description and findings re EC2	See EC1.
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	There are no EU-wide or SSM-specific requirements specifically matching this EC (apart from the prescriptions on internal systems and limits for all risks in general or credit risk in particular). Most national frameworks (with a few exceptions, such as Ireland and Latvia) do not envisage specific requirements on banks' internal systems or require adherence to established country exposure limits beyond those foreseen for all risks in general or credit risk in particular.
EC4	There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include: (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate. (c) The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.
Description and findings re EC4	The SSM Supervisory Manual requires supervisors to verify that debt instruments and contingent exposures to countries experiencing (at least) a significant macroeconomic deterioration that may affect the country's ability to pay be adequately classified and provisioned for in the country risk impairment estimation. There is no EU-wide provisioning scheme against country risk and transfer risk. In a few countries, national schemes exist: in Spain, for example, the central bank circular on banks' financial statements establishes a framework for classifying and provisioning these exposures across six different risk levels; in Ireland, the central bank's Country Risk Policy requires each institution to determine the appropriate level of provisions in relation to country risk, establishes general guidelines in relation to the setting of provisions that must be adhered to by credit institutions, and subjects the adequacy of provisioning to supervisory review.

EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	There is no specific requirement (either at EU or at SSM level) for banks to incorporate country and transfer risk into their stress test exercises, beyond what is required with respect to credit risk (of which country risk is considered a sub-category). Generally, no specific requirement is envisaged in the national legislation of Member States either, with few exceptions (e.g., in Ireland, the central bank's Country Risk Policy provides that credit institutions should conduct stress testing analysis of their country risk exposures in order to monitor actual and potential risks).
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	The main data sources for the assessment of country risk are the geographical breakdown of credit risk exposures by residence of the obligor (COREP) and the geographical breakdown of assets by location of the activities or residence of the counterparty (FINREP). Depending on the country, some JSTs can rely on other non-harmonized NCA reporting: e.g., in Germany, banks must report transactions with borrowers domiciled in emerging market countries and exceeding a given threshold; in Ireland, the central bank receives quarterly data on the stock of loans by sector and by country; in Latvia, banks must prepare and submit to the FCMC monthly information on exposure to each country including information on country risk transfers; in Spain, the central bank circular on banks' financial statements requires banks to submit a specific template on country risk.
Assessment of Principle 21	Materially Non-Compliant
Comments	Country risk is considered a subcategory of credit risk in the EBA SREP Guidelines and the SSM Supervisory Manual. The two documents contain indications for the supervisors on what they should assess, criteria for how to allocate exposures by country, and the indicators supervisors should look at in assessing country risk. However, there is neither a EU-wide framework (and, consequently, no SSM-specific expectations) for country and transfer risk with explicit requirements on how banks should themselves identify, measure, evaluate, monitor, report, and control or mitigate country and transfer risk, as this CP requires. Similarly, the incorporation of country risk into stress tests is not explicitly required. There is no EU-wide provisioning scheme against country risk and transfer risk. In addition, the instructions for supervisors in the SSM Supervisory Manual are very concise and do not contain any indication on the need to assess the adequacy of the banks' policies, processes and internal systems (e.g., IT, risk management, internal control) beyond those for all risks in general or credit risk in particular. In a few Member States local regulations cover some aspects mentioned in this CP.

	The assessors observed the activity of a JST working on an internationally active bank with relevant cross-border exposures and concluded that it did not confine itself within the scope provided by the indications of the EBA SPER Guidelines and the SSM Supervisory Manual, but expanded it to analyze the bank's exposure to country risk from different angles, aligned with the national regulation in the country. That said, a EU-wide framework for country and transfer risk should be developed and the SSM methodological approach should be upgraded with more articulated indications about what supervisors should expect to find in banks with material exposure to such risk. These supervisory expectations should also be disclosed in an appropriate form, as suggested for risk management processes in general (see CP 15).
Principle 22	**Market risk.** The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance, and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	Article 83 of CRD IV requires competent authorities to ensure that banks implement policies and processes for the identification, measurement and management of all material sources and effects of market risks. The EBA SREP Guidelines recommend that supervisors assess whether: • the institution's market risk appetite and strategy is appropriate for the institution given, for example, its: overall risk strategy and appetite; market environment and role in the financial system; and, financial condition, funding and capacity and capital adequacy (paragraph 219 d); • the institution's market risk strategy broadly covers all the activities of the institution where market risk is significant (paragraph 219 f); • the institution's market risk strategy takes into account the cyclical aspects of the economy and the resulting shifts in the composition of the positions subject to market risk (paragraph 219 g); • the institution's market policies and procedures are sound and consistent with the market risk strategy (paragraph 222); and

	• the institution has an appropriate organizational framework for market risk management, measurement, monitoring and control functions, with sufficient (both qualitative and quantitative) human and technical resources (paragraph 220). Market risk is one of the sub-elements of the SREP. An annual assessment is performed, resulting in scorecards built from automatic indicators revised by expert judgement. The SSM Supervisory Manual provides questions and guidance for the assessment of market risk controls, including the adequacy and soundness of the market risk management process of institutions and taking into account the relevance of their market activity. The questions are spread over four dimensions: internal audit, internal governance, risk appetite, and risk management and internal controls. The Manual also provides procedures and techniques for reviewing market risk in onsite inspections. The assessors found evidence of how market risk is actually covered in day-to-day supervisory activity, including: a SREP assessment on market risk, quarterly reports on market risk, and three inspection reports on different segments of a bank's trading business.
EC2	The supervisor determines that banks' strategies, policies, and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	The EBA SREP Guidelines provide that supervisors assess whether: • banks have a sound, clearly formulated and documented market risk strategy, approved by their management body (paragraph 219); • the management body clearly expresses the market risk strategy and appetite and the process for their review (paragraph 219 a); • the management body approves the policies for managing, measuring, and controlling market risk and discusses and reviews them regularly, in line with risk strategies (paragraph 221 a). Supervisors engage with banks through requests for documentation, meetings, and onsite inspections, with a view to assessing the level of awareness of the Board of the market risks generated by the different businesses, and to analyze the reporting lines and accountabilities and the approval processes. Key areas of focus, in this regard, are the definition of the RAF, its translation into an articulated set of limits, the framework for monitoring and timely detection of market risk deterioration and the existence of a contingency plan. Deficiencies in the governance of market risk have been addressed in specific situations as a result of the thematic review on governance and risk appetite, as observed by the assessors.

EC3	The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including: (a) effective information systems for accurate and timely identification, aggregation, monitoring, and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile, and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, where necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	The EBA SREP Guidelines recommend that supervisors assess whether the bank's market risk policies and procedures are sound and consistent with the market risk strategy and cover all the main businesses and processes relevant for managing, measuring, and controlling market risks (para. 221). In particular, the Guidelines recommend that supervisors assess whether: a) banks have effective information systems for accurate and timely identification, aggregation, monitoring, and reporting of market risk activities, and the management control area reports regularly to the management body and senior management (paragraph 226); 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 institution's risk appetite, and 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 (paragraphs 227 b and 228); c) banks have appropriate internal control and practices to ensure that breaches of and exceptions to policies, procedures, and limits are reported in a timely manner to appropriate level of management for action (paragraph 227 c); d) risk managers and senior management are aware of the degree of model risk that prevails in the institution's pricing models and risk measurement techniques and periodically check the validity and quality of the different models used in market risk activities (paragraph 223 f); e) 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 (paragraph 222 b).

	The SSM Supervisory Manual requires JSTs to: • check that the institutions have Management Information Systems (MIS) that allow an accurate, timely identification, aggregation, monitoring, and reporting of market risk exposures; • assess if there are data quality checks put in place to assure consistency of data, and whether the management body and risk committee obtain regular and sufficient information on the nature and level of the bank's market risk; • verify that the bank's RAF reflects the bank's market risk strategies and policies defined by the management body and these are translated into a set of binding limits, the breach of which is promptly reported and triggers adequate actions; • verify, when models are used, that market risk management includes policies, procedures, and controls around the use of models to identify and measure market risk; and • verify that market risk management includes policies and processes for the allocation of exposures to the trading book. The assessors were able to verify the activity in this area conducted by some JSTs (e.g., dedicated meetings on market risk limits, deep dives on fair-valued assets and front-office pricing models, analysis of value at risk overshooting, and limit breaches) and inspection teams (e.g., targeted inspections on specific categories of derivatives). Criteria for delimitating the regulatory trading book are provided in the guide to TRIM and applied in the ongoing investigations.
EC4	The supervisor determines that there are systems and controls to ensure that bank' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	Article 105 of the CRR requires banks to establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates of trading book items (with Article 34 extending the requirement to all assets measured at fair value). These must include at least: (i) documented policies and procedures for the valuation process; and (ii) reporting lines for the valuation process that are clear and independent of the front office, and lead ultimately to the management body. The same article also prescribes that:

	• trading book positions shall be revalued at least daily; • marking to market should be done whenever possible and using the more prudent side of the bid/ask spread; • when marking to market is not possible, marking to model should be performed, in compliance with 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; • when marking to model, the model developed by the institution itself must be based on appropriate assumptions that have been assessed and challenged by suitably qualified parties independent of the development process; • independent price verification—in addition to daily prudent valuation—should be performed; • institutions shall establish and maintain procedures for considering valuation adjustments which shall formally consider a given set of factors; and • less liquid positions shall be subject to an appropriate treatment. The EBA issued RTS on prudent valuation in 2014; these apply to all fair-valued positions regardless of whether they are held in the trading book or banking book. The RTS introduce two separate approaches for the calculation of Additional Value Adjustments (AVA): 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 a "core" approach for institutions above that threshold. The EBA SREP Guidelines require supervisors to assess 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 (paragraph 224 b). The Guidelines also recommend that supervisors assess 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 (paragraph 222 g). The SSM Supervisory Manual also covers prudent valuation; it requires JSTs, inter alia, to assess whether an independent function is responsible for verifying market data and prices, and 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. The ECB is conducting specific assessments of the soundness and reliability of valuation frameworks in banks with significant shares of fair-valued assets and liabilities, especially those considered Level 2 (whose valuation is based, directly or indirectly, on observable market factors) or Level 3 (whose valuation is based on unobservable inputs) according to

	the IFRS fair-value hierarchy. The assessments are conducted through targeted onsite inspections, internal model investigations, and deep dives and address both the accounting treatment ('Day 1' profit and loss reserves for Level 3 instruments and valuation uncertainty reserves for Level 2 and 3) and the prudential one (AVA). The opaqueness in the valuation of certain products classified as Level 3 and the uncertainties in the classification of Level 2 assets and liabilities—together with the sheer size of these in the balance-sheets of some institutions in the Euro Area—justify an intense and frequent supervisory scrutiny.
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	In the EU, banks can use internal models for the computation of capital requirements for market risk (Article 362 of the CRR), subject to approval from competent supervisory authorities, which assess whether the minimum requirements established by the regulation are fulfilled (Article 363). Compliance with the minimum requirements should be verified in a continuous way by ongoing review of the approved models (Article 101 of CRD IV). This is ensured by a combination of ongoing model monitoring—based primarily on offsite reviews, which could include meetings at the premises of either the competent authorities or the credit institution—and internal model investigations. Assessment of the outcomes of the annual benchmarking process (Article 78 of CRD IV) is part of the ongoing model monitoring. To guarantee the reliability of internally developed methodologies, material changes to the models are also subject to supervisory approval (Article 363(3) of the CRR and Commission Delegated Regulation (EU) No 529/2014). Article 105 of the CRR provides a number of requirements for banks regarding prudent valuation of trading book positions, including the adoption of a margin of conservatism when marking to model their positions and portfolios, including when calculating own funds requirements for positions in the trading book (Article 105 (6)) and the use of prudent measures such as valuation adjustments where independent pricing sources are not available or pricing sources are more subjective (Article 105 (8)). A JST must 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. In addition, the SSM methodology includes "in-house" capital quantification tools based on both reporting and managerial data for market risk, which the JST supervisor can use as a base for a dialogue with the bank and, if necessary, as a challenge to the bank's internal capital estimations (ICAAP).
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.

Description and findings re EC6	According to Article 368 (g) of the CRR: "the institution shall frequently conduct a rigorous program of stress testing, including reverse stress tests, which encompasses any internal model used for [market risk own funds requirement calculation] and the results of these stress tests shall be reviewed by senior management and reflected in the policies and limits it sets. This process shall particularly address illiquidity of markets in stressed market conditions, concentration risk, one-way markets, event and jump-to-default risks, non-linearity of products, deep out-of-the-money positions, positions subject to the gapping of prices, and other risks that may not be captured appropriately in the internal models. The shocks applied shall reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions." The EBA SREP Guidelines (paragraph 224) recommend that supervisors assess whether an institution has implemented adequate stress tests regarding market risk that complement its risk measurement system. They recommend that supervisors cover: • stress test frequency; • whether relevant risk drivers are identified (e.g., illiquidity/gapping of prices, concentrated positions, one-way markets, etc.); • assumptions underlying the stress scenario; and • internal use of stress-testing outcomes for capital planning and market risk strategies. According to the SSM Supervisory Manual, JSTs should expect banks using the standardized approach, if significantly engaged in market activities, to develop some stress tests for risk management purposes.
Assessment of Principle 22	Compliant
Comments	In the EU framework, market risk is specifically identified as a separate risk category in the CRR and as a sub-element (as one form of risk to capital) in the harmonized SREP framework developed by the EBA and implemented by the ECB within the SSM. The CRR also contains detailed requirements for prudent valuation, complemented by specific regulatory standards issued by the EBA. The activity of JSTs and inspection teams in this area is wide-ranging, covering the different dimension of market risk described in this CP. The opaqueness in the valuation of certain products classified as Level 3 in terms of fair value hierarchy and the uncertainties in the classification of Level 2 assets and liabilities—together with the sheer size of these in the balance-sheets of some institutions in the Euro Area—justify an intense and frequent supervisory scrutiny. The SSM has stepped up the efforts in this direction with a program of off and onsite initiatives, primarily focused on ascertaining the correct valuation of Level 3 assets and liabilities and, for a specific family of

	products, Level 2 assets. This degree of scrutiny should continue and be extended to all Level 2 instruments, to verify whether the assets and liabilities in this category are correctly classified or should be moved to Level 3 and what impact any transfer could have on valuation and profit recognition. Monitoring the evolution of the fair value hierarchy in all banks could be helped by more granularity in the harmonized reporting (such as a breakdown by sub-type of instruments, share of unobservable parameters in their pricing, type of counterpart).
Principle 23	**Interest rate risk in the banking book.** The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report, and control or mitigate interest rate risk[108] in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile, and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies, and processes are consistent with the risk appetite, risk profile, and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	Article 76(1) of CRD IV requires the management body to approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating risks. Article 84 requires institutions to implement systems to identify, evaluate and manage the risk arising from potential changes in interest rates that affect non-trading activities. Article 98(5) requires supervisory authorities to include the exposure of institutions to IRRBB in their SREP process. Supervisory measures shall be required at least in the case of institutions whose economic value declines by more than 20 percent of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points. The EBA Guidelines on the management of interest rate risk arising from non-trading activities (i.e., IRRBB) provide principles and detailed guidance for: methodology and measurements assumptions related to interest rate risk; stress testing and scenario requirements; governance arrangements; and mitigation of IRRBB through internal capital. They also specify how the calculation of the standard supervisory shock required by CRD IV shall be performed. The EBA SREP Guidelines set out elements that supervisors should cover when assessing the management of interest rate risk from non-trading activities, including: interest rate risk

[108] 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.

	strategies and appetite (paragraph 309); organizational frameworks (paragraph 310); policies and procedures (paragraph 311); risk identification, measurement, monitoring, and reporting; and the internal control framework (paragraph 312). The offsite review of IRRBB, a specific sub-element of SREP (as a form of risk to capital), is governed by the indications of the SSM Supervisory Manual and organized around the assessment of risk levels and risk controls. A set of both high-level and detailed questions guides supervisors in the assessment of risk controls; they allow the supervisor to assess the bank's governance arrangements and the consistency of its strategy, policies, and processes with its risk appetite, risk profile, and systemic importance. JSTs must ensure that market and macroeconomic conditions are properly reflected in banks' internal model assumptions; models need to be reasonably stable over time but re-validated by the bank if any of the underlying assumptions is no longer applicable due to market developments. Onsite practices complement offsite ones: direct access to banks' management bodies allows inspectors to assess whether there is a periodical review of the IRRBB management framework. Inspectors can verify: • whether changes in the external environment (macroeconomic conditions, market developments), regulatory conditions, as well as internal factors (internal capital adequacy, liquidity, profitability) are reflected in the IRRBB management framework; • if a proper governance and an adequate decision-making process are in place for IRRBB issues, with clear involvement of the management body; • the existence of a documented and effective organizational framework for IRRBB management with an adequate segregation of functions between risk-taking units and the Risk Control Function; • the independence of the Risk Control Function; and • if sufficient human and technical resources are available for the functions involved in IRRBB management and control. The assessors found evidence of how the assessment of banks' strategies, policies and processes for IRRBB is carried out by JSTs through the analysis of banks' internal policy documents; JSTs also review the Assets and Liabilities Management (ALM) internal reporting and ALM Committee decisions. The consistency of the IRRBB framework with a bank's risk appetite and risk profile is assessed through the analysis of the annual review of the RAF and of the Risk Appetite Statement provided by banks on a yearly basis.
EC2	The supervisor determines that a bank's strategy, policies, and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.

Description and findings re EC2	Article 88(1a) of CRD IV stipulates the overall responsibility of the management body in approving and overseeing the implementation of the institution's strategic objectives, risk strategy, and internal governance. The EBA Guidelines on the management of interest rate risk arising from non-trading activities require that banks implement robust internal governance arrangements. In particular, the management body shall bear the ultimate responsibility for controlling IRRBB, determine the institution's overall IRRBB strategy and approve the respective policies and processes. The EBA SREP Guidelines require supervisors to assess whether the institution has an IRRBB strategy and policies approved by the management body (paragraph 309); whether the management body discusses and reviews them regularly (paragraph 311a); whether senior management adequately implement management body's guidance (paragraph 311b); whether policies are clearly formalized, communicated, and applied consistently across the institution (paragraph 311 d); and whether the principle of proportionality is applied in the determination of IRRBB risk management framework (paragraphs 312a to 312i). As part of the assessment of IRRBB within the SREP, supervisors specifically assess governance arrangements as well as the RAF related to IRRBB, verifying—also through the review of Board meeting minutes—whether: • the management body formally approves strategy, policies, and processes for the management of IRRBB risk; • senior management is ultimately responsible for the implementation of IRRBB policies and procedures and whether those policies and procedures are adequately formalized but also communicated across the institution; • the Board and senior management receive frequent and relevant reporting, taking into account the size and complexity of the institution. Onsite inspections can verify the extent to which there is genuine involvement of the management body in the IRRBB management framework, through direct access to the bank's key persons/intrusive view into the bank's internal governance. In particular, inspectors can assess whether: • the management body is actually involved in the initiation, design, and update of the IRRBB management framework, in particular as regards the risk strategy and appetite; • there are no overlaps in the governance of the risk profile; • responsibilities and assignments are clearly mentioned; • IRRBB policy and procedures are adequately documented, updated, and available to all relevant staff;

	• actual IRRBB practices do not diverge from policies and procedures formally adopted by the management body; and • the management body regularly reviews the IRRBB management framework along the approval of the risk strategy and risk appetite.
EC3	The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including: (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile, and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	The EBA SREP Guidelines require supervisors to assess whether the institution has the information systems and measurement techniques (including internal hedges) in place (paragraph 312a and 312e); whether the institution has adequate staff and methodologies to measure IRRBB (paragraph 312b); whether the IRRBB management and control area is subject to independent review and is clearly identified in the organization and functionally and hierarchically independent of the business area (paragraph 310 b); whether the institution has risk limits set up for IRRBB (paragraph 316, 316 a and b); whether the IRRBB strategy is effectively communicated to relevant staff (paragraph 309 f); whether the escalation process for a limit breach is timely (paragraph 315 c) and whether monitoring and reporting systems are in place (paragraph 314). Banks' interest rate risk measurement systems are assessed within the broader assessment of the risk management framework, covering, among others: • the existence of an information system and measurement techniques able to capture the inherent IRRBB in all of the material on and off-balance sheet exposures; • the access of management to timely results produced by the information system; and

	• the existence of an appropriate organizational framework, with competent staff and sufficient technical resources. The output of those measurement systems is further assessed by supervisors, who analyze the impact of interest rate changes on both the economic value of banks' equity (EVE perspective) and the short- and medium-term earnings (Net Interest Margin or NIM perspective). Banks' own estimates are benchmarked against metrics computed by the ECB, based on supervisory reporting. Supervisory benchmarks are computed over a "static" balance sheet assumption. However, supervisory expectations are that most complex institutions make use of dynamic balance sheet models in their projections; supervisors take those projections into account in their assessment. While EVE metrics consider the entire life horizon of banks' balance sheets, NIM metrics could differ in terms of time-horizon: supervisory benchmarks are computed over a one-year time horizon, but JSTs also assess NIM changes over a longer time-horizon (three years). JSTs verify that IRRBB measuring systems are reviewed and validated by internal functions, in particular with respect to assumption-dependent "behavioral" models such as (i) models that cover embedded options sold to customers (e.g., prepayment/optionality on loans such as mortgages); and (ii) modelled duration of liabilities (customer deposits). Supervisors verify that interest rate risk measurement systems and methodologies related to behavioral assumptions are adequately assessed by the Internal Audit function. Supervisors also assess whether senior management is aware of the model risk that IRRBB assumptions carry. Within the SREP, JSTs verify that the risk appetite is transposed into metrics and limits to ensure its coherence with the bank's risk taking. Within the assessment of the IRRBB's governance and risk management, JSTs focus on: • the consistency of the risk limit system with the overall risk appetite and risk strategy of the bank; • the internal consistency between limits on EVE and earnings; • the adequacy of processes for the regular review and update of risk limits; and • the adequacy of monitoring and reporting of limits. Exceptions to interest rate risk policies are assessed to gauge the functioning of internal control functions: supervisors assess whether exceptions to risk limits are adequately captured by risk reporting as a mean to make sure the Board and senior management have the chance to take the appropriate actions, if needed.

