



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

# Guide to on-site inspections and internal model investigations

BANKENTOEZICHT

September 2018

BANKTILSYN BANKU UZRAUDZĪBA

BANKŪ PRIEŽIŪRA NADZÓR BANKOWY

VIGILANZA BANCARIA

BANKFELÜGYELET

BANKING SUPERVISION

SUPERVISION BANCAIRE BANČNI NADZOR

MAOIRSEACHT AR BHAINCÉIREACHT NADZOR BANAKA

# BANKING SUPERVISION

PANGANDUJSJÄRELEVALVE

SUPERVISÃO BANCÁRIA

BANKOVNI DOHLED

БАНКОВ НАДЗОР

BANKTILSYN

BANKENAUF SICHT

ΤΡΑΠΕΖΙΚΗ ΕΠΟΠΤΕΙΑ PANKKIVALVONTA

SUPRAVEGHERE BANCARĂ BANKOVÝ DOHL'AD

SUPERVIŽJONI BANKARJA

SUPERVISIÓN BANCARIA

BANKING SUPERVISION

SUPERVISÃO BANCÁRIA

BANKENAUF SICHT

# Contents

<b>Conducting on-site inspections and internal model investigations</b>	<b>2</b>
Introduction	2
<b>1 General framework for inspections</b>	<b>4</b>
1.1 Organisation of the supervision of SIs	4
1.2 Decision-making process for inspections	5
1.3 Objective of inspections	6
1.4 Independence of inspections	7
1.5 Role of the HoM	7
1.6 Composition of the inspection team	7
1.7 Cross-border cooperation	8
<b>2 Inspection process</b>	<b>9</b>
2.1 Overview of the different steps of an inspection	9
2.2 Description of the main steps of an inspection	9
2.3 Inspection outcomes	15
<b>3 Applicable principles for inspections</b>	<b>19</b>
3.1 Inspection team's supervisory and investigatory powers	19
3.2 Inspection team's practices	20
3.3 Inspected legal entities' rights and the supervisor's expectations	22
3.4 Language used during the inspection	26

# Conducting on-site inspections and internal model investigations

## Introduction

In accordance with Council Regulation 1024/2013 of 15 October 2013 (the **SSM Regulation**)<sup>1</sup>, the supervisory authority of the European Central Bank (ECB) over supervised entities is exercised through off and on-site supervision, the combination of which aims to ensure a detailed and thorough analysis of the supervised entities' business. On-site supervision is performed through on-site inspections (**OSIs**) or internal model investigations (**IMIs**) (hereinafter referred to together as "**inspections**"), as stipulated in Article 12 of the SSM Regulation.

For the sake of simplicity, in this document we distinguish between **OSIs**, which are in-depth investigations of risk, risk controls and governance, and **IMIs**, which are in-depth assessments of internal models used for the calculation of own fund requirements, in particular with regard to methodologies, economic appropriateness, risks, risk controls and governance. Both types of inspection are carried out on the basis of a predefined scope, timeline and set of resources. The outcome of an inspection is a report detailing the findings.

The **ECB** is publishing this Guide, drafted with the assistance of the national competent authorities (**NCA**s) of the Member States participating in the Single Supervisory Mechanism (**SSM**), in the framework of its transparency policy. The objective of the Guide is to provide a useful reference document for the supervised entities and other legal entities for which the ECB has decided to launch an on-site inspection, as well as for the work of the on-site inspection teams. The Guide describes the inspection process, from the decision to launch the inspection to the follow-up stage, and sets out the best practices to foster fruitful cooperation between the entities being inspected and the inspection teams.

The Guide applies to the inspections conducted in (i) significant institutions (**SIs**),<sup>2</sup> (ii) less significant institutions (**LSIs**), when the ECB decides to exercise directly all the relevant supervisory powers for an LSI,<sup>3</sup> and (iii) other legal entities as referred to in Article 10(1) of the SSM Regulation, in particular third parties to whom credit institutions have outsourced functions or activities, and any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating

---

<sup>1</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

<sup>2</sup> As defined by Article 6(4) of the SSM Regulation. Inspections are conducted in accordance with Article 12 of the same Regulation.

<sup>3</sup> In accordance with Article 6(5)(b) of the SSM Regulation.

supervisor<sup>4</sup>. The term “**inspected legal entity**” is used for each. In particular, the ECB may carry out inspections in:

- Member States participating in the SSM (hereinafter “participating Member States”), with the assistance of NCAs;
- Member States of the European Union (EU) not participating in the SSM (hereinafter “non-participating Member States”);
- non-EU countries.<sup>5</sup>

This Guide is not, however, a legally binding document and cannot in any way replace the legal requirements laid down in the relevant applicable Union law. In the case of divergences between the relevant applicable law and the Guide, the former will prevail.

Inspections dedicated to areas which do not fall within the scope of the supervisory tasks conferred upon the ECB are also not included in this Guide. This is the case, for example, with inspections related to consumer protection or the use of the financial system for the purposes of -money laundering or terrorist financing arrangements,<sup>6</sup> as such inspections remain under the responsibility of each participating Member State.

Planned inspections are in general included in the simplified supervisory examination programmes (SEPs)<sup>7</sup> which are drawn up for each SI for a period of 12 months and discussed by the Joint Supervisory Team coordinator (JSTC) and institutions beforehand.

This Guide comprises the following three sections:

- Section 1: general framework;
- Section 2: inspection process;
- Section 3: applicable principles for inspections.

---

<sup>4</sup> In accordance with Article 12(1) of the SSM Regulation.

<sup>5</sup> For more information see Section 1.7 “Cross-border cooperation”.

<sup>6</sup> See recitals 28 and 29 of the SSM Regulation.

<sup>7</sup> The simplified SEP is a provisional high-level timeline for the main planned supervisory activities (off-site and on-site) that require the direct involvement of the institution.

