

## **GUIDELINES FOR CO-OPERATION BETWEEN CONSOLIDATING SUPERVISORS AND HOST SUPERVISORS**

### **EXECUTIVE SUMMARY**

1. This paper sets out CEBS guidelines for establishing an enhanced framework for co-operation between consolidating supervisor and host supervisors (Guidelines). They contain sections on general cooperation, distinguishing between subsidiaries and branches, and guidance more specifically related to the approval process of model validation.
2. These Guidelines are primarily directed towards supervisory authorities but credit institutions and investment firms will be affected by the operational aspects of supervisory co-operation. The Guidelines are the starting point for substantial developments in the supervision of cross-border groups, through the creation of operational network mechanisms. The exchange of relevant and essential information, consultation and proportionality are key to the supervisory challenges in the future.
3. This is an endeavour to respond to recent market developments. It also reflects the requirements of the proposed Capital Requirements Directive (CRD)<sup>1</sup>. As banking groups are centralising their risk management activity there is a need to develop further an integrated, risk-based and coordinated approach to supervision. These Guidelines should therefore be of key interest to groups operating on cross-border basis in the EU.
4. The starting point for these Guidelines is the legal text, predominantly Article 129, 131 and 132 of the CRD, which set the statutory framework for a much enhanced collaborative approach to the supervision of cross-border banking groups. In line with the requirements of the Directive this approach will be based on information sharing including, where necessary, consultation on

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<sup>1</sup> The Capital Requirements Directive (CRD), which recasts Directives 2000/12/EEC and 93/6/EEC (see MARKET/1050/04).

supervisory action (Article 132), on joint model validation under the lead of the consolidating supervisor (Article 129) and more generally on written arrangements for coordination and co-operation between home and host supervisors (Article 131). These and other CRD requirements have been fleshed out for practical application by the supervisory authorities being the prime addressees of these Guidelines. The proposed guidelines are intended to further CEBS' main objectives, which are to promote effective supervision of EU banking groups, to streamline the supervisory process by enhancing convergence of practice and standards and to develop operational network mechanisms underpinning supervisory coordination and co-operation. It is expected that these efforts will help avoid an excessive burden of supervision on EU banking groups.

5. Related issues such as the possible need to upgrade the EU framework for deposit insurance schemes, the lender of last resort function or crisis management provisions will not be addressed in this paper as they go beyond the scope of mere supervisory coordination and co-operation discussed here.
6. CEBS has elaborated on a practical framework for the Supervisory Review Process (SRP), comprising the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) and will publish shortly guidance for the model validation process.
7. For cross-border groups, all supervisors could be required – depending on the scope of application as defined by the CRD – to undertake the SREP within the respective Member States. For supervisory co-operation to be effective, the SREP should therefore be based on the same principles, applying similar procedures. This should result in:
  - convergence of supervisory practice among EU supervisors, thus offering scope for coordinating supervisory actions and eliminate duplicate tasks; and
  - a proportionate and risk-based approach to supervisory co-operation, thereby avoiding unnecessary communication and redundant tasks, thus preventing the arrangements between home and host supervisors becoming administratively burdensome.
8. Within the framework set by Article 129, 131, and 132 of the CRD, the extent of coordination, co-operation and information sharing will be influenced by the significance or systemic relevance of the entities, both within the group and in their local market(s). The consolidating supervisor and the host supervisor may have different views on the degree of significance or systemic relevance of the various entities and on the risks stemming from these entities for the group. Significance and systemic relevance remain relative concepts, to be assessed by the consolidating and host supervisors on a case-by-case basis, and determined by the consolidating supervisor for the purposes of the supervision on a consolidated basis. In making their assessment,

supervisors should consider, at a minimum, the complexity, potential impact, and size of the entity.