	The adequacy of information systems and the monitoring and reporting framework is assessed within the review of IRRBB risk management and internal controls, whereas Internal Audit functions are expected to have an explicit role. Supervisors assess: • whether IT systems capture all material IRRBB on- and off-balance sheet, including internal hedges; • whether modelling assumptions used for aggregates with no contractual maturity and/or embedded customer options are appropriately included in the monitoring and reporting framework; • whether monitoring and reporting systems adequately capture the four sub-risk types: basis risk, re-pricing risk, yield curve risk, and option risk; • whether those systems adequately capture the use and risk exposures stemming from the use of derivatives; and • whether IRRBB measurement systems are adequately audited by the Internal Audit function. More in-depth analyses on the above points can be performed during onsite inspections as well. In particular, inspectors can assess whether: • IRRBB policy and procedures are adequately documented, updated and available for key users; the scope, general methodology, objectives, risk appetite, risk limits, and responsibilities should be clearly communicated to all relevant staff; • there is an appropriate limit system in place, the limit system ensures prompt management attention in case of a violation of limits, and a set of indicators and an early warning system have been defined and are used to monitor IRRBB; • adequate staff and IT resources are allocated to the IRRBB management function; and • there is structured reporting on IRRBB to the appropriate management levels and to the relevant business and control units and the reports produced are of satisfactory quality and completeness and not under the sole control of risk-taking units. The assessors analyzed some anonymized monitoring reports, SREP reports, and minutes of meetings on interest rate risk between JSTs and supervised entities. These shows how interest rate risk is covered from different angles: e.g., current risk profile and expected developments, methodology (such as behavioral modeling), stress calculations, limits, governance arrangements, risk appetite, and the role of Internal Audit. Approximately 20 onsite inspections on IRRBB management and risk control systems have been conducted on SIs in the last two years.

EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	The EBA SREP Guidelines set out minimum standards for supervisors to assess the institutions' stress testing framework related to IRRBB. The guidelines require supervisors to assess the results of the scenario analysis and stress tests other than those for the standard shock performed by the institution, as part of its ongoing internal management process (paragraph 305) and also to assess whether additional analysis on accumulations of re-pricing/maturity at different points on the curve is performed. EBA Guidelines on Stress Testing (GL 32) provide guidance to banks on how to stress test their portfolios. Further guidance to banks has been recently put forward by the EBA Guidelines on the management of interest rate risk arising from non-trading activities. During the SREP cycle, supervisors assess whether: • IRRBB stress tests are integrated in the broader stress testing framework of the bank, i.e., whether the macroeconomic scenario and other scenario assumptions are consistent within the overall stress testing framework; • the stress test program is tailored for the risk characteristics of the bank and, as such, provides information on the conditions under which the bank's strategies or positions would be most vulnerable to market movements; • multiple stress scenarios are run—scenarios should at least explore the impact of changes in: (a) interest rate levels; (b) basis risk shock; (c) slope and curvature of the yield curve;(d) liquidity of underlying financial markets; and (e) volatility of market rates; and • methodological assumptions adequately cover the largest sources of customer risk behavior, i.e., whether behavioral assumptions that have a material impact on IRRBB exposure are tested frequently enough to be informative. Stress test results and their evolution over time are part of the risk level assessment for IRRBB and are further assessed through ECB's internal simulations on the impact of interest rate shocks based on supervisory information for each institution. Stress tests are further assessed during onsite inspections. Onsite practices include testing multiple scenarios; the breakdown of key assumptions (e.g., behavior of assets/liabilities, correlations); changes to market and macro conditions; and possible developments related to the business model. The coverage of simulations is also tested; stress tests should cover all sources of risks to which institutions are exposed and should encompass all relevant group entities. In 2017 the ECB decided to carry out its annual supervisory stress-test (as required by Article 100 of CRD IV) by conducting an IRRBB sensitivity analysis; after years of low rates, the intention was to assess banks' exposure to interest rate risk, by assessing the vulnerabilities of SIs to six heuristic interest rates shocks. The outcome was measured in terms of both changes in EVE and NIM projections and was complemented by qualitative

	information for a broader assessment of banks' risk management practices. The quantitative results were used as an informative factor to potentially adjust up or down the level of P2G (using the EVE metrics) and to enrich and inform the business model and IRRBB assessments in the SREP (using the NIM metrics); while the qualitative information on banks' risk management was used for the SREP assessment of internal governance and risk management.
Additional criteria	
AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	Article 98(5) of CRD IV requires supervisory authorities to assess the exposure of institutions to IRRBB in their SREP process. Supervisory measures shall be required at least in the case of institutions whose economic value declines by more than 20 percent of their own funds as a result of a sudden and unexpected change in interest rates of 200 basis points. EBA IRRBB guidelines specify how the calculation of the standard supervisory shock required by CRD IV shall be performed. The new guideline on standards for IRRBB published by the BCBS in April 2016 reduced the threshold for identifying outlier banks from 20 percent of a bank's total capital to 15 percent of a bank's Tier 1 capital; EU legislation should be amended accordingly, to incorporate this change and the principles of the new standard in general. The EBA SREP Guidelines require supervisors to assess whether institutions consider the impact of a standard shock on the economic value as a proportion of regulatory own funds (paragraph 293b). For all SIs, the ECB receives on a quarterly basis banks' own estimates of the impact of a +/- 200 bps shock on both the EVE and one-year NIM projections based on internal measurement systems. Banks also provide estimates excluding the impact of modelling assumptions ruled by the EBA Guidelines on IRRBB. Both EVE and NII types of metrics contribute to the Pillar II assessment performed by bank supervisors at least on a yearly basis. Moreover, the evolution of banks' internal risk figures is monitored by the ECB horizontal functions on a regular basis.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture IRRBB.
Description and findings re AC2	The EBA SREP Guidelines require supervisors to assess whether the institutions have maintained an adequate level of internal capital to cover risks to which they are exposed (paragraph 96) and whether they have allocated sufficient internal capital to IRRBB (paragraph 293d). For SIs, the adequacy of banks' internal capital measurement systems in capturing IRRBB is assessed yearly by supervisors as part of the SREP. Supervisors assess the reliability of

	banks' ICAAP calculations and "verify and challenge" their internal estimates by comparing them with a supervisory proxy, i.e., a quantification of the capital needed by an institution to cover its IRRBB based on standard assumptions; the quantification aims at facilitating the understanding of the main drivers of the capital calculation conducted by the bank but is not intended to oppose the bank estimates directly. The additional knowledge gained using this tool should support the JST in having a more consistent supervisory dialogue with the bank. As a logical corollary to the verify-and-challenge function of the tool, ECB risk quantification may be used as a basis for possible corrections to a bank's internal quantifications, but this is not supposed to be an automatic outcome of the SREP process. The assessors analyzed an example of an ICAAP assessment focused on IRRBB.
Assessment of Principle 23	Compliant
Comments	CRD IV specifies the duties of the management body to approve and periodically review the strategies and policies for taking up, managing, monitoring, and mitigating risks; it also addresses the need for banks to implement systems to identify, evaluate, and manage the risk arising from potential changes in interest rates that affect non-trading activities. EBA Guidelines on the management of IRRBB provide guidance for methodology and measurement assumptions related to interest rate risk; stress testing and scenario requirements; governance arrangements as well as mitigation through the internal capital of IRRBB. They set the requirement that a bank's strategy, policies, and processes be appropriately adjusted with its changing risk profile and market developments and that the bank perform a regular review and independent validation of models used for interest rate risk management. The EBA SREP guidelines set out elements that supervisors should cover when assessing the management of interest rate risk from non-trading activities, including: interest rate risk strategies and appetites; organizational frameworks; policies and procedures; risk identification, measurement, monitoring and reporting; and internal control framework. The assessment of IRRBB is covered in the SREP and represents one of the sub-elements of capital element in the RAS. The assessors obtained evidence of offsite and onsite supervisory activity specifically focused on IRRBB. The stress-test exercise on IRRBB conducted on SIs in 2017 has allowed the ECB to gather granular information on banks' exposure to this risk after years of low interest rates. As part of the exercise the ECB also collected qualitative information for a broader assessment of banks' risk management practices. JSTs will follow up on the results focusing on the modelling of depositor behavior, the use of interest rate derivatives, and the consistency of IRRBB positions and practices with risk appetite/governance frameworks.

	The new guideline on standards for IRRBB published by the BCBS in April 2016 reduced the threshold for identifying outlier banks from 20 percent of a bank's total capital to 15 percent of a bank's Tier 1 capital; EU legislation should be amended accordingly, to incorporate this change and the principles of the new standard in general.
Principle 24	**Liquidity risk.** The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report, and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	In the EU, a LCR requirement has been effective as a minimum requirement for all credit institutions since October 2015; it was established by Article 412(1) of the CRR and supplemented by the commission Delegated Regulation (EU) 2015/61 (DA), which provides instructions for its implementation. The minimum ratio has been raised to 100 percent from January 1, 2018 (from 80 percent in 2017), one year ahead of the internationally agreed schedule. The ECB may waive the application of the LCR requirement on an individual basis, both at the national as well as at the cross-border level (Article 8 of the CRR). Article 414 of the CRR, on compliance with liquidity requirements, states that in case the LCR of an institution has fallen or may be reasonably expected to fall below 100 percent, the institution must immediately inform the competent authority and submit a plan for the timely restoration of compliance. The EU's LCR framework was subject to a RCAP review by the BCBS in 2017. The framework was found to be overall largely compliant with the Basel LCR standard, reflecting the fact that most but not all provisions of the Basel standard were incorporated in the EU LCR framework. However, the RCAP also identified one material deviation and four potentially material deviations that significantly overstate or may overstate the LCR for some banks in the EU and, in turn, may thus affect fairness and comparability both between EU banks and vis-à-vis other banks in jurisdictions that subscribe to the Basel framework. In particular, the EU recognizes high-quality covered bonds and assets issued by certain EU credit institutions as Level 1 HQLA; by contrast, the Basel LCR standard has a strict definition of Level 1 HQLA, which are limited mainly to instruments such as central bank reserves and 0 percent risk-

	weighted sovereigns. The treatment of certain inflows is also less stringent than under Basel, while the opposite is true for some outflows. In its LCR impact assessment report the EBA provides a measurement of the differences between the Basel and EU LCR frameworks. In its last edition (December 2016) it found that, in a sample of 139 banks, the overall LCR is 133.1 percent under both the EU and Basel LCR frameworks, suggesting the existence of some compensation effects between less and more conservative rules. There are, however, differences at a more granular level: while the difference between the two frameworks is negative and small in percentage terms for the 29 larger banks (banks with tier 1 capital in excess of EUR3 billion and internationally active), the difference between the two frameworks among smaller banks (all the other ones) is positive and greater in relative terms. The negative impact of the EU provisions among larger banks is greater for G-SIBs: the major driver behind the negative change for these banks is represented by outflows. The distribution of the results shows a certain dispersion, with 15 banks (of which one large bank, but no G-SIBs) whose LCR moves from below to above 100 percent under the EU framework. The assessors were not able to verify the results for the sub-sample of banks under SSM supervision; however, in the light of the EBA analysis, it is presumable that the deviations of the EU LCR framework from Basel tend to favor the smaller banks more than the larger ones. The LCR is used as one of the indicators for performing supervisory assessments of liquidity risk in the SREP. Additional liquidity monitoring metrics are used to complement the assessment. This quantitative analysis is supplemented by a qualitative phase, in which the assessor must evaluate the compliance of the bank with certain regulatory requirements, technical standards and key guidelines. The process includes the assessment of the reliability of the institution's ILAAP. After finalizing the assessment, JSTs should consider if there is a need to impose liquidity measures. SREP measures should reflect weaknesses and vulnerabilities identified in the liquidity risk assessment. Measures can be either of qualitative or quantitative nature (or both). Quantitative measures should in particular be considered when there are material risks that are not covered by the LCR and the institution is not adequately monitoring and mitigating these risks via its risk controls and ILAAP. In some Euro Area jurisdictions there are national liquidity requirements that supplement the LCR requirement.
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	The DA contains treatments for both on- as well as off-balance sheet items. In particular, banks shall include in their LCR calculation any additional outflow for collateral outflows

	that would result from the impact of an adverse market scenario on their derivative transactions under market stress, a draft RTS has been issued. Banks shall also include an additional outflow for all contracts entered into the contractual conditions of which lead within 30 calendar days, and following a material deterioration of the credit quality of the institution, to additional liquidity outflows or collateral needs, where the competent authority considers such outflows material (Article 30(2) of DA). The EBA SREP guidelines (paragraph 391) envisage the possibility of competent authorities assessing the possible change in and sensitivity of the LCR during mild stress scenarios, by means of supervisory or institution liquidity-specific stress testing. The scenarios applied for this assessment should typically be less severe (e.g., only market-wide stress) than the scenarios used to test the survivability of the institution (market-wide and systemic stress) and consequently reflect situations in which institutions would not be expected to use their minimum liquidity buffer. There is no specific requirement to verify the adequacy of a bank's liquidity with respect to the context of the markets and macroeconomic conditions in which they operate; however, in practice, JSTs require banks, when needed, to incorporate the current and prospective evolution of the markets and of the general economy in the analysis of their liquidity position. This was observed by the assessors in a few anonymized cases.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance
Description and findings re EC3	The legal basis requiring SIs to maintain sufficient liquidity to withstand a range of stresses and to have a robust liquidity management framework is established in Article 86 of CRD IV, which also provides that competent authorities ensure that institutions have robust strategies, policies, processes and systems for the identification, measurement, management, and monitoring of liquidity risk over an appropriate set of time horizons, including intra-day, so as to ensure that institutions maintain adequate levels of liquidity buffers. The assessment of the institution's liquidity risk framework is a key component of the SREP methodology. The supervisor assesses the institution's internal risk controls and policies, complemented by onsite inspections on the functioning of these arrangements. Secondly, the assessment of sufficient liquidity is the key process of the SREP for liquidity, with the liquidity adequacy of the institution being assessed against key metrics. The quantitative part of the assessment starts with the analysis of the LCR, which involves a standardized stress scenario incorporating predefined retail and wholesale outflow rates. As part of the risk control assessment, the supervisor considers whether the institution has an adequate stress testing framework, whether it regularly and adequately identifies,

	measures, and monitories its liquidity and funding risk position in normal and stressed conditions and whether it provides assurance for a sufficient market access even under stressed conditions. A supervisory liquidity stress test tool is then used to challenge the bank's internal stress test and assess if the level of liquidity is adequate under various scenarios. In the qualitative part of the assessment, the assessor verifies whether: • the management body approves and reviews the liquidity management framework; • policies and procedures for liquidity risk are formalized and communicated throughout the institution; • the bank has a defined and documented liquidity risk strategy and tolerance; • there is sufficient evidence that the liquidity risk tolerance and strategy are approved and regularly updated by the management body; • the liquidity risk tolerance and strategy is determined on the basis of a sufficiently comprehensive process, including adequate definitions and documentation, and is reviewed and updated on a frequent basis; and • there is sufficient evidence that the liquidity risk tolerance and strategy are implemented and communicated to all relevant staff.
EC4	The supervisor determines that banks' liquidity strategy, policies, and processes establish an appropriate and properly controlled liquidity risk environment including: (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring, and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	In the SREP assessment supervisors must verify whether: • the bank has a defined and documented liquidity risk strategy and tolerance; • the bank has a documented framework for liquidity risk management;

	• the management body approves and reviews the liquidity management framework; • policies and procedures for liquidity risk are formalized and communicated throughout the institution; • the policies and procedures are in line with the liquidity risk tolerance; • the institution has the capacity to monitor and manage the intraday liquidity position against expected activities and available resources; • the institution has a set of indicators or other tools for measuring liquidity risk; and • the institution identifies potential restrictions on the effective movement of liquidity and unencumbered assets among entities within the group. Additional elements to consider are whether: • the institution has a sound day-to-day management of its liquidity buffer and collateral; • the monitoring of positions and limits vis-à-vis the available liquidity buffer is consistent with the internal policies; • the monitoring is sufficiently granular and frequent to ensure day-to-day positions stay within risk appetite, including the monitoring of the LCR, ensuring compliance also between the reporting dates; and • the institution adequately considers intraday liquidity risks in its day-to-day management (i.e., policies, reporting, measurement, etc.). When assessing a bank's ILAAP, supervisors must verify whether: • the management body discussed and approved the ILAAP key elements and main outcomes, structure, control environment and documentation; and • there are solid foundational risk measurement and management and robust data and IT infrastructures supporting the ILAAP. The framework for JSTs to assess banks' compliance with the requirements listed in this EC is incomplete. For example, there is no explicit requirement, at EU-wide level, for the Board to conduct (at least annually) a regular review and appropriate adjustment of the bank's strategy, policies and processes for the management of liquidity risk in the light of the bank's changing risk profile and external developments in the markets and macroeconomic conditions in which it operates. Such a requirement is included in some national frameworks (e.g., Germany, France). The assessors were provided evidence of how banks can be subject to daily (and, if needed, intra-day) liquidity monitoring once a JST perceives the risk of a deterioration in liquidity positions.

