



# Public consultation

## on a draft guide to on-site inspections and internal model investigations by the ECB

### FAQ

**1** **Why are on-site inspections and internal model investigations (“inspections”) necessary? What kind of information can they provide that a supervisor cannot otherwise obtain?**

Inspections are in-depth investigations of risks, risk controls and governance at a bank. They follow specific procedures and are conducted at a specific point in time by a team which is led by a head of mission, who is independent from the team responsible for ongoing supervision – the Joint Supervisory Team (JST). Both ongoing supervision and inspections are essential for effective supervision, they are complementary and one cannot replace the other. Supervisors must have up-to-date, in-depth knowledge of the credit institution, obtained through ongoing supervision, which mainly relies on the information reported by the credit institution (regulatory, external and internal reporting). This is complemented by point-in-time inspections to check the accurateness of the information used in the ongoing supervision. Furthermore, before granting supervisory approval to the use of internal models for the calculation of own funds requirements the compliance of the model implementation with legal requirements needs generally to be assessed in on-site inspections.

**2** **Can any entity be subject to an inspection? Or only banks?**

The ECB can take the decision to conduct an inspection at any entity belonging to a bank under direct ECB supervision. This includes credit institutions, financial holding companies, mixed financial holding companies, mixed-activity holding companies established in the participating Member States, persons belonging to the entities and third parties to whom these entities have outsourced functions or activities. In other words, non-bank entities can also be subject to an inspection after the parent entity has been notified.

**3** **Will the guide only be applicable to banks directly supervised by the ECB, or also to other banks?**

The guide applies to the on-site inspections conducted at institutions supervised by the ECB directly – the significant credit institutions (SIs). In case the ECB decides to

exercise its right to take on the direct supervision of less significant institutions (LSIs), the guide would also apply to these banks.

However, the guide is not a legally binding document and does not in any way replace the legal requirements laid down in the relevant applicable EU law.

#### 4 How many inspections have you performed so far? How many are scheduled per year? Can you initiate inspections outside the annual plan?

On average, the ECB has been performing around 300 inspections per year.

Inspections can be initiated outside the annual plan. Such ad hoc inspections are generally triggered in reaction to an event or incident which has occurred in a credit institution (or group of credit institutions) and where immediate supervisory action is needed.

#### 5 Why are the heads of mission independent?

The principle of independence enables the head of mission of an inspection to provide an objective and comprehensive assessment of particular aspects and risks of a credit institution at a specific point in time. Independence from the inspected entity is of course crucial. But independence from the JST coordinator, who is in permanent contact with the bank, is also important, in order for the inspector to have a fresh perspective on the situation of the inspected entity. The approach applied is nevertheless coordinated with the JST. In order to ensure that the on-site inspections are conducted in an independent manner, the head of mission cannot be a JST member or an external expert. On-site inspection teams are led by a head of mission from either a national competent authority (NCA) or the ECB. Once the supervisory decision to carry out an inspection has been adopted, how the inspection is implemented is the sole responsibility of the head of mission, who is in charge of producing a report that includes the findings of the inspection team. These findings will inform the possible remediation measures to be requested from the SI in a second stage. At the end of a mission and as part of the finalisation of a report, consistency checks are performed in order to ensure adherence to Single Supervisory Mechanism (SSM) methodologies and consistency across findings.

#### 6 What principles does an inspection have to adhere to?

Inspections are carried out within the SSM as part of the overall supervisory process. They use investigating and inspecting techniques to test controls and substantive procedures. The investigation phase of inspections is performed at the premises of the bank. They are point-in-time investigations and are carried out within a specified period. In line with the supervisory principles for the functioning of European banking supervision, 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.
- Proportional, and commensurate with the size, activities and risk profile of the inspected legal entity. The implementation of this principle also facilitates the effective allocation of resources.
- Intrusive. The evolution of supervisory approaches has increasingly required supervisors to be more intrusive, with more fact and 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, providing an in-depth understanding based on the valuable knowledge provided by checking in situ.
- Forward-looking, observing beyond present or historical figures to foresee future negative impacts.
- Action-oriented, leading to remedial actions and/or corrective measures to be taken by the credit institution with timelines monitored by the JST.