# 1 General framework for inspections

## 1.1 Organisation of the supervision of SIs

Since November 2014 the ECB has been responsible for the direct supervision of SIs, as envisaged by Article 4 of the SSM Regulation and Articles 43 to 69 of ECB Regulation No 468/2014 of 16 April 2014 (**SSM Framework Regulation**).<sup>8</sup>

### 1.1.1 Main provisions related to inspections in SIs

The main provisions governing inspections in SIs are based on the following three texts:

- the SSM Regulation, in particular Article 12;
- the SSM Framework Regulation, in particular Articles 143 to 146;
- Directive 2013/36/EU of 26 June 2013, also referred to as the “Capital Requirements Directive IV” (**CRD IV**)<sup>9</sup>, in particular Article 65(3)(c) and Articles 52, 53, 97, 99 and 118, as transposed into the relevant national law.

### 1.1.2 Role of the Supervisory Board

The Supervisory Board (SB) is the internal body of the ECB in charge of the planning and execution of the banking supervision tasks conferred on the ECB. In particular, the SB is entrusted with preparing the complete draft supervisory decisions which are adopted according to a non-objection procedure by the Governing Council in accordance with Article 26(8) of the SSM Regulation and Article 13g.2. of the Rules of Procedure of the ECB.

As envisaged by Article 12(3) of the SSM Regulation and Article 143 of the SSM Framework Regulation, all inspections are conducted on the basis of an ECB supervisory decision.

---

<sup>8</sup> Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (OJ L 141, 14.5.2014, p.1).

<sup>9</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (OJ L 176, 27.6.2013, p. 338).

### 1.1.3 Role of the Joint Supervisory Teams

A Joint Supervisory Team (**JST**) is assigned to the ongoing supervision of each SI. Each JST is composed of supervisors from the ECB and NCAs and headed by a coordinator, who is an ECB employee of the Directorate General in charge of the microprudential supervision of the SI. The JSTC is assisted by sub-coordinators working in the NCAs involved.

The JST contributes to on-site activities through, inter alia, (i) preparing the SEP, (ii) communicating with the inspection team during the inspection, and (iii) preparing recommendations or preparing/contributing to draft decisions<sup>10</sup> resulting from the inspection findings and subsequently following up on any remedial actions or supervisory measures.

Meetings with the JSTs at the bank's premises and supervisory visits conducted by the JSTs as part of their overall supervisory function (e.g. an in-depth review or "deep dive" on a specific topic carried out at the inspected legal entities' premises over a number of days) are not inspections and fall outside of the scope of this Guide.

### 1.1.4 Role of the ECB in inspections

Inspections complement ongoing supervision. The ECB maintains a permanent in-depth knowledge of the credit institution by performing ongoing off-site supervision, which mainly relies on the information reported by the credit institution, and through inspections to check, among other things, the accuracy of the information used to conduct ongoing supervision.

The relevant divisions within Directorate General Microprudential Supervision IV (DG MS IV), the Centralised On-site Inspections Division (COI) and the Internal Models Division (INM) are responsible for the ongoing monitoring of inspections and for ensuring that common, high quality standards are applied in all inspections. They cooperate closely with the JSTs and the NCAs to achieve this.

## 1.2 Decision-making process for inspections

In accordance with Article 99 of CRD IV, inspections are decided upon on the basis of formal planning, which is adopted at least annually and adjusted during the course of the year. Inspections are conducted on the basis of the ECB's supervisory decision, which specifies the subject matter and purpose of each inspection.<sup>11</sup>

---

<sup>10</sup> The majority of internal model inspections result in a draft decision. In general, draft decisions on internal models are prepared by the ECB's Internal Models Division and reviewed by the JST before submission to the SB. See Section 2.3.1 for more details on inspection outcomes.

<sup>11</sup> Articles 9, 11 and 12 of the SSM Regulation and Articles 142 and 143 of the SSM Framework Regulation.

While the planned inspections are part of the SEP, inspections without prior notification to the supervised entity are triggered in reaction to an event or incident which has arisen in a credit institution or group of credit institutions and which requires immediate supervisory action.

## 1.3 Objective of inspections

Inspections aim to provide an in-depth analysis of various risks, internal control systems, business models and governance. Inspections are conducted within a predefined scope and timeframe at the premises of the inspected legal entities. However, if deemed necessary the scope and timeframe of the inspection can be changed while the inspection is in progress. More specifically, inspections aim to:

- examine and assess the level, nature and features of the inherent risks to which the entity is exposed, also taking into account its risk culture;
- examine and assess the appropriateness and quality of the inspected legal entity's corporate governance and internal control framework in the light of the nature of its business and risks;
- assess the inspected legal entity's control systems and risk management processes, focusing, in particular, on detecting weaknesses or vulnerabilities that could have an impact on its own funds;
- examine the quality of balance-sheet items and the financial situation of the inspected legal entity;
- assess the business model of the inspected legal entity;
- check the inspected legal entity's compliance with banking regulation, and, in the case of internal models, with the legal requirements pertaining to internal models used for the calculation of capital requirements (initial approval, material changes, extensions, roll-out, permanent partial use or reversion to less sophisticated approaches).

Inspections are carried out within the SSM as part of the overall supervisory process. In line with the supervisory principles for the functioning of the SSM, inspections must be:

- **Risk-based**, applying generally accepted concepts and techniques while prioritising efforts where higher risk or a lower level of control is perceived within the inspected area or activity.
- **Proportionate**, commensurate with the size, activities and risk profile of the inspected legal entity. The implementation of this principle also facilitates the effective allocation of on-site resources.
- **Intrusive**, as the evolution of supervisory approaches has increasingly required supervisors to delve more deeply into the inspected area or activity, with more

judgement-based evaluations and a better understanding of the risk profiles and business lines of supervised financial institutions. Inspections play a key role in this regard, giving supervisors the opportunity to develop a more in-depth understanding based on the valuable knowledge provided by checking first-hand.