	Onsite inspections on liquidity risk can be arranged, if needed, at the request of a JST; in the last two years there have been 13 such inspections.
EC5	The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational, and reputation risk) may impact the bank's overall liquidity strategy, and include: (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies, and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets.
Description and findings re EC5	According to Article 86(4) of CRD IV, banks shall develop methodologies for the identification, measurement, management, and monitoring of funding positions. Those methodologies shall include the current and projected material cash-flows in and arising from assets, liabilities, and off-balance-sheet items, including contingent liabilities, and the possible impact of reputational risks. Accordingly, the SSM methodology assesses whether banks have established, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes should include consideration of how other risks (e.g., credit, market, operational, and reputation risk) may impact the bank's overall liquidity strategy, and include: (a) The funding plan is assessed both qualitatively and quantitatively, first and foremost via the assessment of risk control, by verifying whether the bank has in place a funding plan that is regularly updated and approved. Standardized data on the bank's projected assets and liabilities in relation to its funding plans is collected according to the ECB decision on the reporting of funding plans of credit institutions by NCA to the ECB (June 27, 2017). The EBA SREP Guidelines require competent authorities to assess whether the funding plan is feasible and appropriate in relation to the nature, scale, and complexity of the institution, its current and projected activities and its liquidity and funding profile, by taking into account, inter alia, "whether the funding plan is robust in terms of its ability to support the projected business activities under adverse 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 is assessed through:

	• the analysis of the LCR and of specific data collected on the liquidity buffer and on asset encumbrance (ITS), on at least a quarterly basis; • performance of supervisory stress tests, on at least an annual basis; and • the bank's internal determination of liquidity needs (stressed and unstressed), on at least an annual basis. (c) Diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits, is assessed through the analysis of: (i) the specific ITS on Additional Liquidity Monitoring Metrics on the concentration of funding, and (ii) indicators on the quality of the liquidity buffer. (d) The bank's regular efforts to establish and maintain relationships with its liability holders are verified through the assessment of its funding plan. (e) Article 417(b) of the CRR requires that, in order to be considered liquid, assets must be legally and practically readily available at any time during the next 30 days to be liquidated via outright sale or via a simple repurchase agreement on approved repurchase markets in order to meet obligations coming due.
EC6	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	The January 2016 letter from the Chair of the ECB's Supervisory Board to banks' management bodies contains a self-assessment template for ILAAP where banks are required to evaluate their compliance with the requirement to have a formal contingency funding plan (CFP) that clearly sets out the strategies for addressing liquidity shortfalls in emergency situations, outlines policies to manage a range of stress environments, and establishes clear lines of responsibility, including clear invocation and escalation procedures. The CFP should be regularly tested and updated to ensure that it is operationally robust. The JST assesses whether the SI's liquidity contingency plan (LCP) adequately specifies the policies, procedures and action plans for responding to severe potential disruptions to the institution's ability to fund itself. Supervisors need to assess: whether the actions described in the LCP are feasible in relation to the stress scenarios in which they are meant to be taken; the appropriateness of escalation and prioritization procedures detailing when and how each of the actions can and should be activated; and whether the institution has

	adequate policies and procedures with respect to communication within the institution and with external parties. The appropriateness of the assumption regarding the role of central bank funding in the institution’s LCP is taken into consideration. On at least an annual basis, the JST makes an assessment of the adequacy and appropriateness of an SI’s LCP. The assessors had the opportunity to observe the analysis conducted by JSTs on anonymized contingency funding plans.
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 programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies, and positions and to develop effective contingency funding plans.
Description and findings re EC7	The EBA SREP Guidelines require competent authorities to assess whether an institution has implemented adequate liquidity-specific stress testing as part of its overall stress testing program (paragraph 408). These should allow the bank to determine whether the institution’s liquidity holdings are sufficient to cover risks that may crystallize during different types of stress scenarios and/or to address risks posed by control, governance or other deficiencies. Competent authorities should analyze whether the following scenarios are considered as a minimum: (i) short-term and prolonged; (ii) institution-specific and market-wide (occurring simultaneously in a variety of markets); and (iii) a combination of (i) and (ii). Competent authorities should also assess whether the institution takes a conservative approach to setting stress testing assumptions (paragraph 412). Competent authorities should verify whether the outcomes of stress testing are integrated into the institution’s strategic planning process for liquidity and funding and used to increase the effectiveness of liquidity management in the event of a crisis, including in the institution’s liquidity recovery plan (paragraph 413). According to the SSM expectations on ILAAP, stress tests play a key role in the quantitative assessment of institutions’ liquidity needs and their ability to continue their operations throughout periods of stress. They also indicate the kind of backstop actions that institutions (and supervisors) need to take to ensure at an early stage that they are able to maintain their resilience if the simulated adverse scenario actually occurs. The assessors believe that assumptions about the outflows of different categories of deposits within given time horizons should be revised, both for the banks’ own and the supervisory stress testing, in the light of recent episodes that led to the resolution of banks and that, at least in one case, were determined by an exceptional and largely unforeseen

	acceleration of deposit withdrawals. The assessors got no evidence that such a revision has been done.
EC8	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.
Description and findings re EC8	Article 415(2) of the CRR requires an institution to report LCRs separately in the currencies in which it has more than five percent of its total liability or if it has a significant branch in a Member State using a different currency. Article 4(5) of DA requires institutions to also observe the LCR requirement in these currencies. While a foreign currency LCR is calculated and reported, it is not subject to a binding requirement. The EBA SREP Guidelines prescribe that the supervisor should consider the size, location, and currency of an institution's liquidity needs and, where it operates in different material currencies, the separate impacts of shocks in the different currencies, to reflect currency convertibility risk. The supervisor should also consider whether the denomination of liquid assets is consistent with the distribution of liquidity needs by currency (paragraph 383). In the assessment of banks' own stress testing programs, competent authorities should consider the appropriateness of a number of assumptions, including foreign currency convertibility and access to foreign exchange markets (paragraph 412). The current COREP data collection on the LCR and NSFR collects information by currency, for currencies representing at least five percent of aggregated liabilities. The additional liquidity monitoring metrics provide further specification of these mismatches per significant currency. In relation to stress testing and the risk control assessment, the supervisor is asked to consider foreign currency convertibility, access to foreign exchange markets and the ability to transfer liquidity across entities. The supervisor may set limits on the extent of liquidity transformation through the application of stress tests via the LCR in a foreign currency. Foreign exchange risk is assessed by JSTs for both short-term liquidity and funding sustainability risk levels as a specific sub-category of liquidity risk. Based on the assessment, the supervisor may consider requirements for the composition of the institution's liquid-assets profile in respect of counterparties, currency, etc.

	There is no explicit requirement for supervisors to conduct separate analysis of liquidity risk strategy and monitoring of liquidity needs for each significant currency (though this requirement is available in some national jurisdictions) and to evaluate banks' ability to transfer liquidity from one currency to another across jurisdictions and legal entities. Considering the sizeable currency transformation operated by some internationally active banks, some with considerable presence in non-Euro markets, the ECB should ensure that the relevant JSTs receive adequately granular and frequent breakdown of those banks' cash flows in the main non-Euro currencies. Regular reporting of a maturity ladder with a breakdown also by significant currency started in March 2018.
Additional criteria	
AC1	The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.
Description and findings re AC1	Article 100 of the CRR requires banks to report to the competent authorities the level of all forms of asset encumbrance, at least in aggregate terms. In application of this Article, the EBA has published ITS on asset encumbrance. Regarding disclosure, pursuant to Article 443 of the CRR (on unencumbered assets), the EBA published draft RTS on disclosure of encumbered and unencumbered assets. They provide the set of principles and templates that enable the disclosure of information on encumbered and unencumbered assets by products on a consolidated basis. Article 86(5) of CRD IV 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. The EBA SREP Guidelines require competent authorities to assess whether potential shortcomings arising from the institution's funding profile, such as (inter alia) excessive levels of asset encumbrance, could lead to an unacceptable increase in the cost of funding for the institution (paragraph 394). They should take into account whether an increasing level of asset encumbrance above acceptable limits reduces access to and increases the price of unsecured funding. The guidelines do not explicitly require supervisors to ensure that banks set appropriate limits to mitigate identified risks. Competent authorities should assess risks to the sustainability of the funding profile arising from concentrations in funding sources, taking into account (inter alia) the risk that asset encumbrance may have an adverse effect on the market's appetite for the unsecured debt of the institution (in the context of the specific characteristics of the market(s) in which the

	institution operates and the institution's business model) (paragraph 396). Factors for this assessment may include: • the total amount of encumbered and/or borrowed assets compared with the balance sheet; • the availability of free assets (assets that are unencumbered but that may be encumbered), especially when considered in relation to total unsecured wholesale funding; • the level of overcollateralization relative to the capital base; and • the implications of the level of overcollateralization for the deposit insurance scheme if the institution fails. Competent authorities may require action to be taken to amend the institution'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.) (paragraph 497). Within the SREP assessment, supervisors are required to verify whether the bank forecasts its liquidity position taking into account asset encumbrance and identifies restrictions on the effective movement of liquidity and unencumbered assets among entities within the group. The indicators that, at a minimum, need to be assessed are the asset encumbrance ratio, indicating the risk of heavy reliance on secured funding. This ratio provides insight on the extent to which the institution has encumbered its assets and re-used the collateral received over the total assets and collateral received, either for funding purposes or to secure, collateralize or credit enhance a transaction (e.g., financial guarantees). The secured funding ratio measures the concentration of the secured funding provided by financial and nonfinancial counterparties with regard to the total liabilities position (net of derivatives). The level of secured funding should be more deeply assessed in terms of maturity and quality of collaterals (extremely high, high, other). The asset encumbrance at central banks ratio measures the proportion of encumbrance that originates from central bank funding over the total encumbrance value. The overcollateralization ratio may indicate a qualitative aspect of the encumbered collateral providing an overall view of how much collateral is used for funding received, incorporating all haircuts applied. JSTs should differentiate in their assessment between total level of asset encumbrance and overcollateralization, since the total amount of asset encumbered per 1 EUR in funding can greatly vary. In this area, the JST should assess the information about total encumbrance, and encumbrance at central banks, with other relevant data, such as the business model, the institution's capacity to access capital and debt markets, the type of operations with central banks (since the institution may resort to them for low cost financing e.g., TLTRO), the type

	and volume of encumbered asset classes (exhausted assets classes of 'higher' marketability e.g., debt securities and/or extensive encumbrance of loans may indicate liquidity drainage), the overcollateralization both total and per type of financial liability (a high ratio may indicate stringent collateral requirements e.g., for derivatives transactions or usage of lower quality collateral since all haircuts are considered). Further analysis of long-term wholesale funding should be performed by assessing the institution's ability to rollover and raise additional wholesale funds in terms of amount or capacity, maturity, currency, and price compared to the risk-free rate and to the price peer institutions are paying. Moreover, the JST should analyze the amortization profile of the institution's wholesale funding to identify future concentrations of maturities that might exceed the rollover capacity. Given the separation of roles and responsibilities between the monetary and supervisory functions of the ECB and the decentralized operation of emergency liquidity assistance (provided by NCBs), the information on unencumbered assets currently available to ECB banking supervision might not be sufficient to gauge the residual capacity of a bank to obtain emergency liquidity in a quickly deteriorating environment, as one of the recent episodes of bank resolution has demonstrated.
Assessment of Principle 24	Materially Non-Compliant
Comments	The LCR requirements apply to all credit institutions as a Pillar 1 minimum standard. Banks are also required to run regular stress tests where the results are incorporated into the assumptions for contingency funding plans. The EU LCR framework was subject to a RCAP review by the BCBS in 2017, which found the EU LCR framework overall largely compliant with the Basel LCR standard, but with some deviations, especially in the definition of HQLA: one of these deviations was deemed material. The treatment of certain inflows is also less stringent than under Basel, while the opposite is true for some outflows. As shown by a review conducted by the EBA, the average difference between the LCR under the two regimes is almost nil for a large sample of EU banks, though the individual results show how some banks would be compliant with the LCR under the EU regime but not under the Basel one. The assessors had access to the aggregate results for a sub-sample of Euro Area banks and observed how, for the largest ones, there is generally no overestimation of LCR with respect to Basel or a very limited one, though for some relatively smaller banks the overestimation can be sizeable. Liquidity risk is one of the main components of the SREP assessment, and as such is extensively covered in the SSM Supervisory Manual. One of the inputs for the assessment of liquidity risk is represented by a bank's ILAAP, for which the ECB has communicated to banks its expectations and provided indications for its preparation and compilation.

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However, the coverage of this CP is incomplete:

there is no explicit requirement, at EU-wide level, for the Board to conduct (at least annually) a regular review and appropriate adjustment of the bank’s strategy, policies, and processes for the management of liquidity risk in the light of the bank’s changing risk profile and external developments in the markets and macroeconomic conditions in which it operates (EC 4); and
there is no explicit requirement, at EU-wide level, for supervisors to conduct separate analysis of liquidity risk strategy and monitoring of liquidity needs for each significant currency and to evaluate the bank’s ability to transfer liquidity from one currency to another across jurisdictions and legal entities; data to support this kind of analysis were not generally available at the time of the assessment, though regular reporting of a maturity ladder with a breakdown also by significant currency started in March 2018 (EC 8).

The revised ILAAP Guide, subject to a public consultation in the first half of 2018, states the ECB expectations with respect to the above-mentioned requirements; however, the revised Guide has not been issued yet and it will be implemented for the first time for the SREP of 2019.

Considering the sizeable currency transformation operated by some internationally active banks, some with considerable presence in non-Euro markets, the ECB should ensure that the ITS include adequately granular and frequent breakdown of those banks’ cash flows in material non-Euro currencies and by jurisdiction and that the JSTs monitor it on a regular basis (see also CP 10). Regular reporting of a maturity ladder with a breakdown also by significant currency started in March 2018.

There is no explicit recommendation for supervisors to require banks to set appropriate limits to mitigate risks posed by excessive levels of encumbrance (AC 1).

In the assessors’ view, the assumptions on the outflows of different categories of deposits within given time horizons should be revised, both for the bank’s own and supervisory stress testing, in the light of recent episodes that led to the resolution of banks and that, at least in one case, were determined by an exceptional and largely unforeseen acceleration of deposit withdrawals.

Given the separation of roles and responsibilities between the monetary and supervisory functions of the ECB and the decentralized operation of emergency liquidity assistance (provided by NCBs), the information on unencumbered assets currently available to ECB banking supervision might not be sufficient to gauge the residual capacity of a bank to obtain emergency liquidity in a quickly deteriorating environment, as one of the recent episodes of bank resolution has demonstrated.
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Principle 25	**Operational risk.** The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile, and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report, and control or mitigate operational risk[109] on a timely basis.
Essential criteria	
EC1	Law, regulations, or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report, and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite, and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	Article 312 of the CRR establishes the use of the standardized approach and the AMA to operational risk, subject to compliance with certain criteria and standards. The criteria for the standardized approach are detailed in Article 320 and require that the bank have in place: (a) a well-documented assessment and management system for operational risk with clear responsibilities assigned for this system. It shall identify its exposures to operational risk and track relevant operational risk data, including material loss data. This system shall be subject to regular independent review carried out by an internal or external party possessing the necessary knowledge to carry out such review; (b) the operational RAS shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile; and (c) an institution shall implement a system of reporting to senior management that provides operational risk reports to relevant functions within the institution. An institution shall have in place procedures for taking appropriate action according to the information within the reports to management. The qualitative requirements for AMA are described in Article 321 and state that: "(a) internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes; (b) an institution shall have an independent risk management function for operational risk; (c) an institution shall have in place regular reporting of operational risk exposures and loss experience and shall have in place procedures for taking appropriate corrective action; (d) an institution's risk management system shall be well documented. An institution shall have in place routines for ensuring compliance and policies for the treatment of non-compliance; (e) an institution shall subject its operational risk management processes and measurement systems to regular reviews performed by internal or external auditors; (f) an institution's internal validation processes shall operate in

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

	a sound and effective manner; (g) data flows and processes associated with an institution's risk measurement system shall be transparent and accessible." In terms of the risk assessment of operational risk, the EBA SREP Guidelines form the basis for JST action, as operational risk is one of the key risks assessed as part of the SREP. Importantly, supervisory engagement is proportional to the bank's size, complexity and risk profile. Potential supervisory activities include the following: (a) analysis of supervisory reporting (e.g., COREP Templates 16 and 17), financial statements (e.g., provisions for legal risk /other risks and charges) and internal documentation of the supervised institution (e.g., operational risk internal reporting, minutes of operational risk relevant committees, risk management policies, internal audit reports and progress on remediation programs, validation reports); (b) assessment of internal controls and procedures; (c) analysis of reports from external auditors; (d) meetings with external audit; (e) regular and ad hoc meetings with the institution's representatives at various levels of staff seniority (e.g., the risk management function, model development, validation unit etc.); (f) ongoing analysis including regular monitoring of risk level indicators (operational risk losses, legal disputes, regulatory sanctions, major incidents, capital, stress testing) and developments of the risk control framework (including aspects regarding governance, risk appetite, control tools and internal audit activity); (g) thematic reviews (IT risk and cyber security); (h) analysis of approved risk models (model developments and model changes, input data and parameters, model validation); approval of material model changes, extensions and new models; (i) benchmarking and peer analysis; (j) deep-dives on specific incidents/ topics; (k) onsite inspections; (l) assessment of ICAAP and SREP; (m) cooperation with supervisory authorities with local competence. ITS data submitted to the JST for routine assessment will depend on whether the SI is AMA, standardized or Basic Indicator Approach (BIA). The ECB has developed an operational risk benchmarking tool. The IDRA allows advanced users and all SSM supervisors to browse ITS data in a flexible way, create and publish the report templates, and support end users. The end users are all SSM supervisors who use the templates created by the advanced users. IDRA allows users to get key data on the institution and on a peer group basis. It produces

	a dashboard and operational risk data on capital requirements, losses distribution concentrations, severity/frequency, and model monitoring. During onsite inspections, inspectors obtain assurance that operational risk policy and procedures include all the relevant operational risk areas and establish a minimum set of operating instructions in order to have an effective risk management; they also verify if the policy and procedures are adequately documented, updated, and available to all relevant staff. The assessors were provided an example of a Supervisory Board decision where an SI was directed to improve its AMA framework and to impose a new operational risk capital requirement based upon deficiencies observed during a model change request review. The ECB also launched operational risk-related thematic reviews, questionnaires and pilot exercises. Thematic reviews were planned or conducted horizontally in the areas of IT risk, cybersecurity, risk data aggregation capabilities, and risk reporting practices compliance and outsourcing. Separate questionnaires on cybersecurity incident reporting and outsourcing were sent to a sample of institutions. The thematic reviews and questionnaires will inform future ECB supervisory policies and practices in these areas.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	The EBA SREP Guidelines constitute the basis for JST work regarding operational risk. The JSTs must take into account whether: (a) the management body clearly expresses the operational risk management strategy and tolerance level, as well as the process for the review thereof (e.g., in the event of an overall risk strategy review, a loss trend and/or capital adequacy concerns, etc.); (b) senior management properly implements and monitors the operational risk management strategy approved by the management body, ensuring that the institution´s operational risk mitigation measures are consistent with the strategy established; (c) these strategies are appropriate and efficient with respect to the nature and materiality of the operational risk profile and whether the institution monitors their effectiveness over time and their consistency with the operational risk tolerance level; (d) the institution's operational risk management strategy covers all the activities, processes and systems of the institution—including on a forward-looking basis through the strategic plan—where operational risk is or may be significant; and (e) the institution has an appropriate framework in place to ensure that the operational risk management strategy is effectively communicated to relevant staff.