9. This interaction gives shape to an integrated supervisory framework and relies materially on the exchange of information within the operational networks set up between the relevant consolidating supervisors and host supervisors. For certain matters, such as those related to local market characteristics, the host subsidiary supervisor will be best placed to collect and assess information that could be of interest to the consolidating supervisor. Likewise, there are matters for which the host supervisor may find it necessary to obtain information which is best made available by the consolidating supervisor. The information exchange process shall be proportionate and risk-focused to avoid unnecessary information exchanges. Drawing on communication within existing and further enhanced operational networks it shall also be as spontaneous as possible, allowing any supervisor to take the initiative to submit an issue deemed necessary to be raised. The information shall be communicated on a timely basis.
10. Moreover, the co-operative framework should be neutral in the sense that it does not provide an incentive for groups to restructure. It should strive to eliminate duplication of work, which should reduce the burden on the industry.
11. The outcome will be a practical framework for the Supervisory Review Process, comprising the Internal Capital Adequacy Assessment Process, the Supervisory Review Evaluations Process and the Approval Process for Model Validation. The Guidelines will be further complemented with a practical transposition for specific cases; a section on model validation is therefore part of this paper. One for situations of crisis management is under elaboration.
12. In drafting these Guidelines, CEBS has tested their application through a number of case studies, and will continue to explore the practicalities and efficacy of these proposals. The findings from these case studies, which will involve the banking groups, will also influence the final paper, as will any lessons from the Basel AIG process and the colleges being undertaken under the auspices of that body.
13. CEBS believes that a formal consultation of the Guidelines framework at this stage will benefit to both the market participants and the supervisors.
14. CEBS will also hold a public hearing on these proposals in October 2005 at its offices in London. More information on this and a registration form will be published on the CEBS website.
15. CEBS invites comments on this consultation paper by 8 November 2005 (CP09@c-eps.org). Comments should be made in English. The received comments (unless the respondent requests otherwise) will be published on the CEBS website.

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## **GUIDELINES**

### **Introductory statements**

#### ***Overview***

1. Over a period of years, European banking supervisors have developed and put into practice arrangements for co-operation and information-sharing between consolidating and host supervisors<sup>2</sup> within the legal framework of the responsibilities laid down in EU Directives. These arrangements have worked well up to this point, since the consolidating supervisor and the host supervisors each have a specific role to play in ensuring the effective supervision of cross-border European groups.<sup>3</sup>
2. Notwithstanding the demonstrated effectiveness of these arrangements, ongoing developments – including the introduction of a revised capital adequacy framework, the CRD, and the evolving structure of banking groups and systems across the EEA – make it necessary to refine them in order to further strengthen existing coordination and co-operation between supervisors.<sup>4</sup>
3. This paper puts forward guidelines underpinning cross-border supervisory co-operation and sets out a refined practical framework for co-operation and for the exchange of information. The objective is to promote efficient, coherent, and cost- and resource-effective cross-border supervision for the benefit of both supervisory authorities and supervised institutions. Increased co-operation between supervisors within operational networks cutting across consolidating supervisors and host supervisors will lead to a higher degree of commonality in supervisory standards, which should further improve supervisory efficiency. It will also contribute to efforts to promote convergence in supervisory practice, by fostering a better understanding of each others' methods and approaches. Indeed, co-operation and convergence will each reinforce the other, and together they will contribute to establishing and strengthening a common supervisory culture.<sup>5</sup>

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<sup>2</sup> The terminology used in this paper designates the home supervisor of a group as the 'consolidating supervisor,' the supervisor that awarded a licence to a subsidiary as the 'host subsidiary supervisor,' and the supervisor of a branch as the 'host branch supervisor.' The term 'host supervisor' includes both host subsidiary supervisor and host branch supervisor. This terminology is not entirely in accordance with the wording of EU Directives, but it elucidates the practical arrangements used in the supervision of a banking group.

<sup>3</sup> These guidelines can be equally applied to investment firm groups, where the investment firms are subject to the scope of the CRD.

<sup>4</sup> See also CEBS' Communication paper on the role and tasks of CEBS sub Chapter 'CEBS' objectives, tasks and tools'.