- **Forward-looking**, looking beyond present or historical figures to anticipate possible future impacts.
- **Action-oriented**, leading to remedial actions and/or corrective measures to be taken by the credit institution according to timelines monitored by the JST.

## 1.4 Independence of inspections

The Head of Mission (**HoM**) and the inspection team act independently of, but in cooperation with, the JST. Once the supervisory decision to carry out an inspection has been adopted, its implementation is under the sole responsibility of the HoM, who is in charge of producing a report that includes the findings of the inspection team.

## 1.5 Role of the HoM

In accordance with Article 144 of the SSM Framework Regulation, the HoM is appointed by the ECB from among ECB or NCA staff to lead the inspection. In keeping with the independence principle between on-site and off-site tasks adopted by the ECB, a JST member can be part of an inspection team, but cannot be appointed as the HoM.

The HoM is the main contact person for the inspected legal entity on the topics reviewed during the inspection. The HoM manages the inspection team, organises the various steps of the inspection and is the only member of the inspection team to sign the inspection report. The HoM is responsible for keeping the relevant ECB divisions and managers informed of the mission's progress.

In the event of a HoM being replaced due to unavailability, the JST notifies the inspected legal entity as soon as possible.

## 1.6 Composition of the inspection team

Article 144 of the SSM Framework Regulation provides that the ECB is in charge of the establishment and composition of inspection teams with the involvement of the NCAs.

The inspection team can be composed of ECB inspectors, supervisors employed by the NCA of the inspected legal entity's participating Member State, and supervisors

from other NCAs, as well as JST members or other persons authorised by the ECB. Other persons authorised by the ECB might be, for example, external consultants who are considered as regular team members during the inspection. Regardless of their origin, all team members work on behalf of the ECB under the responsibility of the HoM. External firms are contractually obliged to comply with the ECB's strict professional secrecy requirements. They, and their staff, are required to sign individual confidentiality agreements to that effect.

Members of the inspection team are appointed by the ECB in order to conduct all necessary inspections on the premises of the inspected legal entity.<sup>12</sup>

## 1.7 Cross-border cooperation

Inspections decided upon by the ECB take into account any cooperation arrangements or agreements that have been established, in compliance with the relevant applicable legislation, with the supervisory authorities of the jurisdictions where the inspections are to be conducted. The inspections are only conducted (i) in line with such arrangements and (ii) with the consent of the relevant authorities of the jurisdiction(s) where the inspections are carried out.

---

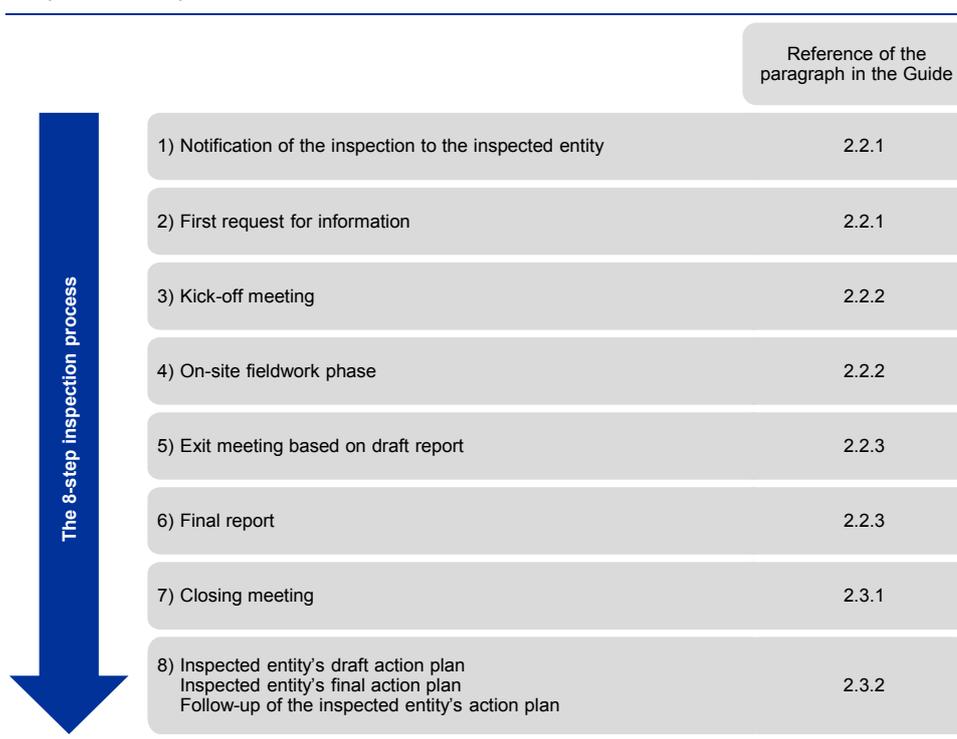
<sup>12</sup> Article 12(1) of the SSM Regulation and Article 143 of the SSM Framework Regulation.

## 2 Inspection process

### 2.1 Overview of the different steps of an inspection

The diagram below outlines the steps involved in an inspection, each of which is explained in more detail afterwards.

**Figure 1**  
Steps of an inspection



### 2.2 Description of the main steps of an inspection

#### 2.2.1 Preparatory phase

##### Confirmation step

In the initial step of the preparatory phase, the availability and readiness of all parties involved is confirmed. For OSIs this is always a purely internal procedure. For IMIs it may also involve the inspected legal entity: in most cases the ECB provides a standardised package of templates that institutions are invited to submit even before they apply for an internal model approval or model change (pre-application

package). These are intended to assist the inspection team with its preparations, and to provide an indication of whether the institution is ready to submit a formal application. In such cases the inspected legal entity receives feedback about the ECB's views on whether or not it is ready to submit an formal application.