	The ECB reviews SIs' operational risk compliance policies and practices in a variety of risk areas through its supervisory programs. The assessors reviewed a sample of the ECB's onsite mission "operational letters" on IT risk, cybersecurity and outsourcing. A thematic review on risk data aggregation capabilities and risk reporting practices was also reviewed. These documents were well supported and contained reasoned conclusions and recommendations.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank's overall risk management process.
Description and findings re EC3	According to Article 320 paragraph (b) of the CRR, one condition to qualify for the use of the standardized approach is that: "an institution's operational RAS shall be closely integrated into the risk management processes of the institution. Its output shall be an integral part of the process of monitoring and controlling the institution's operational risk profile;" For AMA banks, according to Article 321 paragraph (a), one condition in order to qualify for the use of AMA is that: "an institution's internal operational risk measurement system shall be closely integrated into its day-to-day risk management processes." In addition to the general activities and practices as mentioned under EC 1, within the SREP, while assessing the risk control framework related to operational risk in the annual RAS, ECB supervisors must verify several aspects related to the criteria: (a) that the management body of the supervised institution approves and periodically reviews the strategies and policies for taking up, managing, monitoring and mitigating the operational risks the institution is or might be exposed to; (b) the frequency with which operational risk management strategies and policies are updated; (c) evidence that updates of the strategies have been conducted promptly after the changes in operating environment (corporate events) or in legal environment; (d) the impact of the strategy changes regarding actively managing operational risk in the organization; (e) the adequate coverage of the legal and compliance risks, reputational risks and ICT risks. The effective implementation of strategies, policies and processes for operational risk management are further monitored through offsite and onsite activities assessing risk appetite/ tolerance level set, management information, internal audit/ external audit reports, organizing meetings, and thematic audits. Discussions about risk strategies and their implementation are often on the agenda of the meetings with the operational risk function of SIs. The effective implementation of operational risk strategies is also included in the scope of onsite inspections, for example regarding effectiveness of operational risk strategies with respect to outsourcing processes

	and vendor management. Integration within the bank's overall risk management processes is monitored for example also during analysis of the overall risk appetite (as was the case within the thematic review on internal governance and risk appetite). There are a number of areas where the supervisory activities to determine that the operational risk management framework is effectively implemented need further attention by supervisors in applying the framework. The SREP framework assesses the quality of risk management and controls and is used to confirm whether the operational risk framework is implemented effectively. This is especially relevant for AMA banks to verify and test through onsite inspections that the AMA framework is used by management as a way to measure, monitor and manage operational risk and that the constituent elements of the AMA framework are working as per the AMA framework e.g., risk and control self-assessments are being applied by business units as a way to assess the effectiveness of the control framework, an analysis of the business environment and control factors, use of internal and external loss data and lastly scenario analysis. The assessors examined a sample of the ECB's OSIs, deep dives and reviews of a SI in the area of operational risk framework and effective implementation. The ECB assessed AMA compliance, scenario analysis, business analysis, and control factors. The topics of specific ECB reviews focused on outsourcing, IT/cybersecurity risk, cloud computing, fintech, monitoring reports, litigation, IT/cybersecurity incident reporting, offshoring activities, and business continuity planning. The assessors observed that the ECB's 2015 Thematic Review of governance and risk appetite encompassed operational risk management issues. A sample finding from the governance and risk appetite showed that a bank's setting and monitoring of operational risk limits were assessed within its RAF. The assessors also were provided information showing that JSTs regularly meet with SI senior management (CRO, CIO, Risk and Audit Committee chairs and members) to discuss operational risk management issues. Assessors saw evidence where ongoing monitoring reports for operational risk were in place that looked at loss data by Basel event type, loss events and other factors exposing the entity to risk e.g., legal and compliance risks. In addition, assessors saw evidence of management information that included operational risk information (quarterly CRO report) as well as Internal Audit reports. The JSTs use the monitoring reports to perform peer comparisons of losses per event type, business lines, etc. Further initiatives are underway on horizontal comparisons. JSTs also have IMAS data and the IDRA tool to make comparisons between banks. AML is a major operational risk for SIs. The ECB does not have direct responsibility over AML compliance. Union law has entrusted AML regulation to NCAs. However, the ECB needs sufficient and timely information to consider AML risk in their risk assessment and risk supervision of banks. Legal barriers to the mandatory exchange of AML information among the ECB and NCA AML supervisory authorities should be removed. The ECB should take prompt supervisory measures based on a SI's AML related risk management and operational risk deficiencies. Measures which only increase capital and liquidity

	requirements may not be sufficient for high risk business models. More stringent measures such as restrictions on a SI's business activities may be more appropriate in egregious cases.
EC4	The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.
Description and findings re EC4	Specifically, in relation to this EC, the legal framework for outsourcing is based on the requirements for contingency and business continuity plans as set out in Article 85 paragraph 2 of CRD IV. For the assessment of SIs, JSTs use the guidelines issued by the EBA on Internal Governance (GL44), which also encompasses sound IT systems, outsourcing arrangements, and business continuity management. Banks should have in place contingency and business continuity plans, recovery plans, and appropriate training should be provided. According to the EBA guidelines, plans should be regularly tested and updated. In its SREP process regarding operational risk, the SSM follows EBA guidelines (see CP 8). The risks related to business continuity are part of regular meetings with SIs by the JST. In addition, the JST will request related documentation, for example scenarios, contingency and recovery tests results. Business continuity management and continuity plans are often part of onsite inspections related to operational risk. Among the objectives of such inspections, it is relevant whether the institution has an adequate and effective business continuity management process, including adequate procedures, regular testing, and crisis management framework. There are however no provisions within the regulations to establish minimum expectations regarding testing, review, and approval by board of disaster recovery and business continuity plans. As a result, plans typically differ regarding key aspects. Enhancing disaster recovery and business continuity plan standards is currently an industry issue and meetings with banks confirmed this assessment. The ECB's thematic reviews and questionnaires on IT risk, cyber security, and outsourcing will help inform future supervisory expectations and practices. The ECB considers cybersecurity to be a subset of IT risk and does not make a formal distinction between them for purposes of cyberthreat disaster recovery (See EC 5).
EC5	The supervisor determines that banks have established appropriate IT policies and processes to identify, assess, monitor, and manage technology risks. The supervisor also determines that banks have appropriate and sound IT infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security, and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	See also EC 1 in relation to the requirement for SIs to establish appropriate IT policies and processes. JSTs use the EBA's guidelines as the basis for their IT assessments. These are based on two elements of the RAS: (a) risk level: operational risk (identification of material operational risk sub-categories, ICT-risk, and (b) risk control: as part of risk management and controls.

	The risks related to IT are part of regular meetings with the institution (such as with risk management, internal audit or representatives of the bank with specific IT systems and infrastructure responsibilities). IT/cybercrime was a supervisory priority (thematic review) for the SSM in 2015–2016, followed up in the cyber security questionnaire and in the pilot, exercise organized in 2016 for the reporting of IT cyber incidents. Management information and reports, including indicators related to performance systems are analyzed. The pilot cyber incident reporting has been replaced by a mandatory cyber incident reporting for all supervised institutions as of July 2017. Continued attention should be paid to banks' increasing use of and reliance on new technologies including cloud computing and payments innovations. The level of operational risk increases significantly if industry uses new untested technology for core systems. Due diligence and assessment should be commensurate with identified risks. Among the relevant elements to be monitored by the JSTs regarding technology including cloud computing. The assessors note that the ECB has emphasized the existence, or lack, of audit clauses for banks and supervisors, control by the outsourcer on the data location, private data confidentiality requirements, IT security conditions, and the existence of reversibility plans. A sample Fintech Assessment Review of an SI was provided to the assessors. The assessors also note that the ECB has issued for consultation on September 21, 2017 a guide for assessing general credit institution licensing and a guide for assessing fintech credit institutions licensing to clarify supervisory policies in this emerging area. Separate from the ongoing supervision within the JSTs, the SSM conducts onsite inspections of IT as part of inspections related to operational risk. Among the objectives of such inspections, the following are relevant: whether the institution has an appropriate IT risk management, an appropriate governance framework concerning the IT infrastructure and staff, and an appropriate IT security management. The ECB banking supervision considers cybersecurity to be a subset of IT risk and does not make a formal distinction between them. In terms of sound cybersecurity practices for SIs, ECB banking supervision primarily relies upon EBA's general IT SREP guidance. EBA/GL/2017/05, Guidelines on ICT Risk Assessment under the SREP May 11, 2017.[110] ECB banking supervision has not issued any guides or statements of policy on cybersecurity supervisory expectations. Cybersecurity is the most significant operational and systemic risk facing SIs. Until recently, there has been limited cybersecurity related coordination within the European financial sector, The ECB, in its central bank function, is the overseer of financial market infrastructure. In this role, it participated in the issuance by the G7 of "Fundamental

[110] https://www.eba.europa.eu/documents/10180/1841624/Final+Guidelines+on+ICT+Risk+Assessment+under+SREP+%28EBA-GL-2017-05%29.pdf

	Elements of Cybersecurity for the Financial Sector." On January 26, 2018, the ECB Governing Council announced the formation of the Euro Cyber Resilience Board (ECRB) for pan-European financial Infrastructures with the objective of enhancing the cyber resilience of financial market infrastructures and their critical service providers, as well as the wider EU financial sector. The ECRB, chaired by a member of the Executive Board of the ECB, will bring together representatives of (i) pan-European financial market infrastructures and their critical service providers; (ii) Eurosystem lead overseers of pan-European financial infrastructures (i.e., seven NCBs and the ECB); and (iii) three other ESCB NCBs on a rotational basis. The European Commission, the European Union Agency for Network and Information Security, the EBA, the SSM, the European Securities and Markets Authority, Europol, and the ECB's Directorate General Information Systems will be invited as observers. ECB banking supervision recently surveyed SIs through an extensive questionnaire and incorporates cybersecurity assessments within its existing IT offsite and onsite supervision programs. On May 17, 2017, it announced a cybersecurity incident reporting requirement for SIs, effective third quarter 2017. The assessors were shown samples of an SI's cloud computing, outsourcing and cybersecurity incident reporting operational risk framework reviews from late 2015–2017. ECB banking supervision is in a unique position to observe SI cybersecurity best practices or deficiencies. It should share nonconfidential best practice information with SIs and wider audiences.
EC6	The supervisor determines that banks have appropriate and effective information systems to: (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	The CRR includes requirements on effective information systems applicable to banks under the standardized (Article 320 paragraph c) and AMA approaches (Article 321 paragraphs c and g) (see EC 1). There are no requirements for BIA banks. SSM supervision bases its action on the CRR and on the EBA SREP Guidelines. Within the SREP (Block 1), the JST will make an assessment whether the internal audit of the supervised institution reviews the reliability of reporting systems and the accuracy of the MIS. In case of material weaknesses, the JST will assess how shortcomings in the IT framework have affected the management's perception of operational risk. Such analysis is included as part of the assessment of management information, as part of regular meetings with the operational risk function, as well as part of onsite examinations, especially those related to model changes/approvals. The collection, classification and analysis of loss data by SIs that are predominantly AMA users should be enhanced especially in relation to onsite examinations to verify that banks

	have in place appropriate systems and controls to collect and classify operational risk loss data. More effort is needed to ensure that the data is used as a way to identify where controls need to be enhanced and analyzed by senior management and the board to then adjust risk settings and management. The ECB has a well-developed AMA Framework for onsite inspections and benchmarking. From 2015 to 2017, the ECB conducted 113 onsite inspections focusing on operational risk. Seventy-five IT risk related onsite inspections were conducted during the same period. For those SIs subject to an onsite operational risk examination, the following topics are covered: whether the institution has an effective reporting system; whether the institution has implemented adequate means for the identification and assessment of the operational risk inherent in all material products, activities, processes, and systems to make sure the inherent risks and incentives are well understood; whether the internal operational risk framework enables the institution to adequately monitor its operational risk exposure; and whether an adequate operational risk data collection process is implemented, including adequate IT components. The assessors saw sample evidence that the ECB prepares a Data Quality Assessment Report on SIs. From 2015 to 2018, the ECB conducted 13 onsite and 1 offsite internal model investigations focusing on AMA. Chapter 8 of the SSM Supervisory Manual describes the internal model investigation process. The ECB has deprioritized AMA model investigation because AMA models will be removed from the regulatory framework in the future. Internal modelling resources have been redirected to the TRIM, which focuses on capital, credit, and market internal models.
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	The legal basis for the SSM to require banks to have appropriate reporting mechanisms for operational risk is set out in RTS on supervisory reporting (EU Regulation 680/2014) requiring regular reporting to the supervisor regarding own funds requirements for operational risk (quarterly) and operational risk losses by business lines and event types (semi-annually). This requirement does not, however, capture the expectation in this EC for an SI to inform the JST in a timely manner of developments affecting operational risk. Examples include a breakdown in the reliability of control functions, weaknesses identified in risk management that could potentially lead to op risks, or near misses. In relation to breaches, the EBA SREP Guidelines include recommendations that banks should have “appropriate internal controls and practices to ensure that breaches of and exceptions to policies, procedures, and limits are reported in a timely manner to the appropriate level of management for action, and to competent authorities as required.” This however is a narrow interpretation of the EC, which is intended to be broader that just ex-post breaches; it is intended to be forward looking to allow the supervisor the ability to ensure banks are acting to remediate and strengthen risk management and controls so that

	breaches do not occur. Given the potential institution-specific and systemic risks posed by cyber security incidents, the ECB may wish to consider requiring or recommending a requirement for the timely notification of incidents and threats. In addition to the general practices mentioned under EC 1, the supervisory practices include: (a) regular assessments of the COREP data, which is used to determine the starting scoring for the supervisory risk assessment; (b) regular analysis of internal reporting of the institution regarding operational risk, as well as information disclosed in public reporting; (c) regular monitoring of litigations and corresponding charges; and (d) discussion on developments of the risk profile within regular meetings with bank representatives Institutions are also required to notify the supervisors in case of model changes or ask for approval in case of material ones. Additionally, among the objectives of operational risk management related onsite inspections the following are relevant: legal requirements for external disclosure are adequately fulfilled; information provided to the JST about the internal operational risk management is in line with internal data and reporting; the regulatory reporting production process ensures quality and accuracy; and information internally or externally reported or disclosed is in line with the internal operational risk management framework as it is effectively implemented.
EC8	The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers: (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.
Description and findings re EC8	The legal framework for outsourcing is set out in Article 85 paragraph 1 of CRD IV. As part of the SSM RAS, the topic is covered under operational risk and outsourcing. SSM

	supervisors base their action on the EBA's guidelines on outsourcing and internal governance. The risks related to outsourcing are part of regular meetings with the institution and, if applicable, separate from the program management that deals with outsourcing projects. In addition, outsourcing is part of onsite inspections related to operational risk. These verify that: (a) outsourcing of activities follows a controlled process and outsourcing risks are adequately managed; (b) continuity and quality of outsourced activities and integrity of data is not unduly influenced; (c) management and governance bodies perform an adequate level of oversight over outsourced activities; (d) the institution has robust processes for selecting outsourcing service providers; (e) the contracts used for outsourcing agreement are proportionate to the risks involved and the size and complexity of the outsourced activity; (f) the transition from the service performed in-house to the service performed by the outsourcing service provider or from one outsourcing service provider to another follows a controlled process and business continuity is warranted at any time; (g) the outsourcing institution keeps enough internal skills to be able to adequately manage and challenge the service providers. According to some national laws,[111] competent authorities have supervisory powers concerning the outsourcing of activities by credit institutions. These national law provisions require the prior approval or notification of the outsourcing of activities, including the power to restrict the outsourcing of activities or empower the competent authority to request information from the outsourced provider or to undertake inspections. The purpose of these provisions is to ensure that the risks arising from the outsourcing are properly managed and that the institution remains responsible for ensuring that the outsourced activities comply with prudential requirements. Consequently, there may be a need for the harmonization of national laws over outsourcing. Additional supervisory inspection powers with respect to significant service providers also may be warranted.

[111] See for instance: Sections 25b para. 4 and 44 para. 1 of the German Banking Act; Article 101 of the Latvian Credit Institution Law; Article 4(4) of the Lithuanian Law on Banks and Chapter III of the Resolution of the Board No 99 of June 10, 2004; Luxembourg: Point 182, indent 8 of Circular letter 12/552; Article 22 of Spanish Royal Decree 84/2015; Articles 1:74 of the Dutch FSA and 5:15, 5:16 and 5:17; GALA, 31 of Decree on prudential supervision. As regards Italian law, see Banca d'Italia Circular no. 285 on the outsourcing of corporate functions outside and within banking groups (Part I, Title IV, Chapter 3) and of IT systems (Part I, Title IV, Chapter 4); in both cases, a prior communication and an annual report to Banca d'Italia are required for the outsourcing of important control functions.

Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	JSTs and/or ECB horizontal functions may decide to carry out a specific scenario analysis, with common assumptions and methodologies (e.g., description of the scenario, assessment of the time horizon, business units affected, parameters, acceptance criteria) for all the institutions under the scope. These exercises can provide a common benchmark for further analysis and are typically to be conducted on annual basis. If available, JSTs should use the outcomes of these exercises to determine the level of operational risk in a specific institution. Horizontal analyses of operational risk are started in response to the Key Risk Assessment—a process involving all the SSM. Reviews employ a number of tools such as: bilateral discussions with banks perceived as most affected by the issue as well as national supervisors and third parties with knowledge of the matter, SSM-wide questionnaires, and follow-up discussions with banks. Results are input into the development of supervisory practices and contribute to supervisory planning/activities, including targeted onsite inspections. ECB banking supervision has initiated several reviews on operational risk matters, such as on IT and cybercrime risk and conduct risk, IT outsourcing questionnaire, and established a mandatory cyber incidents reporting requirement after its initial pilot exercise. Operational risk is of high priority under the SSM framework, leading to detailed assessments throughout every supervisory cycle. Apart from the ongoing monitoring and assessment by the JSTs, targeted reviews on horizontal bases (e.g., cybercrime) form part of the SSM's work. Given the cybersecurity risk environment, competent authorities may need more direct and intrusive supervisory tools to address emerging threats to the banking industry and to maintain financial stability.
Assessment of Principle 25	Largely Compliant
Comments	The area of operational risk has undergone several enhancements since the SSM's establishment. The ECB has strengthened its cadre of dedicated IT risk specialists to conduct onsite examinations and has developed more mature and sophisticated approaches to IT risk supervision. Nonetheless, there are a number of areas where the regulations and the intensity of supervisory activities need to be strengthened given the increasing level of IT and cybersecurity risks. Data reporting, collection and use of loss data, verification that risk management is effectively implemented, and disaster recovery/business continuity management and outsourcing are all areas meriting continued attention.

	ECB banking supervision should take steps to enhance cybersecurity awareness, business continuity and recovery planning and third-party vendor management in the outsourcing of significant functions. Recommendations include: • The intensity of cybersecurity supervisory activities need to be strengthened given the increasing level of IT and cybersecurity risks; • Intra-industry IT/cyber threat incident information sharing mechanisms should be strongly encouraged; • Inter-governmental IT/cybersecurity threat information sharing and crisis management mechanisms among the ECB banking supervision and Euro Area, EU and global financial regulators should be strengthened and formalized; • The ECB, either alone or in conjunction with the EBA, should periodically publish IT/cyberthreat best practice guidance gleaned from its supervisory activities and IT industry standard setters; • The ECB's IT/cyberthreat recovery planning and crisis management policies and practices should be strengthened and formalized; • The ECB should encourage the industry development of mutual assistance data vaults that would permit one bank to substitute for another bank suffering an IT/cyber using previously preserved data; and • The ECB should strengthen its review of third party vendors and SI due diligence practices in the IT/cyber context. Supervisory practices to assess that operational risk management is effectively implemented need to be given greater attention. An assessment of the effective implementation of a bank's operational risk management framework is conducted at least on an annual basis through the SREP. The inputs to this assessment come from a range of sources and require the supervisor to consider the effectiveness of risk management and controls as well as the risk level. Within the SREP assessment, however, more detail regarding the quality of risk management and controls is needed to confirm whether the operational risk framework is implemented effectively. This is especially relevant for AMA banks to verify and test throughout the supervisory cycle that the AMA framework is used by management as a way to measure, monitor, and manage operational risk and that the constituent elements of the AMA framework are working as they should. In this sense, the recent implementation of the reporting for banks' internal validation function will be useful in allowing a better view of the model performance and enable horizontal comparison of performance across time and banks. The onsite examination process for AMA model accreditation appeared to be robust.

	JSTs perform a systematic assessment of loss data through the IDRA monitoring report, which allows benchmarking and peer analysis of operational losses across business lines, events types, range of losses, and reference dates. Starting in 2018, SIs using the BIA approach need to report operational risk loss data in COREP (EBA Reporting Framework). DGIV has enhanced operational risk benchmarks through IDRA, which will help improve the ability for the JSTs to compare and contrast operational risk indicators against peer groups as a way to identify outliers in a more systematic way (EC 1). While operational risk is considered as part of the annual risk assessments of banks, a system-wide analysis of common points of exposure to operational risk or potential vulnerabilities is needed. There is an opportunity for greater emphasis on the collection and analysis of material outsource providers.
Principle 26	**Internal control and audit.** The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent[112] internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank's Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address: (a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance); (b) accounting policies and processes: reconciliation of accounts, control lists, information for management;

[112] 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.