<sup>5</sup> See also CEBS' Communication paper on the role and tasks of CEBS sub Chapter 'Framework and market trends'.

4. Risks to an international banking group can arise in any of the countries in which it operates. Without an adequate financial structure and sound management practices, these risks can be transmitted across national borders from one part of the group to another. Adequate information systems are critical to managing these risks. Banking groups need to have accurate measurement systems, sound internal control systems, and appropriate transparency policies in order to gather adequate information on the risks that they confront at the group level and at the level of their individual entities. CEBS is working to strengthen practices in these areas.<sup>6</sup>
5. The paper builds upon established practices of supervisory co-operation, on practical guidance issued by international bodies (both existing and under preparation), and on the legal and regulatory framework of the EU and its Member States.
6. This legal and regulatory framework aims at ensuring that:
  - Banking groups and their individual institutions are adequately capitalised;
  - Banking groups and their individual institutions identify, manage and evaluate the risks of their businesses adequately; and
  - Group structures are transparent, enabling, on the one hand, market participants to discern and evaluate the relationships within the group and, on the other hand, its individual institutions to strive for adequate market exposure and evaluation and for a transparent view of group relationships;
  - Proper governance and internal control provisions are in place at all levels of banking groups.
7. The general principles for cross-border co-operation, as set out in this paper, apply directly and in full whenever supervisors are involved in supervision on a cross-border basis, e.g. for assessing the "fit and proper" qualification of a banking group's structure or of its shareholders or for evaluating the adequacy of organisational structures. For practical reasons the paper will, however, illustrate these principles by articulating them around the various steps of the SREP, being one of the key components of the overall supervisory process. These illustrative parts of the text do by no means imply a prescriptive or unique guideline on how to organise the SREP; but they offer a flexible framework on how this process might be conceived in general. On a case by case basis and taking due account of the effective structure of the banking groups concerned, supervisors

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<sup>6</sup> See for example CEBS' Communication paper on the role and tasks of CEBS; CEBS CP 03 (May 2004): The application of the Supervisory Review Process under Pillar 2 (CEBS CP 03); and CEBS CP 05 (March 2005): Consultation Paper on the framework for Supervisory Disclosure.

should thus modulate their approach to the SREP with a view to optimising its effectiveness and efficiency.

### ***Legislative background***

8. Current EU legislation provides Member States with a comprehensive set of rules for banking activity, including references to the respective roles and responsibilities of supervisory authorities.
9. A number of significant legislative proposals that have recently been launched or approved within the EU will require supervisors to co-operate more closely, either because they explicitly require enhanced co-operation, or because they impose new supervisory obligations. This paper focuses on how supervisors should work together to achieve a more effective and efficient interaction, in terms of both information exchange and practical co-operation, in order to make the prudential supervisory regime under the CRD – particularly under the provisions relating to supervision on a consolidated basis – more effective and efficient.<sup>7</sup>
10. Notwithstanding the legislative changes mentioned above, supervisors remain responsible for the overall supervision of the entities they authorise. The responsibilities of the consolidating supervisor will encompass the supervision of group-wide functions and the overall solvency of the consolidated group. Thus, supervisory powers rest substantially with the authorities that license individual institutions, and consolidating supervisors will have to rely on their host peers for effective intervention at subsidiary levels in many areas.
11. It should be kept in mind that the practical arrangements set out in this paper are intended only to improve efficiency and effectiveness in the performance of supervisory tasks. They can never lead to any alteration in the responsibilities and powers of supervisors as laid down in the CRD. It should be emphasized that the Consolidated Banking Directive and the CRD provide for the possibility (never yet been put into practice) for a host supervisor to delegate full responsibility for the supervision of a subsidiary to the consolidating supervisor. Any such delegation should be based on a formal agreement that stipulates responsibilities and refines practical arrangements on the way supervisory tasks are organised.
12. Other changes in EU legislation, regarding company law or tax law, could indirectly impact the responsibilities and powers of supervisors concerned. An example of this is the European Company Statute, which might facilitate the conversion of banking group subsidiaries into branches, potentially leading to the emergence of more systemically relevant branch structures in some countries. In a similar vein, it might become easier to relocate group headquarters between Member States. These possible evolutions have to be kept in mind when

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<sup>7</sup> Including Articles 129, 131 and 132 of the CRD.

developing a framework for co-operation between consolidating supervisor and host supervisors, in particular with regard to branches: the framework must be sufficiently flexible to allow for adequate supervisory responses.