## Notification of the commencement of an inspection

The HoM is formally appointed by means of a letter of appointment from the ECB.

Except under special circumstances (see Section 3.3.1, "Right to be informed of the start of the inspection"), the ECB notifies the inspected legal entity of its decision to launch an inspection. This usually happens a few weeks, but at least five working days, before the inspection is due to commence with the kick-off meeting.<sup>13</sup>

The inspected legal entity is notified through a letter from the ECB to the inspected legal entity's nominee from the management board or supervisory board. If the inspection is conducted on a group of credit institutions with a parent company located in a participating Member State, or if the inspected legal entity is a subsidiary of a parent located in a participating Member State, the notification is generally sent to the parent, which in turn must inform the subsidiaries concerned of the upcoming inspection. The notification letter mentions the name of the HoM and the subject matter and purpose of the inspection.

## Inspection memo

To establish the most suitable plan to achieve the objectives of the inspection efficiently the HoM liaises with the responsible JSTC. In close cooperation they exchange relevant information and prepare an inspection memo setting out the rationale, scope and objectives of the inspection. Once the memo has been agreed and vetted by DG MS IV, the HoM assigns the various tasks to the inspection team members.

## First request for information

Before the kick-off meeting is held, the HoM informs the inspected legal entity of the identity of the team members who will participate in the inspection and as soon as possible sends a first request for information to the inspected legal entity. The request for information details the information the inspection team understands is necessary to have as a starting point for the inspection. If the institution has any questions regarding the requested information, it should not hesitate to contact the HoM and ask for clarification.

---

<sup>13</sup> Article 145(1) of the SSM Framework Regulation.

As part of the first request for information, the HoM asks for a physical place to be made available for his/her team, along with all the necessary information technology (IT) and communication facilities to conduct the inspection (see Section 3.3.3, “Operating conditions”). The information requested generally includes the organisation chart of the inspected legal entity, a description of the procedures regarding the scope of the inspection and any other necessary information (e.g. data tapes with portfolio information). The inspected legal entity may be asked to provide documents or information mentioned in the first request for information before the kick-off meeting in order to allow for discussion at the meeting if required. During the course of the inspection additional information related to the scope of the inspection may also be requested.

## 2.2.2 Investigation phase

### Kick-off meeting

After the ECB has notified the inspected legal entity of the forthcoming inspection, the HoM contacts the relevant person in the entity to check whether the information to be provided before and at the kick-off meeting is available and to answer any questions about the request. Once this has been done, the HoM sets the date of the kick-off meeting. This meeting officially launches the inspection.

The kick-off meeting is the first official meeting between the inspected legal entity and the inspection team. It is organised and chaired by the HoM and is held on the premises of the inspected legal entity. As a rule, during the inspection all the meetings take place at the premises of the inspected legal entity (see Section 3.1, “Right of access to business premises”).

The HoM informs the JSTC of the kick-off meeting. The JSTC, other JST members, and representatives from the relevant division within DG MS IV may attend the kick-off meeting.

To be effective, the kick-off meeting needs to be arranged with enough flexibility in terms of duration and participants. The entire inspection team should take part, unless its size or other circumstances require otherwise.

During this meeting, the HoM introduces the team to the inspected legal entity’s management. The HoM uses this meeting to expand on the notification letter and to present in detail the objectives and scope of the inspection and the various steps involved, notably the planning of the first meetings.

A senior representative of the inspected legal entity should attend the kick-off meeting. This should be the member of the management body (with executive function) responsible for the topic to be inspected, and if no member of the management body (with executive function) is responsible for the topic, the relevant senior manager (hereinafter in both cases referred to as the ‘respective manager’). If

necessary, the HoM may specify other persons who should attend. A first tentative timeline of the investigations may also be communicated.

On this occasion, the HoM may ask the inspected legal entity to give a general presentation on its organisational structure, business model, strategy and governance policy and procedures and on its main processes in the areas covered by the inspection. The HoM may also ask the inspected legal entity to identify the main contact persons for each topic, if applicable.

The inspected legal entity should use the kick-off meeting to clarify any questions it may have about the inspection. The inspection team may also use this opportunity to set deadlines for receiving any outstanding information requested.

## Execution of the work programme

After the kick-off meeting, the inspection team begins its investigations in the inspected legal entity's premises. The investigation phase consists of interviews and an examination of procedures, reports and files. Evidence is collected to ensure that an audit trail is in place for any weaknesses identified by the inspection team.

As a wide variety of inspection techniques exist, the list below is non-exhaustive.

- **Observation, information verification and analysis:** the aim is to check and analyse the information provided by the legal entity and to observe the related processes. Therefore it is necessary to grant the inspection team access to all the requested information and read-only access to all relevant IT systems (see Section 3.3.3, "Operating conditions"), as contemplated in Article 11 of the SSM Regulation.
- **Targeted Interviews:** by meeting with relevant staff at the inspected legal entity, the inspection team collects information about inspected areas and compares the documented processes and organisational structures with the practices at the entity. The team may challenge the interviewees on these. Significant interviews are attended by at least two inspectors.
- **Walk-through:** the aim of this inspection technique is to ensure that the process the inspected legal entity reports having in place is actually applied in practice. This also casts light on the consistency of the procedures, enabling the team to locate gaps or weaknesses in them.
- **Sampling/case-by-case examinations:** samples are taken (e.g. individual loan commitments or other business transactions) to validate the results of the examination and allow inspectors to gauge the quality of the institution's risk management. Furthermore, sampling plays an important role in locating problems and/or risks and helps to assess their severity. Methods of extrapolation may be used and will be made transparent to the inspected legal entity.