	(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	The general framework for internal governance and control for EU jurisdictions is established by the CRR and CRD IV, and is further developed in EBA guidelines, in particular the *Guidelines on internal governance*. Additional national legislation has transposed CRD IV and EBA guidelines into law. This general framework covers a number of Essential Criteria in this Core Principle. The CRR requires that a financial institution have adequate internal control mechanisms including internal control processes and tools for risk identification, measurement, monitoring, and control, and for calculation of capital requirements, as well as for prudential consolidation and identification and management of large exposures. Under Article 74.1 of CRD IV, on internal governance and recovery and resolution plans, institutions are 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." This Article also indicates that the arrangements, processes and mechanisms "shall be comprehensive and proportionate to the nature, scale and complexity of the risks inherent in the business model and the institution's activities." Articles 88 to 96 of CRD IV provide general principles on the review process in institutions' corporate governance. These include, for example, the segregation of duties and the prevention of conflicts of interest, and the "integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards." Additionally, specific requirements for remuneration policies prescribe that staff engaged in control functions are to be independent from 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 the business areas they control. Article 74.3 of CRD IV requires the EBA to issue guidelines on the arrangements, processes, and mechanisms for internal governance and control. In response, the EBA has issued: • *Guidelines on internal governance*; • *Guidelines for common procedures and methodologies for SREP*; • *Guidelines on the assessment of the suitability of members of the management body and key function holders*;

	• *Guidelines on remuneration policies and practices*; • *Guidelines on outsourcing*; and • *Guidelines on sound remuneration policies under Articles 74(3) and 75 (2) of CRD IV and disclosures under Article 450 of CRR*. In September 2017, the EBA published a revision to its earlier *Guidelines on internal governance*. The revised guidelines, which will apply as of June 30, 2018, put more emphasis on the duties and responsibilities of the supervisory board in risk oversight, including the role of its committees. The guidelines aim at improving the status of the risk management function, enhancing the information flow between the risk management function and the management body and ensuring effective monitoring of risk governance by supervisors. Additional requirements were also introduced that aim to foster a sound risk culture implemented by the management body. The revised guidelines state that the internal control functions should include a risk management function, a compliance function and an internal audit function. The risk management and compliance functions should be subject to review by the internal audit function. Heads of internal control functions should be established at an adequate hierarchical level that provides the head of the control function with the appropriate authority and stature needed to fulfil his or her responsibilities; these heads should be independent of the business lines or units they control; and they should be able to have access to report directly to the supervisory board to raise concerns and warn the board, where appropriate, when specific developments affect or may affect the institution (Guideline 19). Furthermore, institutions should have documented processes in place to assign the position of the head of an internal control function and for withdrawing his or her responsibilities. In any case, the heads of internal control functions should not be removed without the prior approval of the supervisory board. In SIs, competent authorities should be promptly informed about that approval and the main reasons for the removal of a head of an internal control function (Guideline 19.1). Finally, the revised guidelines describe in detail the requirements for the internal control framework and mechanisms (Title V). They also define governance policy in a group context. As the supervisory authority for SIs, the ECB is expected to make every effort to comply with the EBA's *Guidelines on Internal Governance*. ECB banking supervision, in consultation with NCAs, will prepare the proposed ECB stance under its "comply-or-explain" procedure. NCAs are also expected to comply with the guidelines by incorporating them into their practices as appropriate (e.g., by amending their legal framework or their supervisory processes).

	"Internal Governance and Risk Management" is a risk category in the SSM RAS and supervisors regularly assess the internal governance and control framework of credit institutions as a key element of the SREP process and in the SREP decision. Identified weaknesses can lead to supervisory actions being included in the subsequent SEP for the institution concerned. The SREP assessment of internal governance includes the definition of the roles and responsibilities of the relevant people, functions, bodies, and committees within an institution and how they cooperate, both in terms of a governance framework and actual behavior. It covers risk management (which is addressed in CP 15), internal audit, 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 is properly managed. Among other things, the internal governance framework would be assessed as adequate where it sets the bank's targets, introduces an effective administration and internal control system, identifies and takes on board the interests of all the institution's stakeholders and ensures that the institution conducts its business in line with the principles of sound, prudent management, while complying with relevant legal and administrative requirements. If the financial institution is part of a group, the group dimension also needs to be assessed. The dialogue between JSTs and SIs is a key part of supervisory work, embracing discussion on the institution's risk profile, business model and strategy, risk management systems, internal control systems, and internal governance (including risk culture). Supervisors hold regular meetings both with the group's management and with the management of significant subsidiaries following a targeted engagement approach and applying the proportionality principle. There is at least one annual meeting with the CEO, CRO, and CFO, along with the Chair of the supervisory board, the Head of Internal Audit and the external auditor at the group level and for relevant subsidiaries. In addition, meetings with the heads of main business lines and compliance and support functions can be arranged, supplemented with thematic meetings at a more technical level. In June 2016, the ECB issued the "SSM supervisory statement on governance and risk appetite," following a thematic review of governance frameworks of SIs. The thematic review identified that board oversight of control functions (risk, compliance, and internal audit) should be further strengthened. This concerned both the regular reporting by these functions to the board and the involvement of the board in the assessment of their effectiveness. Findings from the thematic review led to "deep dive" assessments by JSTs of internal governance, the outcomes of which were reflected in individual SREP decisions.
EC2	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions, and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where

	appropriate, in the case of control functions, sufficient access to the bank's Board) to be an effective check and balance to the business origination units.
Description and findings re EC2	See EC 1. The EBA's revised *Guidelines on Internal Governance* specify that: "Internal control functions should have sufficient resources. They should have an adequate number of qualified staff (both at parent level and at subsidiary level). Staff should remain qualified on an ongoing basis and should receive training as necessary," 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. They should have access to all necessary information regarding all business lines and relevant risk-bearing subsidiaries, in particular those that can potentially generate material risks for the institution" (Guideline 19.2). As part of the SREP assessment of the adequacy of internal control functions, supervisors analyze whether the functions have sufficient status and authority vis-à-vis the business lines and how accountability is distributed between core business areas and control functions. In particular, the dynamics between core business areas and control functions are analyzed (from an accountability perspective) in relation to all relevant risk decision-making processes. Supervisors expect 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. Supervisors expect control functions to be assigned adequate resources. The risk management function should have the independence, proficiency, and appropriate human (competence and staffing) and technical resources needed in order to fulfill its duties properly. The compliance function is expected to have the necessary human (quantitative and qualitative competencies) and technical (access to data) resources to allow it to fulfill its duties effectively and adequately. Similarly, the audit function must be provided with the necessary human and technical resources to carry out audits effectively and according to the planned schedule. Supervisors also determine that compensation for employees in risk, compliance, and other control functions is set independently of any business line these functions oversee, and that performance measures are based principally on the achievement of their own objectives so as not to compromise their independence.
EC3	The supervisor determines that banks have an adequately staffed, permanent and independent compliance function[113] that assists senior management in managing

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

	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.
Description and findings re EC3	The EBA's revised *Guidelines on Internal Governance* require that the compliance function 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 function across the entire institution. The compliance function, inter alia, should have a structured and well-defined compliance monitoring program, should advise the management body on measures to be taken to ensure compliance with applicable laws, rules, regulations, and standards, and should assess the possible impact of any changes in the legal or regulatory environment on the institution's activities and compliance framework (Guideline 21). The adequacy of the compliance function is regularly assessed in the context of the SREP process, which can be complemented by onsite inspections and deep dives for an in-depth review of whether controls outlined on paper are being applied in an efficient and effective way. On average, there are seven onsite inspections annually that are solely focused on the compliance function; these are in addition to onsite inspections carried out in various risk areas, which can address compliance topics. Supervisors verify the organizational structure of the compliance function (on both a solo and group level) and the resources available to it. In particular, the function must have direct access to the management body and an established process of periodically reporting to it. The status of the function is assessed on the basis of essential documents, e.g., regular evaluation of the function by the management body, reports prepared by the compliance function, the integrity policy and the compliance charter. In assessing status, supervisors consider the priorities and standards set for the function, as well as the adequacy of the reporting lines. The compliance function has a responsibility to keep the management body and the supervisory board informed about the activities of the function (e.g., the outcome of compliance risk analysis, significant changes to regulations or laws, any compliance deficiencies discovered, recommendations made to rectify such deficiencies, and how past recommendations have been followed up). Supervisors evaluate if the supervisory board, where applicable via an audit or other dedicated committee, effectively ensures that the function is adequate for the scale and complexity of the institution. Supervisors check that the management body has approved and implemented a compliance policy. Supervisors also assess if the head of the compliance function is led by an appointed compliance officer who reports directly to the management body, and if the officer has the necessary qualifications, experience, and hierarchical status to effectively

	ensure the institution's compliance with laws and regulations and challenge any non-compliance. Supervisors expect the compliance function to have the necessary human (quantitative and qualitative competencies) and technical (access to data) resources to allow it to fulfill its duties effectively and adequately. Furthermore, the function should have the capacity and authority to take initiatives and coordinate actions with regard to compliance matters. The compliance function is expected to devote significant time to new products and new activities. This includes an assessment of the institution's compliance with applicable laws when marketing and communicating new products and services. In a comprehensive compliance risk analysis, the compliance function is expected to identify those legal areas that pose a compliance risk, given the institution's scope of activities. Supervisors assess whether 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, it is expected that the internal audit function, while performing its duties, dedicates sufficient attention to compliance-related issues. Supervisors also assess whether the compliance function enables effective control of compliance risk in all the business units in which the function is in place. Supervisors require the compliance function to monitor, on an on-going basis, 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, AML, etc.) as well as adherence to procedures and instructions related to litigation and reputational risk (including a comprehensive incident database and analysis). The results of such monitoring should be reported periodically to the management in both its management and supervisory functions. The compliance function is expected to have a charter that sets out its objectives, responsibilities and competences, guarantees its independence and permanency, and specifies its relations with the other departments and functions. This charter should authorize the compliance function to take any initiatives it deems necessary and gain access to all the information it needs, specify its reporting lines and give it the right to contact the management body as well as the chair of the supervisory board and the members of the board audit committee.
EC4	The supervisor determines that banks have an independent, permanent and effective internal audit function[114] charged with:

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

	(a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and (b) ensuring that policies and processes are complied with.
Description and findings re EC4	The EBA's revised *Guidelines on Internal Governance* require that the internal audit function assess the appropriateness of the institution's governance framework and be independent of any other function (Guideline 22), report and be directly accountable to the management body, and, as with the heads of the other main internal control functions, have access to and report directly to the supervisory board to raise concerns (Guideline 19.1). The adequacy of the internal audit function is regularly assessed in the context of the SREP process. The function is also generally reviewed in the course of individual onsite inspections of risk management and control functions. The SREP assessment emphasizes that it is the responsibility of the supervisory board, where applicable via an audit committee (see below), to ensure that the institution maintains an adequate internal audit function. Supervisors assess whether internal audit operates as an independent evaluation function within an institution, with appropriate status, impartiality and proficiency. Independence means that the function is not involved in operational organization (design, introduction or implementation of organizational and internal control measures) and that the auditors do not audit activities or functions that they themselves have recently carried out. The function is expected to assist management to fulfill its responsibilities by providing it with analyses, evaluations, recommendations, opinions, and information about the business activities under examination (including the risk control and compliance functions). The function has an obligation to keep the management body informed, regularly and on an event-driven basis, about internal audit activities. Supervisors assess the nature and scope of internal audits in order to ensure that they effectively and comprehensively cover the institution's activities and risks, including outsourced activities. The assessment is also designed to confirm that the methodology used by internal audit is in line with relevant international and European standards. Special attention must be paid to any new and/or complex activities that the institution may have undertaken. Supervisors also assess whether the frequency and level of detail of internal audit reports are commensurate with the size of the institution and its risk profile. CRD IV requires SIs to establish a permanent, independent audit committee, which monitors the effectiveness of the internal control system, the internal audit function, and risk management systems. Such a committee is considered a key factor in achieving sound governance. Hence, supervisors assess if the supervisory board or its audit committee takes all steps necessary to ensure that the institution always has an adequate internal audit

	function (including independent reviews of the functioning of the internal audit function if necessary).
EC5	The supervisor determines that the internal audit function: (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies, or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (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	The EBA's revised *Guidelines on Internal Governance* emphasize that the institution should ensure that the qualification of the internal audit function's staff members and the function's 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. Further, 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 management information systems and minutes of all committees and decision-making bodies (Guideline 22). Supervisors regularly assess: • the internal audit function and its position within the financial institution (hierarchical and functional), and whether it is able to operate autonomously and with authority; • the reporting lines (directly to the institution's management body in its management and supervisory functions, possibly through an audit committee); and • the effectiveness of the function in identifying and raising issues. Supervisors expect that the internal audit function will produce and revise, at least annually, an internal audit plan, approved by the management body in its supervisory function, covering all relevant activities and risks of the institution. The audit universe should be comprehensive and include new activities and activities developed outside the institution's

	usual framework (e.g., in terms of their geographical location or legal background). The frequency of audits would depend on the impact of potential weaknesses in the institution's risk profile and earnings situation. All relevant activities and risks are expected to be covered within a reasonable term. The SSM Supervisory Manual makes explicit that this term should never exceed three years. Supervisors also 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 whether the level of remuneration and internal status of internal audit staff is high enough to attract qualified and sufficiently experienced staff. Internal auditors should be offered 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. The audit methodology applied by the internal audit department must: • include an audit charter, which is approved by the management body in its supervisory function 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 by auditing staff during audits; and • ensure that internal audit policies, methods, and procedures are clearly set down in writing, refer to professional standards, and apply to the entire internal audit function within the institution (or group). Supervisors require that: • adequate procedures for drawing up and communicating audit findings and recommendations be implemented; • corrective measures be clearly set out with a schedule for implementation, which must be followed up; • the head of the internal audit department keep the supervisory board and/or its audit committee regularly and properly informed of internal audit activities regarding the fulfillment of objectives/responsibilities, adequacy of resources, shortcomings identified, corrective measures, and follow-up of recommendations made; • the supervisory board and/or its audit committee regularly evaluate the adequacy of the internal audit function;

	• the internal audit function assesses the effectiveness of the implementation of the RAF and report any material deficiencies in a timely manner. The RAF should take into account the organizational culture, as well as strategic business planning, remuneration, and decision-making processes on a group-wide basis as well as on an individual business line and legal entity basis; and • the internal audit function identifies whether breaches in risk limits are being appropriately identified and reported to senior management, and reports on the implementation of the RAF to the board and senior management as appropriate. Supervisors also evaluate the support of the supervisory board in ensuring the timely and adequate implementation of requested corrective actions.
Assessment of Principle 26	Compliant
Comments	European law and EBA guidelines, particularly the revised *Guidelines on Internal Governance*, provide a comprehensive set of requirements and supervisory expectations for the internal control framework of credit institutions. This has been reinforced by the ECB's supervisory expectations set out in the June 2016 "SSM supervisory statement on governance and risk appetite" and by the detailed assessment of internal governance undertaken by supervisors as part of the SREP process. The revised *Guidelines on Internal Governance*, which will apply from June 2018, clarify the responsibilities of the supervisory board in relation to the internal control framework, and emphasize the importance of a direct reporting line from the heads of compliance and internal audit to the supervisory board so that concerns and warnings may be raised. The ECB's stance on the revised guidelines is currently being determined under its "comply-or-explain" procedure, in consultation with NCAs. Germany has already aligned its domestic requirements with the revised guidelines through recent revisions to its MaRisk system. As a matter of supervisory practice, ECB banking supervision has for some time been emphasizing the importance of a direct reporting line from the compliance and internal audit functions to the supervisory board, consistent with this Core Principle. The June 2016 SSM supervisory statement confirmed supervisory expectations for such a direct reporting line. The SSM Supervisory Manual contains detailed procedures for the assessment of internal governance, including reporting lines, in the SREP process and in onsite inspections. Assessors saw evidence of supervisory reviews and onsite inspections of internal control frameworks, and subsequent supervisory actions to address identified weaknesses.
Principle 27	**Financial reporting and external audit.** The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and

	performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
Essential criteria	
EC1	The supervisor[115] holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	Under EU law, listed entities (i.e., those whose securities are traded on a regulated EU market) must prepare their consolidated financial statements in accordance with IFRS, and publish audited statements annually. Where an entity is not required to prepare consolidated accounts, the audited financial statements must be prepared in accordance with the national law of the Member State in which the entity is incorporated, which may be either IFRS or national GAAP. These requirements have been transposed into national law. Member States have the option to allow or require IFRS reporting in the annual financial statements of listed entities (stand-alone) or to the financial statements of any other companies (stand-alone and/or consolidated). Some Member States have exercised such options for credit institutions whose securities are not traded on a regulated EU market. Article 24(2) of the CRR empowers the competent authority to require regulatory reporting in accordance with IFRS, including in cases where the national accounting framework requires the use of national GAAP for financial reporting purposes. The ECB has determined not to exercise this power generally; however, it may on a case-by-case basis grant permission for the use of IFRS for regulatory reporting on the request of an institution. Under Article 24(4)(h) of the Transparency Directive,[116] Member States are required to establish a competent authority with 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). These authorities generally take the form of national audit oversight bodies, which are coordinated at the EU level by the Committee of European Auditing Oversight Bodies and by ESMA. Under Article 33 of the Accounting Directive,[117] Member States are required to ensure that the members of the administrative, management and supervisory bodies of an institution have collective responsibility for ensuring that the annual and the consolidated financial

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

[116] Directive 2004/109/EC, which was amended by Directive 2013/50/EU of October 22, 2013.

[117] Directive 2013/34/EU.

	statements are drawn up and published in accordance with the requirements of this Directive and, where applicable, in accordance with IFRS. Member States are to ensure that their laws, regulations, and administrative provisions on liability also apply to the members of the administrative, management, and supervisory bodies of the undertakings for breach of these duties. Article 88 of CRD IV, which establishes governance arrangements for credit institutions, requires *inter alia* 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. 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." Hence, EC 1–2 are not relevant to the assessment of the ECB's supervisory functions.
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	Article 34 of the Accounting Directive requires that Member States ensure that the financial statements of public-interest entities[118] are audited. Credit institutions meet the definition of a public-interest entity. Article 26 of the Audit Directive[119] stipulates that "Member States shall require statutory auditors and audit firms 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.

[118] According to Article 13 (2) of the Directive 2006/43/EC, 'public-interest entities' means entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State, credit institutions as defined in point 1 of Article 1of Directive 2000/12/EC and insurance undertakings within the meaning of Article 2(1) of Directive 91/674/EEC. Member States may also designate other entities as public-interest entities, for instance entities that are of significant public relevance because of the nature of their business, their size or the number of their employees.

[119] Directive 2006/43/EC was amended by Directive 2014/56/EU of April 16, 2014

	Article 39 of the Audit Directive also requires, *inter alia*, that public-interest entities 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; and (d) reviewing and monitoring the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity. The Audit Regulation[120] adds additional requirements related to the statutory audit of public-interest entities, including specific rules for the auditors (e.g., independence, limitation of the provision of non-audit services), specific requirements related to the audit report, and limits on the length of the audit engagement (audit rotation).
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	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. Article 24(2) empowers the competent authority to require regulatory reporting in accordance with IFRS (but see EC 1 above). Under separate regulations, financial institutions reporting under IFRS at the consolidated level are required to submit FINREP templates to the competent authorities. Standardized reporting is required for all SSM supervised entities that are subject to capital requirements (i.e., non-waiver institutions), and the reported financial information must be based on valuation rules existing under the relevant accounting standards. 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. 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.