13. This legislative background defines the scope and provides the basic elements for a framework for enhanced co-operation. The guidelines set out in this paper should always be applied within the context of applicable EU and national law and the requirements in force in the various Member States. Thus, for example, arrangements for exchanging information pertaining to a group need to respect EU and national requirements for preserving confidentiality. Measures may need to be put in place to ensure that supervisors are able to satisfy themselves that adequate safeguards exist.

### ***The European Financial Market***

14. Some groups – particularly larger groups – are centralising an increasing number of key functions, while continuing to use local subsidiaries as the preferred method of entry into foreign markets. As a result, there may no longer be a direct relationship between the legal structure and the operational structure of the group.
15. As such trends in the European financial markets are essentially market-driven, it is impossible to predict in which areas and to what extent they will continue. The goal of supervisors is to develop a comprehensive framework of co-operation which will ensure financial stability and which is also sufficiently flexible to adapt to a changing environment.

***I. Are there any changes not mentioned here that you deem significantly impacting on the European financial sector and, in particular, on the supervision of cross-border banking groups?***

***II. What are your views on the need for a co-operative framework among supervisors that is at the same time comprehensive and flexible?***

### ***Supervisory considerations with regard to these changes***

16. These trends in the European banking environment are likely to reinforce the legitimate interest of all competent authorities in the supervision of banking groups. A well-conceived framework for supervisory co-operation could help ensure that:
  - the supervision of a banking group on a consolidated basis is organised, planned, and carried out in a coordinated and efficient manner; and



- the consolidating supervisor is fully aware of the concerns, policies, strategies, and risk assessment methodologies of the host subsidiary supervisors, especially those that supervise subsidiaries which are of significant importance to the group's overall risk profile.
17. Both consolidating and local host supervisors have a legitimate interest and role in the supervision of EU banking groups. The consolidating supervisor has prudential responsibility for the group as a whole as specified in Article 124 and 129 of the CRD, building on his oversight of the group's structure, activities and the risks it is facing. The role and responsibilities of a host supervisor differ depending of whether the entity being supervised is a branch or a subsidiary. The host subsidiary supervisor is responsible for supervision of subsidiaries and for their obligations towards their depositors. Moreover, the host supervisor can meaningfully contribute to the overall supervisory process over a group as it can offer
- a depth of knowledge of the local banking landscape and local market conditions that is not available to the consolidating supervisor. This capacity to understand and assess local risks faced by subsidiaries and branches will be essential in supervising the more sensitive risk-based approaches to the assessment of capital adequacy.
  - For a subsidiary, it is the supervisor possessing the necessary legal prerogatives and authority to impose supervisory or precautionary measures on subsidiaries located within their jurisdictions.
  - It can undertake supervisory tasks more efficiently for entities in their jurisdictions, and can communicate more easily with these entities due to their geographical and cultural proximity.
18. Co-operation and information sharing within operational networks cutting across consolidating supervisors and host supervisors involved in the supervision of cross-border groups is essential for effective and efficient supervision. Supervisory co-operation must go beyond the mere exchange of information, although information exchange remains the foundation as well as a key feature of co-operative arrangements.
19. Because the new capital adequacy rules involve supervisors more deeply in the capital adequacy assessment process, under both Pillar 1 (for example, in the Internal Ratings Based (IRB) and Advanced Measurement (AMA) approval processes) and Pillar 2, they increase the demands on supervisory resources. They also demand new skills and expertise from supervisors, particularly where a banking group has adopted the advanced approaches to risk measurement.
20. It is in the mutual interest of consolidating and host supervisors to develop a model of supervisory co-operation which optimises the use of their collective supervisory resources, avoids the performance of redundant or duplicative supervisory tasks, enhances and facilitates

the flow of information, and generally promotes effective and efficient supervision across a group. The enhanced dialogue between supervisors and the coordination by the consolidating supervisor should be designed to address these objectives.