- **Confirmation of data:** the integrity, accuracy and consistency of the inspected legal entity's data must be checked by recalculations, by performing a benchmarking analysis or even by requesting counterparty confirmation (circularisation).
- **Model testing:** the inspected legal entity is asked to test the performance of its models and their output under various hypothetical and historical market conditions (e.g. scenario analysis).

Over the course of the investigation phase, the inspection team has the possibility to hold status meetings with the inspected legal entity at working level to discuss preliminary facts and findings before the exit meeting is held (see Section 3.3.1 "Right to be informed of the inspection outcomes"). For this purpose the team may share draft documents with the inspected legal entity. The inspected legal entity also has the possibility, within reason, to request status meetings with the inspection team.

### 2.2.3 Reporting phase

The inspection findings are formalised in an inspection report or model assessment report (the term "report" is used to refer to both). The report stems from the conclusions of the investigations conducted throughout the inspection. It includes an executive summary, a table of findings, and the body of the report. Appendices may be added.

The findings of an inspection are categorised according to their actual or potential impact on the inspected legal entity's financial situation, level of own funds or own funds requirements covered by the inspection, internal governance, risk control and management. The impact is categorised as follows:

- (i) low impact (F1);
- (ii) moderate impact (F2);
- (iii) high impact (F3);
- (iv) very high impact (F4).

After completion the draft report is sent to the relevant division within DG MS IV (COI or INM) and to the relevant NCA for a consistency check, possibly involving discussions with the HoM. Taking into account feedback received from the consistency checks, the HoM produces the draft report to be shared with the inspected legal entity. For institutions which have requested to be addressed by the ECB in their national language the draft report is translated into the language chosen, unless the institution has agreed otherwise with the ECB (in general or for a specific document), as this accelerates the process. Institutions may choose to waive the right to receive the draft report in their national language with no effect on future procedures.

The HoM sends the draft report of the inspection, together with a standardised feedback template, to the inspected legal entity. The inspected legal entity may fill out the feedback template. Based on the draft report, the HoM calls an exit meeting and invites the persons effectively directing the business of the inspected legal entity.

The aim of the exit meeting is to discuss the report with the inspected legal entity. It is chaired by the HoM and representatives from the relevant division within DG MS IV, the NCAs and the JST are invited to attend. The draft report should be sent a few days in advance to enable the inspected legal entity to adequately prepare for the meeting. If the inspected legal entity is a subsidiary of a parent located in a participating Member State, the draft report can also be shared with the parent. In the case of inspections of groups with a parent located in a participating Member State, the draft report is sent to the parent.

During the exit meeting, the HoM presents the outcome of the inspection. This opens the opportunity for the inspected legal entity to provide written feedback within two weeks (see Section 3.3.1 “Possibility to comment on the facts and findings”).

Afterwards the HoM finalises the draft report based on the feedback received, if necessary. The feedback template is then completed with the HoM’s response and attached to the final report, which is signed by the HoM. The final report is then sent to the relevant inspected legal entity. If the inspection is conducted on a group of credit institutions with a parent located in a participating Member State, or if the inspected legal entity is a subsidiary of a parent located in a participating Member State, the final report is sent to the parent.

The report serves as a basis for: in the case of OSIs either (i) a draft follow-up letter that includes recommendations to remedy the shortcomings mentioned in the report or (ii) a draft decision that stipulates binding supervisory measures to remedy those shortcomings.

In the specific case of IMIs, the report serves as the basis for a draft decision which communicates the result of an application for a model approval or model change approval (if applicable) or the assessment of a model. Figure 2 lists the steps involved in the reporting phase.

**Figure 2**  
Steps of the reporting phase



## 2.3 Inspection outcomes

### 2.3.1 Presentation of the requested remedial actions

The final phase of the inspection enables the ECB to present any recommendations or required supervisory measures to the inspected legal entity in the form of one of two different instruments.

The first instrument, a letter expressing supervisory expectations, constitutes an operational act and is mostly applied to OSIs. It is not legally binding and does not require a decision by the SB. Hence, the formal procedure for the adoption of an ECB decision, including the right to be heard, is not followed.

After consulting with the relevant division of DG MS IV, the JSTC sends a draft of the follow-up letter, which includes recommendations, to the inspected legal entity. In the case of OSIs, this is done before the closing meeting is held.<sup>14</sup> The closing meeting, arranged and chaired by the JSTC, is also attended by the HoM and possibly representatives from the relevant division of DG MS IV. The aim of this meeting is to inform the inspected legal entity of any recommended follow-up to the inspection. After the closing meeting, which officially ends the reporting phase of the inspection, the inspected legal entity, as well as the relevant NCA(s), receives the final follow-up document from the ECB.

---

<sup>14</sup> No closing meeting is included in the process for IMIs.

The second instrument is an ECB supervisory decision addressed to the inspected legal entity and containing legally binding supervisory measures. In the case of IMIs, it also contains the ECB assessment of an initial application for a model approval or for the approval of a model change (if applicable), or the ECB assessment of a model already in place.

For the adoption of such a decision, the non-objection procedure established in Article 26(8) of the SSM Regulation is followed and the due process principles established in Article 22 of the same Regulation and further elaborated in Articles 25 to 35 of the SSM Framework Regulation, including the hearing of the affected party, are observed.

The JST prepares the proposal for a draft decision. For IMIs, however, the proposal is prepared by the relevant DG MS IV Division for submission to the SB. In such cases the proposal, which is based on the report and the outcome of the consistency checks, is sent to the JST for review.