[120] Regulation (EU) No 537/2014

	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. The assessors saw examples of discussions between a JST and the external auditor of an SI in relation to inconsistencies between the provisioning framework of the SI and accounting standards.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.
Description and findings re EC4	The EU's Audit Regulation establishes the scope of the external audit of public-interest entities according to a risk and materiality based approach. Article 10 requires that the audit report include, *inter alia*, in support of the audit opinion, the following: • 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 • where relevant, key observations arising with respect to those risks. In the case of each significant assessed risk of material misstatement, the audit report is to include a clear reference to the relevant disclosures in the financial statements. The ECB has no powers under EU law to establish the scope of external audits of credit institutions. The Audit Regulation does not empower the ECB to ask statutory auditors to perform additional or specific audits, reviews or other assurance procedures, or to produce written opinions, reports, or other statements on specific topics or transactions. National laws in a few Member States do empower the supervisor to establish the scope of external audits of banks. In Luxembourg, for example, the supervisor may set rules regarding the scope of the mandate for the statutory external audit of annual accounts, while in The Netherlands the scope of the audit and the standards to be applied, as well as the scope and suite of standards for the audit of the prudential returns, are determined by the Ministry of Finance in cooperation with the Ministry of Justice, after consulting the supervisor.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, nonperforming assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other

	involvement with off-balance sheet vehicles, and the adequacy of internal controls over financial reporting.
Description and findings re EC5	Article 26 of the Audit Directive stipulates that Member States shall require statutory auditors and audit firms to carry out statutory audits in compliance with international auditing standards adopted by the EC. Member States may apply national auditing standards, procedures or requirements as long as the EC has not adopted an international auditing standard covering the same subject matter. 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. For example, IAS 39 dealing with the risks of material misstatement requires the auditor to obtain an understanding of internal controls relevant to the audit, to evaluate the design of those controls, and determine whether they have been implemented. Within the SSM, all but three Member States have adopted ISAs issued by IFAC. France, Germany, and Portugal are awaiting 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).
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	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. 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 from the managerial body of the audited entity. Additional requirements for public-interest entities are set out in Articles 4–18 of the Audit Regulation. The ECB itself has no powers under EU law in relation to the approval of external auditors. However, all but four of the participating Member States have various powers in this area under national laws. The Supervisory Board has clarified that, as from January 1, 2017, supervisory powers related to the appointment/replacement of external auditors of SIs granted to NCAs are to be directly exercised by the ECB, as a means of ensuring compliance with prudential requirements in the area of own funds, liquidity, and leverage.
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	Article 17 of the Audit Regulation limits the duration of audit engagement and thus requires rotation of the auditors of public-interest entities. The maximum duration of an audit engagement must be less than 10 years (or less than 20 years subject to a tendering process, or less than 24 years in the case of joint audits). Audit engagement can be renewed only after a four-year period. Key audit partners are to cease their participation in the statutory audit no later than seven years. Key audit partners can re-start their participation in the audit of that entity after a three-year period.

	Following clarification of the ECB's supervisory powers on external auditor appointments (see EC 6 above), the ECB has taken an active role in encouraging credit institutions to rotate long-standing auditors. The assessors saw evidence of ECB supervisory intervention in relation to the renewal, in breach of Article 17, of the mandate of an auditing firm.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	ECB banking supervision meets 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. Article 12(2) of the Audit Regulation includes the requirement that an effective dialogue be established between the supervisors of credit institutions and insurance undertakings, on the one hand, and the statutory auditor(s) and audit firm(s) carrying out the statutory audit of those entities, on the other hand. Responsibility for compliance with this requirement rests with both parties to the dialogue. In July 2016, the EBA published its *Guidelines on communication between competent authorities and auditors,* which aims at establishing an effective dialogue between these parties. The guidelines, in effect from March 31, 2017, require at least one annual bilateral meeting between the auditors and the prudential supervisor, when in-depth communication takes place. The guidelines also require that communication between the prudential supervisor and auditors collectively should be as frequent as necessary to ensure timely sharing of information on issues that are relevant to supervisory tasks and the statutory audit of credit institutions. ECB banking supervision is implementing these guidelines through incorporation of a framework for communication with external auditors in the SSM Supervisory Manual; the relevant text has already been made available to JSTs. Communications with external auditors will be included in individual SEPs and MELs. All Euro Area Member States have indicated that they are compliant or intend to comply with the guidelines, in most cases by the end of 2017.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies, and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	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 that entity certain material information that has emerged during the statutory audit. Article 12(3) stipulates that the disclosure of this information in good faith does not constitute a breach of any contractual or legal restriction on disclosure of information.

	Section III of CRD IV establishes duties of auditors similar to the ones referred to above. According to Article 63(1), the auditor has 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: • constitute a material breach of the laws, regulations, or administrative provisions which lay down the conditions governing authorization or which specifically govern pursuit of the activities of institutions; • affect the ongoing functioning of the institution; and/or • lead to refusal to certify the accounts or to the expression of reservations. Under Article 63(2) of CRD IV, "disclosure in good faith" to the competent authorities by auditors (of any fact or decision referred to in Article 63(1) above, does not constitute a breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision and does not involve such persons in any liability. Such disclosure is to be made simultaneously to the management body of the institution unless there are compelling reasons not to do so. The assessors saw examples of reports from external auditors to supervisors on matters thought to be of material significance.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	There are no EU-wide requirements in this regard. Article 56 of CRD IV allows for the exchange of information between the supervisor, in the discharge of its supervisory functions, and the auditor, subject to professional secrecy. As noted in EC 9 above, there are also requirements on auditors to report certain material information. National laws generally do not provide this power either. In some Member States, the supervisor may access external auditors' working papers (Luxembourg) or documentation on each audit (Spain) while in the case of Italy and the Netherlands, the power to access external auditors' working papers resides with another competent authority.
Assessment of Principle 27	Largely Compliant
Comments	ECB banking supervision 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. The ECB has no accounting powers nor powers to establish the scope of external audits of credit institutions. Responsibilities under EU directives in this area lie with other competent authorities. The overall EU framework, however, appears robust and ensures broad consistency with a number of ECs in this Core Principle;

	supervisors gave no indication that the ECB's supervisory function had been frustrated by these arrangements. That said, the ECB is stepping up its involvement in the external audit process. In the first place, the ECB has clarified that, where national laws in Member States have granted the relevant NCA supervisory powers in relation to the appointment/replacement of external auditors, the ECB is exclusively and directly competent to exercise these powers. The ECB has become active in this area. In its Opinion on the Commission's proposed reforms of CRR/CRD IV, the ECB has argued that EU law should include a clear reference to additional supervisory powers regarding the replacement of an external auditors, to avoid legal uncertainty about the ECB's direct supervisory powers and in the interests of a level playing field across the Banking Union. In the second place, implementation of the EBA's *Guidelines on communication between competent authorities and auditors* will further heighten engagement with external auditors, although engagement at the individual and collective level is already well established. The assessors saw a number of examples of supervisory interactions with the external auditors of individual SIs, as well as agendas and supporting material for regular meetings between ECB banking supervision and audit firms. The Additional Criterion under this Core Principle represents best international practice rather than a requirement, but the power to access external auditors' working papers is absent in EU law and most national laws, and (informal) requests for such papers are not part of normal supervisory practice. Non-compliance with AC 1 is the basis for the Largely Compliant overall rating for this Core Principle.
Principle 28	**Disclosure and transparency.** The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies, and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures[121] of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability, and timeliness of the information disclosed.
Description and findings re EC1	Various requirements regarding disclosures and transparency are imposed on significant banks and investment firms (See CP 10). According to Part Eight of the CRR, institutions must disclose various quantitative and qualitative information pertaining to capital and capital requirements, risk management, credit risk, market risk, counterparty credit risk, securitization risk, equities risk, interest rate risk, asset encumbrance, leverage, operational risk, and remuneration, or of a financial nature (IFRS disclosures focused on financial

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

	performance and on the risks posed to this performance by financial instruments). In addition, CEBS issued in April 2010 principles for disclosures in times of stress that institutions are recommended to apply in their public disclosures (Pillar 3, financial statements and other disclosures made on the basis of requirements or in an ad hoc manner). Articles 6 and 13 of the CRR require the disclosure of information by all banks and investment firms on an individual, and where relevant consolidated basis. Article 13 also governs the provisions of disclosure on a solo basis for consolidated entities within a group. IFRS disclosures, however, should be provided depending on the scope of application of IFRS standards. Regulation 1606/2002, on the application of international accounting standards, mandatorily applies IFRS to the consolidated accounts of publicly traded companies, including in case only debt securities of that company are listed on the market (Article 4). Article 5 allows Member States to permit listed entities to prepare their solo financial statements based on IFRS, and to permit other (non-listed) entities to prepare their solo or consolidated accounts under IFRS. Entities that do not apply IFRS for their consolidated or solo financial statements apply national GAAP. Financial disclosures are expected to appear in the financial statements and notes. IAS 1.10 makes notes a required component of a complete set of financial statements, for the purpose of disclosing information required by IFRS or otherwise relevant to the understanding of the financial statements (IAS 1.112). IFRS 7.1, .7, and .31 requires all entities applying IFRS to disclose in their financial statements information that enables users to evaluate the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks. Specific formats (templates and definitions) have been introduced by the EBA to improve comparability between institutions in some Pillar 3 disclosure areas. They include: • technical standards on own funds (Article 437 of the CRR with Regulation (EU) 1423/2013; • technical standards on the leverage ratio (Article 451 of the CRR); • technical standards on methods used to compute the countercyclical buffer (Article 440 of the CRR); • technical standards on disclosures of G-SIB indicators (Article 441 of the CRR and Regulation 1030/2014) and Guidelines; and

	• guidelines on disclosure of encumbered and unencumbered assets (Article 443 CRR). IFRS does not require the use of a specific format for disclosures in financial statements. However, there are a few exceptions. They are: tabular formats are required for disclosures on offsetting of financial instruments (IFRS 7.13C); fair value of financial instruments (IFRS 7.27); and, transfer of financial instruments (IFRS 7.42). Examples of tables are provided in IFRS 7 IG40B and C for transferred assets and in IFRS 7 IG40D for offsetting of financial assets. These examples are, however, not incorporated into EU law. There is no requirement in Pillar 3 disclosures to disclose comparative information except for disclosures related to the value adjustments on IRB exposures (Article 452g of the CRR) and the back-testing of IRB models (Article 453i of the CRR). As for financial statements disclosures, IAS 1.38 requires the disclosure of comparative information in respect of the previous period for all amounts reported in the current period's financial statements. IAS 1.36 requires comparative information to be disclosed at least on an annual basis. Article 431 of the CRR requires Pillar 3 disclosures to be appropriate and timely. If the disclosure requirements laid out in the CRR would not be enough to convey their risk profile comprehensively to market participants, institutions shall disclose any supplementary information necessary, to the extent that information is material, not proprietary and not confidential. Guidelines issued by the EBA outlines those instances where nondisclosure of information is permitted due to materiality reasons or concerns about information of a proprietary or confidential nature. Article 104 of CRD IV empowers supervisors to require additional disclosures for the purpose of applying the CRR requirements. IAS 1.17 requires the presentation of information in financial statements to be in a manner that provides relevant, reliable, comparable and understandable information, and the provision of additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance. IAS 1.112 requires the presentation in the notes of any information that is relevant to the understanding of the financial statements. IFRS7.32 follows the same approach—disclosures on risks that arise from financial instruments and on how these risks have been managed should cover, but not be limited to, credit risk, liquidity risk, and market risk. Pillar 3 information is not required to be audited under EU law. However, the practice in some jurisdictions is to require assurance by the external auditor, at least annually, that the Pillar 3 data is prepared in accordance with the national audit framework. Furthermore, during offsite inspections, supervisors check the accuracy of data.

	In addition, Pillar 3 information disclosed in the notes to the financial statements is required to be audited (see below) and Article 431 of the CRR requires institutions to have policies to assess the appropriateness of their disclosures, including their verification. Disclosures in accordance with IFRS are to be audited in application of Directive 2006/43 and the relevant applicable auditing standards in each Member State (for the audit requirements in the EU as stated above). Article 433 of the CRR requires disclosure of Pillar 3 information at least on an annual basis, in conjunction with the date of publication of the financial statements, and requires institutions to assess their need to publish some or all disclosures (especially disclosures on own funds, capital requirements, information on risk exposures, and other items prone to rapid changes) more frequently than annually, based on their relevant characteristics. EBA Guidelines on Disclosure frame the assessment process of institutions in accordance with Article 433 of the CRR and stress the need for G-SIB institutions and all institutions with a balance sheet higher than EUR 30 billion to especially conduct this assessment. The Guidelines also list information the provision of which should especially be considered when disclosing more often than annually. Article 106 of CRD IV empowers supervisors to require information to be published more frequently than annually and with specific deadlines. As for financial information, IAS1.36 requires at least annual disclosures of information specified in IFRS. IAS 34 specifies the requirements for interim disclosures but does not set the frequency of interim disclosures. In the case of banking groups, disclosure requirements are generally applicable at the top consolidated level. Disclosure is governed by the principle of materiality and is not applicable to legally protected or confidential information. However, in the two latter cases, institutions are required to publish more general information about the facts that they are not at liberty to disclose for the aforementioned reasons. The required information is to be published at least annually and is published as part of the annual report and not the Pillar 3 reports.
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, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance, and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	Some of the disclosures required by Part Eight of the CRR duplicate accounting disclosure requirements. Disclosures on exposures and transactions with related parties (IAS 24) and accounting policies (IAS 1.117 to 124, IFRS 7.21) are only required in the financial statements, with the exception of accounting policies for past-due and impaired (Article 442a of the CRR) and securitization transactions (Article 449j). Therefore, in general SIs are

	not required to disclose related party exposures or transactions with related parties as part of Pillar 3 disclosures. The ECB is in the process of examining its supervisory powers in this area. Some Member States' national laws restrict credit to related parties. However, the definition of "related parties" varies widely across Member States (See CP 20). The issue of the scope and content of disclosures as well as their level of aggregation is connected with the issue of materiality; immaterial elements of the accounts can be aggregated while more disclosure is required for material elements of the accounts and a greater amount of disaggregation required (including disclosures that are not explicitly required by specific provisions included in Part Eight of the CRR, consistently with Article 431(3)). Guidelines specify how institutions must implement, in relation to disclosures, materiality as defined in Article 432(1), and specify a process and the criteria institutions should take into consideration when assessing materiality. As regards disclosures in the financial statements, IAS 1.29 requires the separate presentation of each material class of similar items, and of items of a dissimilar nature or function unless they are immaterial. IAS 1.30 clarifies that where a line item is not individually material, it is aggregated with other items either in those statements or in the notes to the accounts, but that an item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes. According to Title II and III of Part 8 of the CRR, institutions must disclose their risk management objectives and policies, their governance arrangements, their risk exposures under different aspects and their remuneration policy. Since the CRR is directly binding for EU countries, SIs and LSIs must fulfill its disclosure requirements. In addition, the financial performance, financial position, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business of supervised entities are publicly disclosed in the annual report, either in the financial statement or the management commentary. Further, the EBA has published Guidelines on disclosure requirements under Part Eight of the CRR in December 2016. The purpose of the Guidelines is to further specify Pillar 3 disclosure requirements in the CRR in the following areas: general requirements for disclosures, risk management, and governance arrangements, scope of application, capital requirements, credit risk, counterparty credit risk, and market risk. Standardized templates and tables, based on the standards published by the Basel Committee, are mandated to foster harmonization and comparability across institutions. In effect, the Guidelines align the formats used for complying with the Pillar 3 disclosure requirements of the CRR, and they are directed to both competent authorities and institutions. The ECB complies with these Guidelines. The Guidelines also apply in full to G-SIIs and O-SIIs, while institutions not included in the aforementioned categories—which are of less systemic importance—will be expected to comply with only certain parts of the Guidelines, in line with the proportionality principle

	The content of information disclosed, and the level of disaggregation and detail are commensurate with the risk profile and systemic importance of SIs and LSIs. Supervisors pay attention to the content of Pillar 3 disclosures.
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	For supervisory purposes, the scope of consolidation is the CRD IV regulatory scope of consolidation rather than IAS/IFRS consolidation. Accordingly, the group structure in Pillar 3 disclosures relates to the scope under CRD consolidation (Articles 18 and 19). Article 436b of the CRR requires the disclosure of an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities therein, explaining whether they are: (i) fully consolidated; (ii) proportionally consolidated; (iii) deducted from own funds; or (iv) neither consolidated nor deducted. For SIs, material entities in the group structure will be disclosed, and this enables users of the consolidated financial statements to understand the group and the interest in non-controlling interests. Disclosures to be provided in the financial statements (and which therefore follow an accounting scope of consolidation) relate to the name and registered office of subsidiaries, associates, proportionally consolidated entities, indirect subsidiaries, immaterial entities excluded from consolidation and entities for which consolidation would be too onerous, the proportion of capital held in the above-mentioned entities, the proportion of voting rights held in the above-mentioned entities, and the rationale for consolidation of subsidiaries (Article 43(2)(h) of the CRR, Directive 86/635). Similar requirements—although with a possible narrower scope—also exist in IFRS 12 (IFRS 12.2 and B4, IFRS 12.12 and B10). Institutions should also disclose the circumstances for applying the derogation from the application of prudential requirements on an individual basis (Article 7 of the CRR) and the application of the individual consolidation method (Article 9 of the CRR). The accounting scope of consolidation is defined in the local GAAP and in IFRS for banks applying IFRS (IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, and IAS 28 Investments in Associates and Joint Ventures). 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.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	JSTs verify that disclosure statements comply with the disclosure standards as part of the annual supervisory cycle. As a second line of defense, the EBA reviewed disclosures by institutions on their crisis-related exposures (from 2008 to 2010) and has been assessing the compliance of the Pillar 3 disclosures of banks with the CRR disclosure requirements (from 2010 onwards). These assessments have led to the identification of best practices for

	enhancing disclosures, which institutions are encouraged to implement. The EBA reports are made available on its website. The assessment of Pillar 3 disclosures is normally a part of MEL activities. The exercise normally results in a number of recommendations for banks to enhance reporting and P3 disclosures aligned with the nature and scope of this EC. Pursuant to Article 18(1) SSMR the ECB may directly impose pecuniary penalties on SIs for breaches of disclosure requirements. In addition, the ECB may request, pursuant to Article 18(5) SSMR the relevant NCA to impose non-pecuniary penalties and /or sanction natural persons responsible for such breaches, but only if the national law requires sanctions to remedy deficiencies in disclosure practice. The ECB seeks sanctions when breaches of disclosure requirements are detected. The assessors were given samples of such referral reports from JSTs to the ECB's Enforcement and Sanctions Unit. The breaches involved improper reporting of own funds requirements, large exposure limits, and other disclosures. The files included records from the administrative proceedings up to the Supervisory Board's imposition of pecuniary penalties (See CP 11).
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).

Description and findings re EC5	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:
	• information on texts of laws, regulations, administrative rules and general guidance adopted in the respective Member State in the field of prudential regulation;
	• information on how they exercise options and discretions available in EU law;
	• information on the general criteria and methodologies used for SREP;
	• aggregate statistical data on key aspects of the implementation of the prudential framework by countries:
	  o number of banks and investment firms
	  o total banking assets and share of GDP
	  o total Tier I, total Tier 2 capital
	  o total capital requirements
	  o total capital adequacy ratio
	  o own funds requirements by type of risks (in percent of own funds requirements)

- credit exposure by exposure class (in percent of own funds requirements)
- own fund requirements for operational risk by type of approach (in percent of total own fund requirements)
- own fund requirements for market risk by type of approach (in percent of total own fund requirements).

As a reference, the EBA makes public aggregate statistical data on key aspects of the implementation of the prudential framework in each Member State. The disclosure includes national statistical data on the banking sector, credit risk, operational risk, market risk, and supervisory actions and measures. http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/aggregate-statistical-data An additional reference is contained within the ECB's "Consolidated banking data" on the EU banking sector, on a country-by-country basis (aggregated balance sheet, profit and loss, and supervisory ratios). https://www.ecb.europa.eu/stats/money/consolidated/html/index.en.html

For SIs, a Supervisory Banking Statistics series has been developed by the ECB. This series provides consolidated data including profit and loss, balance sheet items, NPLs, and provisions; its aim is to serve as a benchmark for the health of the banking system in the medium term. The final set of indicators are based on data reported under the ITS on Supervisory Reporting and provide information on the banking system at an aggregate level, including balance sheet and profit and loss items and capital adequacy (risk-weighted assets as well as capital levels and ratios). In November 2016, the set of Supervisory Banking Statistics was expanded to include tables on: (i) general statistics, (ii) balance sheet composition and profitability; (ii) capital adequacy and asset quality; (iv) funding; and (iv) data quality.