21. The co-operative framework should be neutral in the sense that it does not provide an incentive for groups to restructure. It should strive to eliminate duplication of work, which should reduce the burden on the industry.
22. The supervisory framework should allow for a consistent approach to risk assessment within a group, and should make clear which tasks are to be carried out by the different supervisors involved at the group and local level, in particular under Pillar 2.
23. Within the framework of the CRD, certain tasks may be undertaken by one supervisor acting on behalf of another, thus making optimal use of resources and expertise. Supervisors may consider the resource implications, including the cost impact of such co-operation.

**III. What are your views on the description of the respective interests and roles of consolidating and local supervisors within the proposed framework?**

**IV. What are your views on the concept that supervisory co-operation should go beyond the mere exchange of information in order to enhance effectiveness?**

**V. What are your views on the suggestion that supervisors should, with a view on efficiency, consider the possibility of performing tasks on behalf of one another in strict respect of each other's legal powers and responsibilities?**

**VI. Do you see major risks for duplication of tasks under the proposed framework? If yes, which are these?**

**VII. Do you wish to make any comments or suggestions with regard to the considerations set out in this chapter?**

## **Framework**

### ***Basic principles***

24. The Basel Committee of Banking Supervisors has published guidance on cross-border co-operation for supervisors of international groups.<sup>8</sup> The Basel Committee guidance takes the form of high-level principles

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<sup>8</sup> High-level principles for the cross-border implementation of the New Accord (August 2003) and Principles for the home-host recognition of AMA operational risk capital (January 2004).

for co-operation which address how best to minimise the burden of the new prudential capital regime.

25. These principles provide a good starting point for a model of co-operation between supervisors. However, a more integrated and practical co-operative framework should be developed that responds to the EU's single-market goals and to the evolving legislative framework mentioned above. Moreover, the CRD expands on the Basel principles by clearly delineating the rights and responsibilities of the consolidating supervisor and host supervisors with respect to subsidiaries and branches, and these additional principles will need to be incorporated into the EU framework. In particular, it is necessary to:
- i. differentiate between the host supervisors of branches and the host supervisors of subsidiaries. This is the reason for the 'two scenarios' approach adopted in the practical framework set out in this paper;
  - ii. take into account the fact that the CRD identifies features and functions<sup>9</sup> which are likely to be centralised within a group, with the result that the consolidating supervisor and the host subsidiary supervisors are interested in many of the same group functions;
  - iii. coordinate supervisory approaches, to the extent possible, in order to streamline the overall supervision of the group. The CRD sets out several provisions that require co-operation, and the EU framework should conform to those provisions.

### ***Overview of the EU framework***

26. According to the CRD and its principle of proportionality, the consolidating supervisor is responsible for planning and coordinating supervisory activities and for undertaking the overall assessment of the group. The consolidating supervisor should therefore initiate a process of consultation between the individual supervisors involved and take the lead in establishing co-operative arrangements based on the SREP.<sup>10</sup>
27. CEBS has elaborated a practical framework for the Supervisory Review Process and its two main components: the ICAAP and the SREP.<sup>11</sup>
28. For cross-border groups, all supervisors could be required – depending on the scope of application as defined by the CRD – to undertake the SREP within the respective Member States. For supervisory co-

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<sup>9</sup> For example board and senior management oversight, sound capital assessment, comprehensive assessment of risks, monitoring and reporting, and internal control systems.

<sup>10</sup> See Appendix I for an overview of this framework.