## 7 What kind of access rights does an inspection team have? Can it interview every employee of the entity in question?

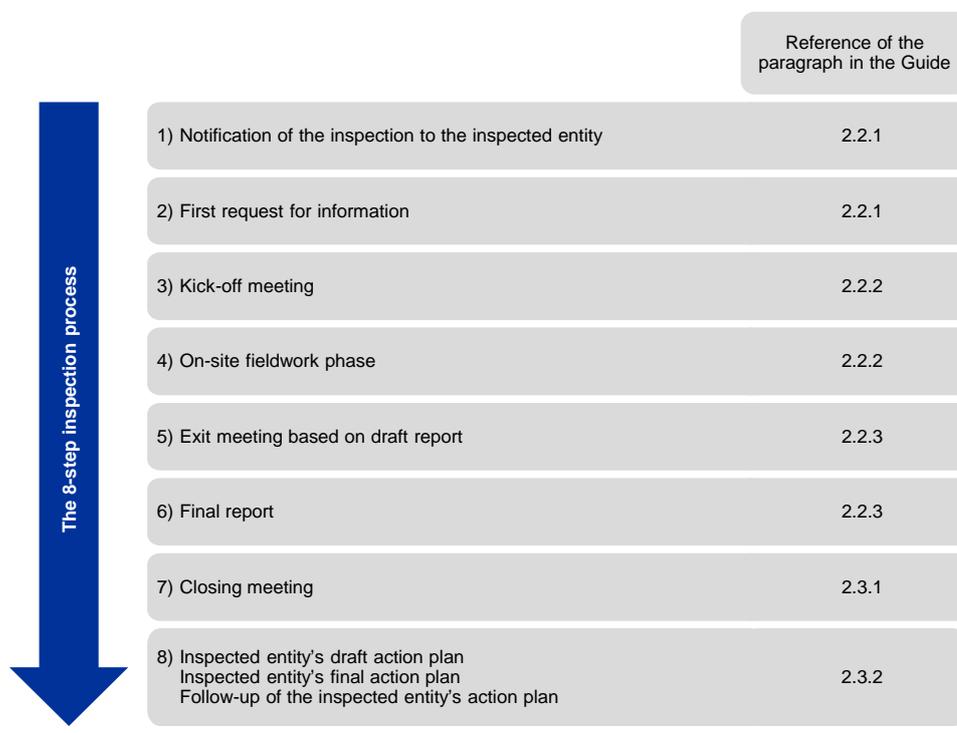
The inspection team has the right to access the business premises of the inspected banks or legal entities covered by an ECB decision. The inspection team has access to all documents relevant for the mission.

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

The inspection team has the right to interview 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 qualified staff of the inspected legal entity according to the nature of the information requested, in accordance with Article 11 of the SSM Regulation.

## 8 What does the inspection process look like?

The image below sets out the main steps of the inspection process:



## 9 Can the Supervisory Board of the ECB initiate an inspection without giving the entity in question prior notice?

Yes, the ECB may decide to conduct an unannounced inspection. In this case the inspection may be carried out without notifying the inspected legal entity in advance. The notification letter will instead be handed to the inspected legal entity when the inspection begins.

## 10 What is the average duration of an inspection?

The average duration of an on-site mission on the bank's premises typically lasts for between eight and 16 weeks. When you include the time for preparation, quality assurance and discussing the findings with the bank, the total duration can reach 20 to 25 weeks. This will vary between inspected banks depending on their complexity, the scope of the inspection and the resources allocated to it. The scope depends on the size, activities and risk profile of the inspected legal entity, as well as the number of objectives and depth of review.

11 **How do the inspection team and the JST interact? What happens with the results of an inspection?**

The head of mission and the inspection team act independently of, but in cooperation with, the JST. During the inspection, in particular during the investigation phase, there is regular communication between the head of mission, the JST coordinator and the relevant division of the ECB (Centralised On-site Inspections Division or Internal Models Division). The results or the findings of the inspection are summarised in the draft report, which is discussed by the head of mission and the inspected legal entity at the exit meeting. The final report and the implementation of its supervisory expectations will feed into the work of the JST, who will follow up with detailed recommendations and/or supervisory measures.

12 **How many members does an inspection team have? Are they only ECB staff? Can third-party providers be part of such a mission?**

The size of the inspection team should be proportionate to the inspection entrusted to it. The team is composed of at least two people, including the head of mission. The average team is made up of around seven full-time inspectors, but size and composition varies depending on the scope of the inspection, the timeframe of the investigation, the geographical locations to be covered and the skills and expertise of the team members, among other things.

The inspection team can be composed of ECB inspectors, supervisors employed by NCAs, JST members and external consultants. Regardless of their origin, all team members work under the responsibility of the head of mission.

13 **What is the working language for the inspection team and the employees of the bank? In which language will the written communication be conducted?**

The head of mission determines the working language of the inspection, i.e. the entity's national language or English, taking into account any efficiency constraints, the composition of the inspection team and the practices and preferences of the inspected legal entity. With regard to written communication, the working language for European banking supervision is English, therefore the inspection report, to be produced at the end of the inspection, is delivered to the ECB and the inspected legal entity in English.

Where the inspected legal entity has agreed with the ECB to use another official language of the European Union, the ECB will provide a version of the report in the language chosen by the entity.

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### Can you describe how on-site inspections look in different Member States? What did you learn from the existing practices?

Before the implementation of the SSM, on-site inspection processes and procedures varied greatly across Member States. For example, some NCAs had a dedicated, independent on-site function in place, while in other NCAs inspections and ongoing supervision were conducted by the same team and/or within the same function. Many NCAs also had diverging practices in relation to the methodologies used to assess risks.

The ECB's Centralised On-Site Inspections Division and Internal Models Division have cooperated closely with NCAs to harmonise the approach on the basis of the best practices and lessons learned from existing practices across Member States. These experiences have been used to develop a single SSM on-site inspection process and harmonised procedures and methodologies, in close cooperation with NCAs. This ensures that there is a level playing field and that all supervised institutions are treated equally.