The draft decision (for both OSIs and IMIs) is then submitted to the SB and, after acceptance, the complete draft decision is sent to the inspected legal entity, in accordance with the “right to be heard” as contemplated in Article 31 of the SSM Framework Regulation. At the end of the hearing period<sup>15</sup> the JST or, in the case of IMIs, the relevant DG MS IV Division, addresses the comments from the inspected legal entity and, if appropriate, revises the draft decision. This revised draft decision is then submitted again to the SB and, after acceptance, adopted by the Governing Council using the non-objection procedure. The finalised ECB decision is then sent to the inspected legal entity with immediate legally binding effect.

For decisions adopted after conducting an IMI, besides addressing the institution’s request for approval the ECB supervisory decision may exercise other supervisory powers that take one of the following forms.

- (i) Conditions: these suspend the legal effectiveness of an ECB permission to use, change or extend an internal model until the inspected legal entity has undertaken a specific remedial action in order to ensure compliance with a legal requirement.
- (ii) Limitations: these restrict or modify the use of a model. A restriction can, for example, prohibit the use of the model for certain portfolios, whereas a modification can, for example, prescribe changes to the values of certain model parameters or to the calculated own funds requirements. In either form, a limitation must be applied as of the date on which the permission granted under the decision becomes effective, i.e. usually immediately, unless the decision stipulates a specific date as of which the new model will be used.
- (iii) Obligations: these are remedial actions imposed on an inspected legal entity in order to ensure compliance with a legal requirement, without postponing or

---

<sup>15</sup> In general, the hearing period is 2 weeks. However, the inspected legal entity may request an extension or send its comments earlier.

limiting the use of the internal model. Obligations include a deadline for completing the remedial actions requested.

- (iv) Recommendations: these are actions recommended to the inspected legal entity. Unlike obligations, they are not legally binding.

The violation of a limitation, or the failure to give satisfactory proof of completion of the obligations within the stated deadlines, may cause the ECB to reconsider the terms of the permission; this may include the revocation in whole or in part of the decision.

In most cases an IMI results in a decision, whereas an OSI usually results in a recommendation.

## 2.3.2 The follow-up phase

### Recommendations and action plan

The JSTs are responsible for the follow-up phase of the inspection.

As described in Section 2.3.1 “Presentation of the requested remedial actions”, the ECB sends a final follow-up letter/decision (in the case of OSIs) or a final decision (in the case of IMIs) to the CEO of the inspected legal entity describing the recommended/required actions or the supervisory measures, including their deadlines, if appropriate.

If the outcome of the inspection takes the form of a decision, in a second stage, and by the date set by the ECB, the inspected legal entity is asked to send a response, including its action plan, detailing how it will address the corrective steps required by the ECB. The objective of this phase is to ensure that the inspected legal entity addresses the actions requested by the ECB in a timely manner. The content of this response is assessed by the JSTC.

### Follow-up of the measures required of the inspected legal entity

The JSTC is responsible for following up on the implementation of the corrective measures by the inspected legal entity until they have been completed. The entity may be required to submit updates on the remedial action to the JSTC by interim deadlines.

At the deadline set out in the action plan, the ECB may decide:

- to close the follow-up phase,<sup>16</sup> if it considers that the actions taken by the inspected legal entity are fully compliant with the follow-up request;
- to request additional information, in order to adjust the action plan.

If the inspected legal entity has not implemented the measures imposed in the decision within the relevant time frame, the ECB has the power to enforce supervisory measures.<sup>17</sup>

---

<sup>16</sup> Agreement to close the follow-up phase may be contingent upon the inspected legal entity fulfilling the obligations deriving from a decision.

<sup>17</sup> The ECB is entrusted with disciplinary powers providing the right to apply administrative sanctions and measures aimed at preventing and resolving banking crises. All decisions taken by the SB in this regard must be approved by the ECB Governing Council through a non-objection procedure, in accordance with Article 26(8) of the SSM Regulation and Article 13g of Decision ECB/2014/1 of 22 January 2014 amending Decision ECB/2004/2 adopting the Rules of Procedure of the European Central Bank.

## 3 Applicable principles for inspections

### 3.1 Inspection team's supervisory and investigatory powers

#### General work

The proper conduct and efficiency of the inspection should be the common goal of inspectors and the inspected legal entity. An inspected legal entity's internal rules and policies should not be misused to interfere with this goal.

#### Right of access to business premises

In order to perform its investigations, the inspection team has the right to access the business premises of the inspected legal entities covered by the scope of the inspection.<sup>18</sup>

The extent to which property is protected depends on the particularities of national law. In this regard, in accordance with Article 13 of the SSM Regulation the ECB must respect those national laws which require prior authorisation by judicial authorities for inspections.

#### Right to request any information or document

The inspection team may, within the scope of the inspection, conduct all necessary investigations of any persons referred to in Article 10(1) of the SSM Regulation<sup>19</sup> established or located in a participating Member State, and of any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating supervisor. Therefore, in relation to the activities and operations included in the scope of the inspection, the inspection team has the right<sup>20</sup> to:

- request from the inspected legal entity any information, explanation or justification;
- be provided with and check every document it requires of whatever nature, such as books and records, registers, contracts, statements, official reports, accounting documents and methodological documentation;

---

<sup>18</sup> Article 12(2) of the SSM Regulation and Article 143(3) of the SSM Framework Regulation.

<sup>19</sup> Credit institutions, financial holding companies, mixed financial holding companies and mixed-activity holding companies established in the participating Member States as well as persons belonging to these entities and third parties to whom these entities have outsourced functions or activities.

<sup>20</sup> In accordance with Articles 10 and 11 of the SSM Regulation and Article 139 of the SSM Framework Regulation.

- take copies of or extracts from these documents, if they are not provided electronically;
- carry out the checks by having read-only access to all relevant IT systems, databases, IT tools, electronic files and data used by the inspected legal entity.