<sup>11</sup> CEBS CP 03.

operation to be effective, the SREP should therefore be based on the same principles, applying similar procedures. This should result in:

- i. convergence of supervisory practice among EU supervisors, which will expand the scope for coordinating supervisory actions and eliminating duplicate tasks; and
  - ii. a proportionate and risk-based approach to supervisory co-operation, which will avoid information overload and unnecessary tasks and thereby prevent the arrangements from becoming administratively burdensome.
29. The extent of co-operation and information sharing will be influenced by the significance or systemic relevance of the entities, both within the group and in their local market(s). The consolidating supervisor and the host supervisors may have different views on the degree of significance or systemic relevance of the various entities and on the risks stemming from these entities for the group. Significance and systemic relevance remain relative concepts, to be assessed by the consolidating and host supervisors on a case-by-case basis, and determined by the consolidating supervisor for the purposes of the supervision on a consolidated basis. In making their assessment, supervisors should consider, at a minimum, the complexity, potential impact, and size of the entity.
30. The assessment of significance may consider a broad set of factors, taken into account separately or in combination, including:

For measuring the impact on the host local market:

- the market share of the entity, on either the assets or liabilities side (e.g. in relation to (mortgage) loans, deposits, or savings products);
- the role of the entity in specific markets (e.g. principal market-maker);
- whether the entity is an integral part of the infrastructure of the financial system (e.g. payment systems, exchanges and clearing houses);
- the extent to which the entity provides liquidity to the market (either generally or to individual key markets).

For measuring the impact on the group as a whole:

- the contribution of the entity to the performance and earnings of the group as a whole (e.g. to overall capital requirements, turnover, or pre-tax profit);
- the risk of activities undertaken in the entity;

- the group’s organisational structure, systems, and controls; its risk management functions; and senior management oversight to monitor and control risks in the entities;
  - the extent to which the entities are autonomous;
  - the correlation of risks across entities.
31. The consolidating supervisor and the host supervisors may each have a different focus in their supervision of a given entity. It is therefore important for them to communicate to each other their assessment of the entity’s significance and the rationale for that assessment, and to take each others’ assessments into account in structuring their co-operation.
32. A key aspect of coordinating supervisory activities is developing a common understanding, on the part of all the supervisors concerned, of a group’s internal governance, internal strategies, plans and processes, particularly as they relate to the group’s application of the advanced approaches under Pillar 1 and the formulation of its ICAAP under Pillar 2. The ICAAP is an important input to an efficient supervisory process. In the absence of a clear mutual understanding of a group’s internal plans and timetables, it will be difficult for supervisors to coordinate their approaches effectively.
33. In parallel with discussions with a group about its governance, strategies, plans, and processes, the consolidating supervisor should keep the group informed of the supervisory approach to the group at the consolidated and individual levels. This process should engender greater mutual trust between institutions and supervisors.
34. Consolidating supervisors and host supervisors should have written arrangements specifying their respective roles in the supervisory co-operation. Written arrangements have the advantage of providing commonality of standards and certainty of expectations. The arrangements may take the form of bilateral or multilateral Memoranda of Understanding (MoUs), or ad hoc arrangements tailored to a specific cross-border banking group, depending on the structures of the supervised institutions.

***VIII. What are your views on significance of each entity within a group and/or within its domestic market as key elements, with a view on proportionality, for structuring the process?***

***IX. What are your views on the proposed approach to assess significance? Do you want to make any suggestion as to improve this approach?***