The expansion of publicly available data has led not only to a large increase in the data published but also to a higher frequency of publication, i.e., quarterly, thereby significantly enhancing transparency. Specifically, Supervisory Banking Statistics have been expanded in the following directions:

(i) the scope has been expanded to include NPLs, forbearance and coverage ratios;
(ii) data is presented with a country breakdown;
(iii) in addition to the country breakdown, banks' classifications have been prepared across different dimensions (e.g., size or degree of international activities) and data is presented using the respective categories of banks; and
(iv) solvency and leverage ratios, as published by the SIs pursuant to Part 8 of the CRR, are also be published.

The scope of publication comprises SIs in 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. This

	approach leads to a different list of banks for each reference period. Usually the change is restricted to a small number of banks with the exception of 2015Q4 when SIs preparing their accounts under nGAAP at consolidated level and banks at solo level were required to submitted financial information based on the FINREP framework, as mentioned earlier. The number of entities per reference period is expected to stabilize, with any changes resulting from amendments to the list of SIs following assessments by the ECB. The definitions of indicators are consistent with those featured on the ID-Cards for the Supervisory Board developed for ECB banking supervision. The statistics are updated yearly (see also ECB Regulation on reporting of supervisory financial information). Another example of is the Consolidated Banking Data (CBD), which also applies ITS data.
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	Disclosures are more often provided using end-of-period values. While the CRR refers to some average values or over-the-period values, there was no evidence to show that these inputs are used in the risk assessment to date. European banks calculate the leverage and LCR ratios as of quarter end, giving rise to spikes in money markets at quarter end as banks are "sanitizing" their balance sheets for reporting. This is a distortion. End of quarter reporting for these ratios is not a best practice and may have adverse consequences. Article 442 (c) of the CRR requires disclosure of the total amount of exposures after accounting offsets and without taking into account the effects of credit risk mitigation, and the average amount of the exposures over the period broken down by different types of exposure classes. Article 449 (n) (iv) requires the disclosure of a summary of the securitization activity of the current period, including the amount of exposures securitized and recognized gain or loss on sale. Disclosures on asset encumbrance are made using median vales (Article 443). As regards disclosures in the financial statements, IFRS 7.42 G (c) requires, in cases where the transfer activity qualifying for de-recognition was not evenly distributed throughout the reporting period, the disclosure of when the greatest transfer activity took place within that reporting period, the amount (e.g., related gains or losses) recognized from transfer activity in that part of the reporting period, and the total amount of proceeds from transfer activity in that part of the reporting period. IFRS 12.27 requires, for sponsored entities that are sponsored without the sponsor having an interest in them, the disclosure of the income from those structured entities during the reporting period, and of the carrying amount (at the time of transfer) of all assets transferred to those structured entities during the reporting period.

Assessment of Principle 28	Largely Compliant
Comments	Disclosure standards are generally sound and promote transparency, reflecting the substance of the Basel II Pillar 3 standards. As part of their routine activities, supervisors confirmed compliance with the standards through both sample testing and thematic reviews. Euro area banks do not mandatorily disclose related party exposures or transactions with related parties as part of the Pillar 3 disclosures. They should be required to do so. In relation to disclosure of data that is not end-of-period data, supervisors have made attempts to adjust the frequency of disclosures in some cases; however, data that is not end-of-period has not been made use of in the supervisory process with any impact on the outcomes of analysis (AC 1). Euro area banks should be required to disclose/report average ratios instead of only end-of period for certain ratios, such as the leverage ratio and LCR.

SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives, and powers	LC	The allocation of supervisory responsibilities under the SSM is clear and the ECB has a broad set of powers. However, the SSM legislative framework—reflecting in particular the uneven coverage of national laws—leaves the ECB facing gaps or legal uncertainty with regard to its direct supervisory powers in some areas.
2. Independence, accountability, resourcing, and legal protection for supervisors	LC	ECB banking supervision is independent in law and operation. However, decision-making processes are complex and time-consuming and the ECB does not have full control over the level and availability of NCA staff committed to SI supervision.
3. Cooperation and collaboration	C	The framework for cooperation and collaboration is extensive and effective. Progress in finalizing MoUs with third country authorities, within and outside the EEA, has been slower than expected. Substantial differences between legal systems and national legal requirements have also affected finalization of WCCAs for crisis management coordination in supervisory colleges in which

Core Principle	Grade	Comments
		the ECB is consolidating supervisor. The absence of formal arrangements has not, however, precluded effective working relationships with key authorities.
4. Permissible activities	LC	Definition of permissible activities for banks and powers regarding the use of the word "bank" are conferred to the NCAs. Third-country groups have increasingly complex structures in the Euro Area, operating through entities that escape ECB supervision. Investment firms undertaking "bank like" activities, for instance, are not authorized and supervised by the ECB as credit institutions but are supervised at the national level.
5. Licensing criteria	LC	Supervisory assessments of applications for authorization are comprehensive. The ECB is the licensing authority, making decisions on the basis of applicable national laws and NCAs are fully involved in the authorization process. However, the ECB does not have authority to authorize and supervise Euro Area branches of non-EU or EEA banks. These branches are regulated by national laws and regulations (not CRR/CRD IV) and supervised directly by local NCAs. These arrangements create regulatory and supervisory arbitrage opportunities for non-EU banks, which can, inter alia, establish a presence in the Euro Area through branches.
6. Transfer of significant ownership	LC	The SSM legislative framework provides a clear basis for approving acquisitions or disposals of qualifying holdings in a credit institution, but there are gaps in notification and reporting requirements. There are no specific EU requirements 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, while notification requirements in national law are not consistent. There is no consistent requirement for periodic reporting

Core Principle	Grade	Comments
		by credit institutions of the ultimate beneficial owners of qualifying holdings, nor are there specific penalties in respect of the modification or reversal of a change of control that took place without proper authorization.
7. Major acquisitions	MNC	The SSM legislative framework does not provide an adequate or consistent basis for ECB banking supervision to approve or reject, and impose prudential conditions on, major acquisitions or investments by a credit institution. In particular: (i) there are no prior notification or approval requirements for acquisitions in an undertaking outside the financial sector; (ii) requirements relating to the acquisition of a qualifying holding in another EU credit institution are focused on safeguarding the sound and prudent management of the target, not the acquiring, institution; (iii) there are no explicit requirements on the acquisition of holdings in credit institutions outside the EU; and (iv) there are no harmonized procedures or criteria at EU level for assessment of major acquisitions by credit institutions, including whether the acquisitions expose the credit institution to undue risks or hinder effective supervision.
8. Supervisory approach	LC	The fundamentals of the ECB's methodological framework for supervision are sound. The main elements of the supervision methodology—SREP, RAS, and SEP—are firmly in place. The greater emphasis on quantitative analysis is consistent with the EBA's SREP Guidelines. The methodology is a forward-looking risk-based assessment of individual banks and banking groups, proportionate to their systemic importance. The ECB's supervisory approach identifies risks within banks and the banking system. While a formal resolution framework is in place, the timeliness and level of coordination

Core Principle	Grade	Comments
		and collaboration between the ECB and SRB could be improved. The ECB's crisis management function could make better use of recovery plan assessments and developing operational guidance for crisis management activities and to enhance management reporting systems.
9. Supervisory techniques and tools	C	The ECB, through the SREP, uses a mix of offsite analysis and onsite inspections that focus on both horizontal risk themes and vertical assessments of institution-specific risks. The ECB uses a complete array of techniques and tools to implement its supervisory approach that is appropriately designed, as evidenced by the SSM Supervisory Manual and Appendices. The SEPs and onsite inspections also are appropriately calibrated according to institutions' risk profiles and systemic importance. The ECB SEP appropriately covers the tasks and activities related to offsite ongoing supervision and onsite missions, in line with available quantitative and other resources. The ECB's horizontal thematic reviews, in-depth reviews and ad hoc reviews are conducted on certain topics by offsite analyses and dedicated onsite missions are effective and address key areas and allow peer comparisons. The ECB's General Information Systems maintains and develops appropriate information and communications systems necessary for ECB banking supervision to carry out its tasks.
10. Supervisory reporting	LC	Harmonized supervisory reporting is not sufficiently granular to adequately support offsite supervision. The ECB complements it through additional data collections and surveys that, if confirmed as necessary, can migrate to the harmonized reporting set, but only via a lengthy and cumbersome process.

Core Principle	Grade	Comments
11. Corrective and sanctioning powers of supervisors	MNC	ECB ongoing supervision effectively identifies issues and recommends specific corrective actions within defined time periods to SI management informally and in writing through informal "operational acts" and formal, enforceable ECB Supervisory Board Decisions. Noncompliance with a Decision constitutes a breach that is subject to sanctions. The ECB's sanction and enforcement powers contain gaps and are fragmented. They do not act as a deterrence and do not ensure a level playing field because of gaps in Union law and national law implementing EU directives.
12. Consolidated supervision	LC	The ECB is the consolidated supervisor for all SIs. The ECB utilizes its SREP and SEP programs to monitor consolidated parents and affiliates and applies its prudential standards to all aspects of the business conducted by the banking group worldwide to the extent permitted by law. The supervisory framework is effective. However, there are several legal gaps regarding the activities of certain affiliates and parent companies, which may not be supervised entities at all. Gaps also exist with respect to Mixed Financial Holding Companies. The lack of authority to review such activities in national law may hinder the ECB's ability to assess whether these entities activities have a material impact on the safety and soundness of the bank and the banking group and its ability to take appropriate supervisory action if warranted. There is no framework for resolution of a conglomerate.
13. Home-host relationships	LC	The ECB-led supervisory colleges provide effective oversight by considering the risk profile and systemic importance of the banking group and the corresponding needs of its

Core Principle	Grade	Comments
		supervisors in the case of subsidiaries of SIs located within and outside the SSM. The ECB has not finalized agreements with all international supervisors of G-SIBs with systemic importance. 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 significantly improved because of the creation of the SSM and the SRM, as well as the adoption of the BRRD. The ECB's participation as home or host authority for significant banking groups in supervisory colleges fosters coordination between competent authorities in crisis. The ECB does not have the authority to expressly prohibit shell banks or the continued operation of shell banks. There is also no clear mandate to supervise booking offices in a manner consistent with internationally agreed standards.
14. Corporate governance	C	The ECB has established clear regulatory corporate governance expectations. The qualifications, effectiveness and remuneration of management bodies and key function holders through the SREP. The ECB applies the governing legal requirements and guidelines on remuneration in the context of SREP's internal governance subcomponents and as part of the SEP process. The fit-and-proper authorization process effects necessary changes in SIs' management bodies and key function holders.
15. Risk management process	LC	EU law addresses the main risk categories at a high level, leaving room for non-harmonized

Core Principle	Grade	Comments
		standards at national level. While the ECB has published a number of documents that provide indications about its expectations regarding the management of different categories of risk, these documents neither cover the whole spectrum of risks listed in this CP, nor ensure that banks can be held to comply with them, given the potential overriding by national (binding) legal provisions. The practice of supervision within the SSM demonstrates how JSTs, onsite inspection teams and internal model investigation teams strive to overcome gap in the regulatory framework. Nevertheless, some important elements are missing at EU level and some national legal frameworks, such as: (i) the need for Board and senior management awareness of the uncertainties attached to risk measurement; (ii) the requirement for the removal of CROs to be discussed with the supervisor and for such a removal to be disclosed publicly; (iii) certain requirements on stress testing, such as the need for stress testing programs to actively involve the Board and senior management and to be appropriately documented and regularly maintained and updated; and (iv) the requirement for banks to appropriately account for risks (including liquidity impacts) in their new product approval process.
16. Capital adequacy	MNC	The EU's capital adequacy requirements, found in CRR and CRD IV, do not conform to the Basel standards. Some of the deviations, such as the non-deduction of insurance holdings, are material and continue to be authorized by the ECB OND Guide. The ECB requires banks to hold capital in excess of the minima through its supervisory powers exercised under Pillar 2 through the SREP process.

Core Principle	Grade	Comments
		The ECB does not regularly monitor the effects on banks' capital ratios of deviations from the Basel standard. Internal model requirements are not consistently applied, including the enforcement of the permanent partial use of the standardized approach by IRB banks in line with Basel standards (i.e., only for asset classes that are immaterial in terms of size and perceived risk profile).
17. Credit risk	LC	EU law sets some general requirements on banks' credit risk management, but these are not accompanied by more detailed requirements or supervisory expectations. The SSM Supervisory Manual provides suggestions for onsite inspections, broadly covering the lifecycle of the lending activity, from granting loans to foreclosing collateral. However, these suggestions are meant for onsite activity and for the use of examiners, and are not shared with the supervised entities, hence, they cannot be considered either (binding) regulatory requirements or (non-binding) supervisory expectations. In addition, in the EU framework there is no explicit requirement for banks to make credit decisions on an arm's-length basis, and no requirement 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. Some of these elements exist in some national jurisdictions.
18. Problem assets, provisions, and reserves	LC	The supervisory activity on problems assets and provisioning in the SSM has progressed significantly since the issuance, by the ECB, of its guidance on NPLs. This has allowed the SSM to tackle with more determination the long-term issue of extremely high NPL ratios in

Core Principle	Grade	Comments
		certain banks. The NPL guidance has filled a number of pre-existent gaps in the EU-wide framework, but it is non-binding. The ECB powers to require credit institutions to apply specific adjustments to own funds calculations have been clarified, but should be explicitly enshrined in the law. However, the ECB cannot impose a reclassification as NPL in those cases where an exposure does not fully meet all the conditions necessary to be considered defaulted.
19. Concentration risk and large exposure limits	LC	The EU large exposures regime is not fully aligned with the Basel standard (which will only take effect from January 2019), in particular regarding some off-balance sheet contingent facilities, and the treatment of covered bonds, as well as the definition of eligible capital. The EU-wide framework does not cover concentration risk in the broader sense, i.e., beyond credit risk; there is no requirement that all material concentrations be regularly reviewed and reported to a bank's supervisory board.
20. Transactions with related parties	MNC	There is no EU-wide framework for transaction with related parties. Some, though not all the SSM Member States have laws and/or regulations in place that provide definitions of related parties and, in certain cases, prescribe limits for such transactions. While some JSTs actively discuss related party risk in individual cases, there is no common approach to the supervision of related party risk for SIs in the SSM.
21. Country and transfer risks	MNC	There is no EU-wide framework and no SSM-specific expectations for country and transfer risk with explicit requirements on how banks should identify, measure, evaluate, monitor, report and control or mitigate country and transfer risk. Similarly, the incorporation of country risk into stress tests is not explicitly

Core Principle	Grade	Comments
		required. There is no provisioning scheme against country risk and transfer risk.
22. Market risk	C	Market risk management standards are generally sound and supervisors take an active approach. The opaqueness in the valuation of certain products classified as Level 3 and the uncertainties in the classification of Level 2 assets require an intense and frequent supervisory scrutiny. The SSM has stepped up the efforts by ascertaining the correct valuation of Level 3 assets and liabilities and, for a specific family of products, Level 2 assets. This degree of scrutiny should continue and be extended to all Level 2 instruments,
23. Interest rate risk in the banking book	C	The stress-test exercise on IRRBB conducted on SIs in 2017 has allowed the ECB to gather granular information on banks' exposure to this risk after years of low interest rates. As part of the exercise the ECB also collected qualitative information for a broader assessment of banks' risk management practices. The assessors verified evidence of offsite and onsite supervisory activity specifically focused on IRRBB.
24. Liquidity risk	MNC	The LCR requirement is not fully aligned with the Basel standard: there is no explicit requirement for the Board to conduct a regular review and appropriate adjustment of the bank's strategy, policies and processes for the management of liquidity risk in the light of the bank's changing risk profile and external developments in the markets and macroeconomic conditions in which it operates; and no explicit requirement for supervisors to conduct separate analysis of liquidity risk strategy and monitoring of liquidity needs for each significant currency and to evaluate the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities. Data to support this kind of analysis were not generally

Core Principle	Grade	Comments
		available at the time of the assessment, though regular reporting of a maturity ladder with a breakdown also by significant currency started in March 2018. The information on unencumbered assets currently available to the SSM might not be sufficient to gauge the residual capacity of a bank to obtain emergency liquidity in a quickly deteriorating environment.
25. Operational risk	LC	The ECB has strengthened its operational risk program, the caliber of IT risk specialists, data reporting, collection and use of loss data, verification. IT, cybersecurity, and outsourcing are all areas meriting continued attention. Supervisory practices to assess that operational risk management is effectively implemented need to be given greater attention in order to confirm whether the operational risk framework is implemented effectively. While operational risk is considered as part of the annual risk assessments of banks, a system-wide analysis of common points of exposure to operational risk or potential vulnerabilities is needed. There is an opportunity for greater emphasis on the collection and analysis of material outsource providers.
26. Internal control and audit	C	European law, EBA guidelines, and the SSM supervisory statement published in 2016 provide a comprehensive set of requirements and supervisory expectations for the internal control framework of credit institutions, which is reinforced through the SREP process.
27. Financial reporting and external audit	LC	Responsibilities under EU directives in this area lie with other competent authorities, but the ECB is stepping up its involvement in the external audit process. The overall EU

Core Principle	Grade	Comments
		framework appears robust, but the power to access external auditors' working papers is absent in EU law.
28. Disclosure and transparency	LC	Disclosure standards are generally sound and promote transparency, reflecting the substance of the Basel II Pillar 3 standards. Supervisors routinely confirm compliance with the standards through both sample testing and thematic reviews. Euro area banks do not mandatorily disclose related party exposures or transactions with related parties as part of the Pillar 3 disclosures. Euro area banks disclose/report some average ratios instead of only end-of period for certain ratios, such as the leverage ratio and LCR.
29. Abuse of financial services		Not assessed.

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 1,4,5	The EU should give the ECB supervisory powers over all significant forms of credit intermediation in the Euro Area.
Principle 2	• The ECB should further streamline its decision-making processes. • The ECB should formalize staffing arrangements with NCAs if collaborative efforts cannot ensure the level, suitability and availability of NCA staff on JSTs and OSIs.
Principle 3	• The ECB should finalize MoUs with third-country authorities within and outside the EEA. • The ECB should finalize WCCAs for crisis management coordination in supervisory colleges for which it is consolidating supervisor.
Principle 4	The CRR/CRD should be amended to ensure that large cross-border investment firms undertaking "bank-like" activities establishing in the Euro Area are authorized and supervised by the ECB as credit institutions.

Principle 5	Euro area branches of a third country banking group exceeding a certain threshold should be authorized and supervised by the ECB.
Principle 6	The ECB should confirm its supervisory expectation that credit institutions notify their JST 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.
Principle 7	The EU should give the ECB supervisory powers to require a credit institution undertaking a material acquisition or investment within or outside the EU to notify the ECB in advance of the proposed transaction, and to approve or reject the proposed transaction.
Principle 8	• The ECB should continue to streamline and simplify its supervisory processes to ensure effective resource use and timely responses to emerging supervisory issues. • The ECB's supervisory processes should also be reviewed for effectiveness in light of recent resolution experience. The ECB's crisis management function should make better use of recovery plan assessments and develop operational guidance for crisis management activities. • The ECB and SRB should forge closer working relationships in recovery and resolution planning. • The ECB should finalize revisions to the existing MoU with the SRB. In doing so, priority should be given to maximizing information sharing early in the process, well before formal "failure or likely to fail" notifications are required, to facilitate seamless recovery and resolution planning.
Principle 9	• The ECB should streamline Internal reporting lines to ensure the timely communication of supervisory and other information within the ECB and timely feedback to SIs. • The ECB should seek a mandatory notification requirement that SIs report all substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments. • The ECB should increase its transparency about its supervisory policies, expectations, and approaches through the publication of further guides on supervisory topics.
Principle 10	• Processes for amending and augmenting harmonized supervisory reporting should be streamlined and expedited. • The development and widespread adoption of BIRD and IReF as the single source for supervisors' multiple information needs should be further promoted.
Principle 11	• The legal framework for enforcement and sanctions is asymmetrical and should be harmonized, including for direct enforcement measures and sanctions on individuals and entities regarding all breaches of the CRR. • The EU should give the ECB express authority to impose non-pecuniary sanctions, such as enforceable "cease and desist" orders with affirmative covenants, as an additional supervisory tool.