### Right to receive explanations

The inspection team has the right to obtain written or oral explanations from any person referred to in Article 10(1) of the SSM Regulation, regardless of their seniority, who could provide it with information and documents useful to its investigations. In this capacity, the inspection team may request the cooperation of the representatives or qualified staff of the inspected legal entity, according to the nature of the information requested.<sup>21</sup>

The ECB may also interview any other person who consents to be interviewed for the purpose of collecting information relating to the subject matter of an investigation.

### Exchange of information with the statutory auditors

In accordance with Article 56(f) of CRD IV and Article 12(2) of Regulation (EU) No 537/2014 on specific requirements regarding the statutory audit of public-interest entities,<sup>22</sup> the HoM may contact the inspected legal entity's statutory auditors in order to gather all the information and/or relevant points of view within the scope of the inspection.

### Right to ask NCAs for assistance in the event of opposition

Under Article 12(5) of the SSM Regulation, if any person opposes the conduct of the inspection the NCA concerned must provide the HoM with the necessary assistance, in accordance with national laws.

## 3.2 Inspection team's practices

The inspection team acts in an ethical and professional manner in accordance with applicable laws, regulations and professional procedures. It takes into account the operating constraints of the entity being inspected, insofar as this does not hamper the investigation process.

<sup>21</sup> In accordance with Article 11 of the SSM Regulation.

<sup>22</sup> Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities (OJ L 158, 27.5.2014, p. 77).

## Professional secrecy

Article 27 of the SSM Regulation defines the professional secrecy standards of the ECB in the context of the SSM. In this perspective *“Members of the Supervisory Board, staff of the ECB and staff seconded by participating Member States carrying out supervisory duties, even after their duties are ceased, shall be subject to the professional secrecy requirements set out in Article 37 of the Statute of the ESCB and of the ECB and in the relevant acts of Union law.”*

In addition, the obligation of professional secrecy as defined in Article 53 of CRD IV (as implemented in the relevant national law) applies to all persons working for or who have worked for the competent authorities and auditors or experts acting on behalf of the competent authorities. Professional secrecy entails the general obligation not to disclose information received in an official capacity, except in the cases contemplated by law.

External firms are contractually obliged to comply with the ECB’s strict professional secrecy requirements. They, and their staff, are required to sign individual confidentiality agreements to that effect. Throughout the inspection, additional measures are put in place to share any confidential data only on a “need to know” basis and safeguard it with the highest possible level of protection.

Professional secrecy is applicable to the facts, actions and non-public information that the inspection team members become aware of during the inspection. It extends to all confidential information obtained during the checks performed.

## Independence and objectivity

The ECB, with the assistance of the NCAs providing the resources for the inspections, must ensure that the inspection team’s members avoid any conflict of interest.

Article 10(3) of the ECB Guideline of 12 March 2015<sup>23</sup> identifies the rules to be complied with during an inspection, as regards the prohibition on receiving advantages: *“By way of derogation from paragraph 2, no exemptions shall be made for advantages offered by credit institutions to ECB or NCA staff members during inspections or audit missions except hospitality of a negligible value offered during work-related meetings”*.

Within the context of the investigations, the inspection team must refrain from giving any advice or sharing personal opinions.

---

<sup>23</sup> ECB Guideline of 12 March 2015 laying down the principles of an Ethics Framework for the Single Supervisory Mechanism (ECB/2015/12) (OJ L 135, 2.6.2015, p. 29).

## Compliance with the internal rules of the inspected legal entity

The inspection team must comply with the inspected legal entity's internal rules regarding data protection, information systems and physical access to premises, as communicated by the inspected legal entity, to the extent compatible with the inspection's needs. The inspection team must refrain from any unauthorised use of equipment or access made available for the purpose of the investigations. The team must be able to access, in read mode, relevant information systems and databases, but may not request or accept any access rights allowing the modification of documents or internal data.

### 3.3 Inspected legal entities' rights and the supervisor's expectations

#### 3.3.1 Rights of the inspected legal entities

##### Right to be informed of the start of the inspection

As envisaged by Article 145(1) of the SSM Framework Regulation, the ECB notifies the legal person subject to an inspection of its decision to conduct the inspection at least five working days before the start date. Nevertheless, Article 145(2) of the same Regulation specifies that, when required by the *"proper conduct and efficiency of the inspection"*, the ECB may carry out an inspection without notifying the supervised entity beforehand.

##### Possibility to comment on the facts and findings

The inspected legal entity is given the opportunity to submit written comments on the content of the draft report within a period of two weeks. These comments should focus on the executive summary and key findings and should be submitted in a feedback template (3-column-table) that will be provided to the inspected legal entity along with the draft report. The first column is used to quote the parts of the draft report the inspected legal entity wishes to comment on; the second column is used by the inspected legal entity to comment on the report; and the third column is used by the HoM to respond to the comments received. The filled-out feedback template will be added to the final report as an annex. The HoM takes the feedback provided into account when finalising the report after the exit meeting.

##### Right to be informed of the inspection outcomes

During the inspection, the senior management of the inspected legal entity may ask the HoM to have one or several status meetings on the progress of the inspection or

on any related topic. At these meetings, the inspected legal entity may communicate its observations concerning the inspection investigations in order to highlight any useful information. Before such a meeting takes place the inspected legal entity should communicate the topics for discussion, as well as the rationale and goals of the meeting.

After the investigation has been completed, a report is prepared. The draft report includes the facts and findings, which are discussed by the HoM with the inspected legal entity during the exit meeting.

The results of the inspection are provided to the inspected legal entity through a final report which is signed by the HoM and sent to the inspected legal entity (or its parent, see Section 2.2.3 “Reporting phase”) by the ECB. A draft follow-up letter or draft decision is then sent to the inspected legal entity containing either the recommendations or the supervisory measures to be implemented by it. The inspected legal entity can discuss the draft follow-up letter during the closing meeting, which is chaired by the JSTC and attended by the HoM. In the case of a supervisory decision, which involves a formal “right to be heard” period at a later stage, closing meetings are generally not held.