## **Model of co-operation**

### ***Guidelines overarching the practical co-operative framework***

35. The consolidating supervisor and host supervisors should co-operate to ensure effective and efficient supervision of EU banking groups on a consolidated and individual basis. They have a mutual interest in strengthening the framework for co-operation. The consolidating supervisor may need information or assistance from the host supervisors in order to be able to properly assess the group's capital adequacy on a consolidated basis, paying due consideration to local conditions. Conversely, host subsidiary supervisors may need information from the consolidating supervisor concerning systems and processes that are centralized at group level, in order to assess the capital adequacy of subsidiaries.
36. Enhanced co-operation should seek to avoid an undue burden on supervised institutions. In particular, part of the SRP under Pillar 2 will consist of a dialogue with the institution in the course of reviewing its ICAAP. To avoid burdensome duplication of effort, the respective roles of the consolidating supervisor and the host supervisors in this dialogue should be clearly defined.
37. The co-operation arrangements for the supervision of banking groups should:
  - i. be conducted within a risk-based approach to supervision, with due consideration to the banking group's structure, systems and controls, and management. The degree of centralisation in management (banks operating with a business-line model versus banks operating on a legal-entity basis) might be used as an orientation;
  - ii. be proportionate;
  - iii. take into account the degree of significance of subsidiaries in the financial system of the host countries;
  - iv. be transparent to the supervised group. The consolidating supervisor should be responsible for keeping the group's senior management informed of the overall arrangements for supervising the group. Host supervisors should nevertheless inform their contacts of matters relevant to the entities within their remit of their supervision;
  - v. be neutral with respect to the banking group's business model and structure;
  - vi. include the common understanding of groups' internal strategies, plans and processes. Without such understanding, effective coordination of approaches by supervisors would be very difficult to achieve;

- vii. be regarded as subject to refinements, should new structural changes within the European banking system materialize, or whenever otherwise deemed necessary.
38. Within the legal framework as laid down in the CRD, assigning to the authority having authorized the credit institution full responsibility also for its branches, similar co-operation agreements can be established between the consolidating supervisor and host supervisor(s) with regard to systemically relevant branch(es), also having regard to each supervisors' particular responsibilities for e.g. local financial stability and liquidity. Such agreements will pertain primarily to information exchange and state clearly that, whenever an authority accepts to perform any work on behalf of another with respect to a branch, it does so within the framework of both the requesting and accepting authority's competence and legal responsibilities.

### ***Information exchange***

39. A free flow of information is important in building co-operation. Information exchange is the starting point for developing sound relationships between supervisors, and building trust and confidence in their respective assessment processes. It is also a core element in planning supervisory tasks and coordinating the activities of supervisors under the umbrella of the consolidating supervisor. A proposed framework for information exchange in the context of ongoing supervision is set forth below. It is essential that any information exchange starts by communicating the status quo on these issues.
40. The communication of information between supervisors should:
- be a two-way process, but should be balanced to reflect the needs of the supervisors involved. For certain matters, such as those related to local market characteristics, the host subsidiary supervisor will be best placed to collect and assess information that could be of interest to the consolidating supervisor. Likewise, there are matters for which the host supervisor may find it necessary to obtain information which is best made available by the consolidating supervisor;
  - be proportionate and risk-focused, to avoid unnecessary information flow; and
  - be as spontaneous as possible, allowing any supervisor to take the initiative, and should provide information on a timely basis.
41. A communication strategy should be developed under the auspices of the consolidating supervisor, in full consultation with other concerned supervisors. The strategy should coordinate at a minimum the gathering and the dissemination of information. It should have regard to defining by whom and to whom information should be disseminated, be it between host supervisors and (sub)consolidating supervisor or

mutually between host supervisors. In particular, supervisors should ensure that:

- the consolidating supervisor has unfettered access to all relevant information;
- essential information and, if deemed useful, relevant information is provided to all supervisors at an appropriate level; and
- no undue limitations are imposed on spontaneous communication between supervisors.

The process may naturally lead to an asymmetric flow of information.

42. Article 132 of the CRD distinguishes between two types of information: 'essential information,' which supervisors shall communicate on their own initiative, and 'relevant information,' which they shall communicate on request.
43. According to the CRD, information shall be regarded as essential if it could materially influence another Member State's assessment of the financial soundness of a credit institution. The table below provides an illustrative list of essential information.
44. Although the CRD does not define 'relevant information,' this is understood to mean information that is relevant to the performance of another supervisor's obligations. Supervisors should agree on the scope of relevant information to be communicated, and may consider specifying the content, format, and the manner in which information will be exchanged (e.g. contacts, regular conference calls, regular meetings, written agreements etc). Supervisors requesting information should state clearly the purpose for which the information is requested. This will help to assess relevance.
45. The CRD states that the supervisors responsible for consolidated supervision of EU parent credit institutions shall provide host subsidiary supervisors with all relevant information. In determining the extent of relevant information, the importance of the subsidiaries within the financial system of the Member States where they are licensed should be taken into account.
46. The following table provides an illustrative list of essential information that could be exchanged between the consolidating supervisor and host supervisors.