Principle 12	• Gaps in national law that impact the ECB's ability to supervise the activities of companies affiliated with parent companies should be closed. • Potential gaps in the ECB's fit-and-proper supervisory authority where there is corporate ownership of the group and there is no governing national law should be closed. • Potential gaps in the supervision of financial conglomerates under FICOD, which do not require MFHCs to obtain authorization from regulators should be addressed. • Thresholds for the conglomerate definition under FICOD should be changed to include off-balance-sheet assets, with supervisory discretion to include other assets or to deem a group a conglomerate based on risk. • A framework for resolution of a conglomerate should be established.
Principle 13	• The ECB should finalize MoUs with all supervisors of G-SIBs as quickly as possible. • The EU should give the ECB express authority to prohibit shell banks or to limit the use of foreign branches as mere booking offices.
Principle 14	• The fit-and-proper framework should be harmonized in line with international best practice principles. • The ECB should have greater discretion to object to persons whose prior work experience and relationships may make them not fully independent from management. • Internal governance standards for financial conglomerates should be enhanced.
Principle 15	• Responsibility for defining the prudential standards for different categories of risk should be assigned to competent authorities (e.g., by moving Articles 79 to 87 of CRD IV to the CRR). • The ECB should issue a comprehensive document on risk management that collects, structures, and reorganizes all existing guidelines, letters and other documents issued so far and completes them, with indications on areas not covered yet. • A requirement or explicit supervisory expectations about Board and senior management awareness of the uncertainties attached to risk measurement should be introduced. • EU law should introduce a requirement that the removal of a CRO should be discussed with the supervisor and should be disclosed publicly. • A requirement or explicit supervisory expectations should be introduced that stress testing programs should actively involve the Board and senior management, be appropriately documented and regularly maintained and updated. • A requirement or explicit supervisory expectations should be introduced for banks to appropriately account for risks (including liquidity impacts) in their new product approval process.
Principle 16	• The EU should conform the capital adequacy requirements of the CRR and CRD IV to the Basel standards.

	• The requirement for banks to hold capital in excess of the minima should remain a supervisory power exercised by the ECB under Pillar 2 through the SREP process. • The ECB should regularly monitor the effects on banks' capital ratios of deviations from the Basel standard. • The ECB should continue to require the consistent application of internal model requirements, including by enforcing the permanent partial use of the standardized approach by IRB banks in line with Basel standards (i.e., only for asset classes that are immaterial in terms of size and perceived risk profile).
Principle 17	• EU law should introduce a requirement for banks to make credit decisions on an arm's-length basis. • EU law should introduce a requirement for banks' credit policies to prescribe Board or senior management approval of credit risk exposures that exceed a certain amount or percentage of a bank's capital, or are especially risky, or are otherwise not in line with the mainstream of the bank's activities.
Principle 18	• Further convergence between the definitions of defaulted and NPEs and between these and the accounting definition of 'impaired' should be promoted. • The EU legislation should confirm the ECB powers to require capital deductions in case of mis-classification or under-provisioning of assets from a prudential perspective. • Criteria and approaches for adequate write-off should be introduced.
Principle 19	• The EU should amend the rules on large exposures to ensure closer alignment with the international standard. • Supervisors should address the potential consequences of deviations of the large exposure regime from the international standard in their risk assessments, closely monitoring the risk concentrations that these deviations could incentivize. • SIs should obtain LEIs for all supervised entities in their group and regularly use LEIs in reporting and in identifying their corporate clients. • A requirement or explicit supervisory expectations should be introduced that all material concentrations be regularly reviewed and reported to a bank's Board. • 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.
Principle 20	The EU should introduce a harmonized framework for exposures to related parties, compliant with this Core Principle.
Principle 21	The EU should introduce a harmonized framework for country risk, compliant with this Core Principle.
Principle 22	Verification of the adequacy of classification and valuation should be extended to all L2 assets and liabilities.

Principle 23	EU legislation should incorporate the principles of the Basel standard on IRRBB (April 2016).
Principle 24	• The EU should conform the rules on LCR to the Basel standard. • Assumptions on the outflows of different categories of deposits within given time horizons should be revised, both for the bank's own and supervisory stress testing, in the light of the circumstances that led to the recent resolution of certain banks. • Adequate circulation of relevant information—within the ECB and at national level—between the units in charge of Emergency Liquidity Assistance (ELA) and the JSTs should be ensured for banks experiencing (or likely to experience) liquidity stress. • A requirement or explicit supervisory expectations should be introduced for the Board to conduct (at least annually) a regular review and appropriate adjustment of the bank's strategy, policies and processes for liquidity risk management. • Supervisors should conduct separate analyses of liquidity risk strategy and monitoring of liquidity needs for each significant currency and evaluate the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities; supervisory reporting should be integrated accordingly.
Principle 25	• IT and cybersecurity risks require more intense supervisory attention. • Intra-industry IT/cybersecurity threat incident information sharing mechanisms should be strongly encouraged. • Inter-governmental IT/cybersecurity threat information sharing and crisis management mechanisms among ECB banking supervision and Euro Area, EU and global financial regulators should be strengthened and formalized. • The ECB, either alone or in conjunction with the EBA, should periodically publish IT/cybersecurity threat best practice guidance gleaned from its supervisory activities and IT industry standard setters. • The ECB's IT/cybersecurity threat recovery planning and crisis management policies and practices should be strengthened and formalized. • The ECB should encourage the industry development of data vaults that would permit the storage and recovery of preserved data should a bank suffer an IT/cybersecurity incident. • The ECB should strengthen its review of third party vendors and SI due diligence practices in the IT/cybersecurity context. • The EU should give the ECB prior approval and notification powers over outsourcing activities, including the power to restrict such outsourcing, to require information from the outsourcing provider and to undertake inspections. • The ECB should have sufficient and timely information to consider AML risk in its risk assessments and supervision of banks. Legal barriers to the mandatory exchange of AML information among the ECB and Euro Area AML supervisory authorities should be removed. The ECB should take supervisory measures based on AML-related risk management and

	operational risk deficiencies (instead of only increasing capital and liquidity requirements).
Principle 27	EU law should include a clear reference to additional supervisory powers for the competent authorities regarding the replacement of an external auditor.
Principle 28	• Euro area banks should be required to disclose related party exposures or transactions with related parties as part of their Pillar 3 disclosures. • Euro area banks should be required to disclose/report average ratios instead of only end-of period for certain ratios, such as the leverage ratio and LCR.

B. Authorities' Response to the Assessment

European Central Bank's Response:

The ECB welcomes the comprehensive assessment undertaken by the IMF of the banking supervision methods and practices carried out by the European Central Bank (ECB) in close coordination with National Competent Authorities (NCAs) in the SSM (SSM), as part of the Euro Area FSAP. The ECB appreciates the effort made by the IMF to produce this thorough, high quality assessment based on the Basel Core Principles (BCP) methodology, and generally, except on liquidity risk supervision, the ECB concurs with its findings and values the recommendations included therein, as they can serve as an opportunity to further improve banking supervision in the Banking Union.

The Euro Area FSAP has taken place five years after the IMF performed a financial stability assessment of the European Union, and almost three years after the SSM (SSM) was formally established. This has allowed the system to go through an initial set-up phase and reach its current full consolidation, in which intrusive, forward–looking, risk-based, homogeneous supervision of significant institutions is carried out on a daily basis across the Euro Area. In this period of time also the Single Resolution Board (SRB) has been established, so both supervision and resolution of significant institutions have now a truly Euro Area dimension.

For these reasons, the ECB considers that this Euro Area FSAP is especially timely, as the analysis of the effectiveness of the system now in place needs to be done from a Euro Area-wide perspective, and that future national Euro Area Member State FSAPs should fully take into account the new Banking Union architecture for the supervision and resolution of significant institutions.

As regards the concrete findings and recommendations included in the BCP Detailed Assessment Report (DAR), the ECB appreciates that the IMF recognises the ECB's achievements, in particular the increased level of supervisory intensity and intrusiveness, and the definition of clear supervisory methodologies and processes, as they have led to a more forward-looking, pre-emptive and even-handed supervision, and promoted the level playing field within the Euro Area and the harmonisation of supervisory practices across the SSM. The ECB also welcomes that the IMF acknowledges the ECB's efforts to streamline the ECB's decision-making process by way of delegation, and to simplify its processes to the extent possible. The ECB broadly shares the other findings and welcomes the related recommendations.

However, the ECB disagrees with **the assessment of BCP24 on Liquidity Risk** as Materially Non-Compliant. In the view of the ECB, this assessment severely misrepresents the intrusiveness, intensiveness, timeliness and efficaciousness of the current supervisory practices carried out by the ECB in close cooperation with the NCAs to ensure that significant institutions have this risk under control. This assessment also downplays the ECB capacity and readiness to act when significant institutions' controls are not up to the ECB standards and expectations regarding liquidity risk. While we agree with the IMF that some regulatory deficiencies still exist, the determined actions carried out by the ECB during recent episodes of crisis affecting a number of significant institutions have proved that the regulatory deficiencies have not prevented the ECB from delivering on its supervisory mandate.

In this regard, the ECB wants to emphasize that by means of the work of the Joint Supervisory Teams and the Horizontal Functions, and in close cooperation with the National Competent Authorities, the ECB monitors the liquidity situation of all significant institutions in a timely and forward-looking manner, both in normal and stressed situations. Furthermore, as proved during the crises mentioned above, when early signs arise of a potential deterioration of the liquidity position of a significant institution—due to either idiosyncratic weaknesses or challenging market conditions—the intrusiveness and frequency of the engagement with these institutions and the other relevant stakeholders increases with a view to determine current and future liquidity needs. These supervisory actions are adopted well ahead of the actual manifestation of any liquidity constrains, in order to ensure that in case an outright liquidity crisis eventually occurs all relevant stakeholders are sufficiently informed and the necessary decisions can be timely made.

This supervisory approach to liquidity risk also permitted the orderly resolution, according to the applicable legislation, of those institutions whose deteriorating liquidity situation threatened the very existence of the bank, without affecting financial stability or the banks' depositors, or requiring public funding.

In addition to liquidity risk, the ECB would like to highlight a number of key policy issues that it deems of particular relevance. These relate to supervisory scope and powers as well as to harmonising the EU regulatory framework.

With regard to the scope and powers of the ECB in the area of banking supervision, three topics should be emphasized.

- First, the ECB concurs with IMF that the lack of ECB supervisory powers in the domain of large branches in the Euro Area of non-EU banks (often referred to as '3rd country branches') entails important risks for regulatory and supervisory arbitrage. As a consequence, the ECB agrees that further harmonisation at the EU level through appropriate legislative changes is needed as soon as possible.

- Second, the ECB strongly supports IMF staff's recommendation that the supervisory powers of the ECB should be extended to cover also relevant cross-border investment firms which carry out bank-like activities in the Euro Area.

- Third, the ECB welcomes the IMF staff's recommendation that the requirement for banks to hold capital in excess of the minima should remain an agile supervisory power exercised by the ECB under Pillar 2 through its Supervisory Review and Evaluation Process (SREP). In this regard, the ECB underlines that this power includes the setting of the appropriate level of additional capital taking into account a holistic risk analysis as well as its capital composition on a general basis. The ECB notes also the recommendation to the EU co-legislators that the deviations of the capital adequacy requirements of the CRR and CRD IV from the Basel standards should be minimised.

Moreover on the EU prudential framework, the ECB agrees with the IMF assessment that there are still a number of important areas which are yet to be harmonised at EU level, or which have been harmonised by means of a Directive leaving too much flexibility for their transposition into national laws, or where options are provided to Member States to determine the actual provisions on key aspects of the regulatory framework, like Large Exposure limits. This regulatory heterogeneity has an important impact on the level playing field and complicates the exercise of homogeneous supervision across the SSM. For these reasons, the ECB welcomes that the IMF acknowledges the need for further harmonization of, notably, the 'fit and proper' framework and authorisation requirements, including licensing and license withdrawals, where harmonisation is urgently needed, as well as a more complete set of harmonised supervisory powers, including sanctioning. More specifically, the ECB shares the IMF's assessment that the current legal framework does not ensure a level playing field regarding enforcement and sanctioning measures, and that therefore further harmonization is necessary.

In this regard, the ECB has already signalled in its Opinion on the Commission's proposal to amend CRDIV that the list of infringements subject to sanctions under the CRD does not include a number of important breaches in respect of Pillar 1 capital requirements, supervisory regulations and decisions issued by a competent authority, the requirement to apply for prior permission, and the obligations to notify the competent authority. It is therefore for the Member States to discretionary decide as to whether to provide the competent authorities with the power to impose administrative penalties in such cases or not, which may lead to inconsistencies among the Member States and undermine the effective enforcement of prudential requirements. To counter this, the ECB already proposed at least to expand the list of infringements subject to sanctions. More generally, the ECB welcomes the IMF's recommendation that the scope of the ECB's enforcement and sanctioning powers should be fully aligned with the ECB's supervisory tasks, in order to ensure proper deterrence.

The ECB also agrees with the IMF assessment that the EU legal framework should be completed to ensure proper supervision of exposures to related parties and the transfer of significant ownership of banks.

Regarding the recommendations related to crisis management, the ECB agrees that the existing operational guidance for crisis management should be updated in light of the lessons learned from recent cases. The ECB has already decided on an action plan to address the issue, including revisions in its crisis procedures and manuals, more explicit incorporation of recovery planning in crisis identification and management, and further work on early intervention operational guidance. The ECB also agrees that close working relationships with the SRB in recovery and resolution planning is necessary and considers that such crucial relationships are already in place. The ECB and SRB have recently reviewed their bilateral Memorandum of Understanding to reflect the experience gained in the first two years of its implementation. The revised Memorandum of Understanding will further enhance cooperation and information exchange between ECB Banking Supervision and the SRB for resolution planning purposes as well as for crisis cases.

As regards supervisory reporting, the ECB shares the views expressed in the IMF’s assessment that, while a fundamental pillar for the development of the single market in the EU, the maximum harmonization principle applied in the field of supervisory reporting is not necessarily compatible with the need of a supervisory authority to swiftly adapt the reporting framework as new risks develop. For this reason, the ECB agrees with the IMF’s recommendation that the process for amending and augmenting harmonized supervisory reporting in the EU should be streamlined and expedited. Moreover, the ECB would like to stress the necessity for the institutions to keep the flexibility—as provided by Article 10 of the SSMR—to promptly and efficiently address, consistently with the maximum harmonization principle, any data needs necessary to perform a sound, homogeneous supervision across the SSM.

Finally, the ECB wants to welcome once again this Euro Area FSAP, which should take place on a regular basis in order to fully account for the new supervisory and resolution framework for significant institutions currently in place in the Euro Area, and whose findings and conclusions are to be used in national FSAPs in Euro Area Member States. The ECB fully supports the IMF in its efforts to improve by means of FSAPs the quality of financial supervision globally, as we consider that this is a key element to achieve efficient financial systems that are capable of providing financing and other services to the economy in all phases of the economic cycle. The ECB looks forward to continuing its current close engagement with the IMF with a view to promote stable and efficient financial sectors globally, also by ensuring effective supervision.

European Commission’s Response:

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.

Most notably, the European Commission disagrees with the assessment of the Basel Core Principle on liquidity risk as 'materially non-compliant'. In the European Commission's view, it is not clear how, based on the argumentation provided in the detailed assessment, the assessment team came to its conclusion. The driver behind the grade cannot be the deviations contained in the EU liquidity coverage ratio (LCR) framework since those were deemed as not having a significant overall impact by the Basel Committee (as indicated in the assessment, the Basel RCAP found the EU implementation of the international standard on the LCR to be 'largely compliant'). To the extent that the grade is driven by the alleged deficiencies of the EU regulatory framework on liquidity risk management, the European Commission would like to point out that the assessment appears to be based on a misunderstanding of the actual requirements set out within that framework. Article 86(1) of the Capital Requirements Directive (CRDIV) contains all-encompassing requirements on how competent authorities need to supervise liquidity risk,[122] including inter alia a clear reference to the need to ensure that the management of liquidity risk is tailored to different currencies. As such, the deficiencies that the assessment identifies are actually not present.

In addition to liquidity risk, the European Commission would like to highlight a number of other key policy areas where the assessment appears to be based on a misunderstanding of how the existing (future) EU framework works (would work).

First, the assessment appears to be overly focused on the tasks of the European Central Bank (ECB) and, in some instances, appears not to take into account the tasks attributed to the National Competent Authorities (NCA) under the Single Supervisory Mechanism (SSM). Indeed, the SSM was set up as a system composed of different supervisors, with clear rules on task allocation and with the ECB as the authority responsible of ensuring its overall functioning. In short, as regards the supervision of the bigger and more relevant institutions (so called Significant Institutions), the ECB is responsible for the main supervisory tasks, with the support of the NCAs. In some occasions, certain supervisory powers are allocated to the NCAs, which can be requested to act by the ECB. This is the case, for instance, of certain sanctioning powers. Assessing only the powers explicitly attributed to the ECB without taking into consideration the broader framework of the SSM may lead to an inaccurate view of the harmonised supervisory and regulatory framework in the Euro Area.

Second, the assessment references the proposed amendments to the CRDIV that concern supervisory powers under Pillar 2, noting their potential impact on the exercise of the ECB's supervisory powers. Specifically, the assessment team opines that while mitigating the legal uncertainty around the exercise of powers in some cases, the amendments could at the same time "*constrain supervisory discretion in the setting of prudential requirements*." The European Commission is of the view that the assessment should be based on adopted rules and not on proposed ones. Furthermore, the assessment appears to misunderstand the proposed amendments. These would not change or limit any powers or tools that are currently used by the SSM under Pillar 2. In fact, their aim is to provide further clarity and harmonisation in the Pillar 2 framework, as well as greater transparency towards the supervised entities. Additional provisions and clarifications proposed by

[122] "Competent authorities shall ensure that institutions have robust strategies, policies, processes, and systems for the identification, measurement, management, and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that institutions maintain adequate levels of liquidity buffers. Those strategies, policies, processes and systems shall be tailored to business lines, currencies, branches and legal entities and shall include adequate allocation mechanisms of liquidity costs, benefits, and risks."

the European Commission are also codifying certain best practices, elevating such best practices to the level of EU legislation.

Third, while acknowledging the European Commission's clarification of the supervisory powers to impose capital deductions in case an institution is considered to have insufficient provisions for non-performing loans, the assessment still calls for an explicit granting of these powers in EU legislation. The European Commission would like to point out that those powers are already explicitly granted in Article 104(1)(d) of the CRDIV. Furthermore, the existence of such powers is fully accepted and acknowledged—as demonstrated by the "Action Plan To Tackle Non-Performing Loans in Europe" endorsed by the ECOFIN Council on 11 July 2017, the Commission proposal on a Regulation amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures, as well as the Addendum to the ECB Guidance to banks on nonperforming loans: Prudential provisioning backstop for non-performing exposures.

Fourth, one of the main findings concerns the supervisory reporting framework, which is harmonised at EU level, but allegedly "*not sufficiently granular*" for the purposes of the off-site supervision. In this specific context, harmonisation is deemed as a negative feature since it "*does not allow for sufficient flexibility and agility*." The explanation of the finding is somewhat more nuanced, mentioning "some flexibility" via supplementary data collections by the ECB. This flexibility is not coincidental, but is explicitly envisaged by the primary legislation as part of the Pillar 2 powers of supervisory authorities to require any missing data necessary for effective supervision.

Fifth, in the assessment of the EU disclosure framework, the assessment team opines that disclosures, especially those related to the leverage ratio, are not in line with international best practice because they are made based on end-of-period instead of average figures. The European Commission would like to point out that the EU rules on the particular issue are fully in line with the international standards agreed by the Basel Committee.

Last, but not least, the assessment still contains some factual inaccuracies. For instance, while corrected elsewhere, the finding 25 still stipulates that "*the mixed financial holding companies are not included in the definition of conglomerates*" and are thus not included in the supervisory perimeter. Both statements are incorrect, as evidenced by the very definition of the term 'mixed financial holding company' in the FICO Directive and numerous provisions in the CRD IV and the CRR which explicitly include mixed financial holding companies into the scope of consolidated supervision.