### 3.3.2 The supervisor’s expectations with regard to inspected legal entities

#### Professional working conditions

Inspected legal entities must make the necessary arrangements to enable the inspection team to fully exercise its investigatory powers as described in Chapter III, Section 1 of the SSM Regulation. In particular, they must provide the members of the inspection team with access to all the documents necessary to carry out its investigations as well as all the qualified staff members needed to obtain access to the information required.

#### Confidentiality of the documents exchanged during the inspection

The inspected legal entities are expected, in accordance with the applicable law, to preserve the confidentiality of documents provided by the ECB or NCAs in the context of the inspection process and its follow-up. Similarly, the HoM is responsible for preserving the confidentiality of the documents provided by the inspected legal entity.

#### Communication during the inspection

The inspected legal entity should inform the HoM of any difficulties encountered in implementing the provisions of this Guide, especially if they could have an impact on

the inspection team's work plan or the duration of the inspection. The HoM should report such difficulties and their potential impact on the duration and deliverables of the mission to the ECB and the relevant NCA.

### 3.3.3 Cooperation expected from the inspected legal entity's representatives during the inspection

In order to conduct the inspection, practical aspects such as physical access to the premises, requests for information and meetings are agreed at the start of the inspection by the inspected legal entity and the HoM.

#### Operating conditions

The inspected legal entity should ensure that the inspection team has the appropriate operating conditions such as, but not limited to, secured offices, individual workstations, internet access and telephones, etc. in a suitable room that can be locked and is located near the areas being inspected.

The inspection team may require one or several email boxes to be opened at the entity's address to facilitate the organisation of meetings and the submission of any documents required. At the end of the inspection the inspection team may ask the inspected legal entity to provide a copy of the content of its email boxes.

#### Submission of information required

The documents required by the inspection team should be provided in electronic format, but also on paper if required by the team.

For the inspection team's convenience, a folder, broken down by topic and to which the team should be given access, may be created in the inspected legal entity's information system or alternatively in a secure shared drive for data exchange if necessary.

#### Availability of the inspected entity's staff

The inspected legal entity's senior management and employees are expected to respond to the inspection team's interview and information requests in a timely manner without any unnecessary delays. They should cooperate in good faith and with speed and competence on requests for interviews and information.

Requests for information should be answered with careful consideration and delivered within agreed timelines. The persons concerned should also inform the inspection team members of any relevant related information, even if it is not explicitly requested by them.

The inspected legal entities are expected to provide the required documents and files as soon as possible, when available immediately, or otherwise within a reasonable time frame, as requested by the HoM. The HoM should assess the challenges faced by the inspected legal entity with due consideration for the time constraints of the inspection and prioritise the information requests.

## Organisation of meetings

Inspected legal entities should facilitate the organisation of meetings with contact persons the inspection team wishes to meet. These counterparts could be internal or external stakeholders at any level, particularly consultants or providers of outsourced services. The inspected legal entity should ensure that all the interviews requested by the inspection team take place as soon as possible.

## Seniority of the inspected entities' representatives

It is expected that the respective manager (see Section 2.2.2 “Kick-off meeting”) will be present or represented at a sufficiently senior level at meetings dealing with the strategy or operational policy of the inspected legal entity. The HoM may further specify who should attend. The respective manager should attend, in particular, the kick-off meeting, as well as meetings at which the inspection team's findings and the JSTC's recommendations are presented, i.e. the exit and closing meetings.

## Appointment of a point of contact

The HoM may request a point of contact with enough seniority within the inspected legal entity's organisation to ensure that the inspection team's requests are handled correctly and in good time and that the right people are contacted directly by the team. The point of contact may facilitate exchanges between the inspection team and the inspected legal entity.

In this case, the inspected legal entity should appoint a contact person with adequate seniority in functional and hierarchical terms to interact with the inspection team. This person should have a position that enables him/her to follow up and organise the interviews and information requests. It is the responsibility of the inspected legal entity to ensure that either the designated person or, when necessary, a replacement is available during normal office hours, in order to avoid delays to or the prevention of the inspection.

However, whenever the HoM deems it necessary, any team member has the possibility to contact any other staff member(s) of the inspected legal entity directly and hold a meeting without the contact person being present.

## 3.4 Language used during the inspection

Article 24 of the SSM Framework Regulation provides that supervised entities and any other legal or natural persons individually subject to ECB supervisory procedures may agree to use one official EU language in their written communications, including with regard to ECB supervisory decisions. If a supervised group chooses to communicate with the ECB in one official language for the whole group it must indicate the language it wishes to use in a letter to the JSTC.

At the start of an inspection, the working language should be agreed with the HoM, as a matter of efficiency.

### Language of the inspection report

The working language for European banking supervision is English. As a result, the inspection report, produced at the end of the inspection, is delivered to the ECB and the inspected legal entity in English. If the inspected legal entity has agreed with the ECB to use an alternative official EU language in accordance with Article 24(2) of the SSM Framework Regulation, the ECB will provide a version of the report in the language selected by the entity. As a matter of efficiency and to accelerate the process, the inspected legal entity may, on an ad-hoc basis and with no effect on future procedures, waive its right to receive the draft and final report in its chosen language.

© European Central Bank, 2018

Postal address 60640 Frankfurt am Main, Germany

Telephone +49 69 1344 0

Website [www.bankingsupervision.europa.eu](http://www.bankingsupervision.europa.eu)

All rights reserved. Reproduction for educational and non-commercial purposes is permitted provided that the source is acknowledged.

For specific terminology please refer to the [SSM glossary](#).