Objectives	Essential information to be communicated by the consolidating supervisor to host supervisors on its own initiative	Essential information to be communicated by the host supervisors to consolidating supervisor on their own initiative
<p>1. Be aware of significant changes in the group structure and in the authorities involved in the group's supervision at the consolidated, sub-consolidated and local levels, for significant entities within the group.</p>	<ul style="list-style-type: none"> <li>• Significant changes in the group structure, including all major institutions (including investment firms) in the group.</li> <li>• Significant changes in the competent authorities involved in the supervision of the group.</li> <li>• The group structure should be understood as encompassing: <ul style="list-style-type: none"> <li>- the legal structure of the group and the location of significant business units;</li> <li>- significant investments in non financial entities (e.g. insurance);</li> <li>- significant capital links between entities; and</li> <li>- significant qualifying holdings.</li> </ul> </li> <li>• Changes in the levels (individual, sub-consolidated, consolidated) at which capital requirements are applied within the group.</li> </ul>	<ul style="list-style-type: none"> <li>• Significant changes in the structure of significant supervised entities within the group.</li> <li>• Significant changes in the competent authorities involved in the supervision of these entities.</li> <li>• The structure of significant supervised entities should be understood as encompassing: <ul style="list-style-type: none"> <li>- the legal structure of the entities and the location of significant business units;</li> <li>- significant investments in non financial entities (e.g. insurance);</li> <li>- significant capital links between entities; and</li> <li>- significant qualifying holdings.</li> </ul> </li> <li>• Changes in the levels (individual, sub-consolidated, consolidated) at which capital requirements are applied.</li> </ul>
<p>2. Be aware of significant changes in the way information is reported to different supervisors within a group and exchange on methodologies used</p>	<ul style="list-style-type: none"> <li>• Changes in the procedures for the collection of information from the institutions in a group, and in the verification of that information. This covers: <ul style="list-style-type: none"> <li>- the information to be collected by the</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Changes in the procedures for the collection of information from the institutions in a group, and in the verification of that information. This covers: <ul style="list-style-type: none"> <li>- the information to be collected by the</li> </ul> </li> </ul>

to review that information. <sup>12</sup>	<p>different supervisors;</p> <ul style="list-style-type: none"> <li>- the means by which that information will then be disseminated;</li> <li>- any additional information flows from host supervisors of significant entities.</li> </ul>	<p>different supervisors;</p> <ul style="list-style-type: none"> <li>- any additional information flows from host supervisors of significant entities.</li> </ul>
3. Communicate difficulties that have potentially significant spill-over effects within the group.	<ul style="list-style-type: none"> <li>• Adverse developments, such as: <ul style="list-style-type: none"> <li>- matters which cast doubt on the viability of the group as a going concern;</li> <li>- factors which suggest a potentially high risk of contagion (significant intra-group transactions);</li> <li>- significant developments in the financial position of the group: declining capital ratios, losses, loss of liquidity, increase in funding costs;</li> <li>- major fraud.</li> </ul> </li> <li>• Major sanctions and exceptional measures taken by competent authorities.</li> <li>• Other matters, paying due consideration to how the group is organised (centralised versus decentralised functions): <ul style="list-style-type: none"> <li>- changes in organisation or senior management that have a significant impact on internal controls,</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Adverse developments, such as: <ul style="list-style-type: none"> <li>- matters which cast doubt on the viability of the subsidiary as a going concern;</li> <li>- excessive reliance on intra-group transactions or parental support (e.g. guarantees);</li> <li>- significant developments in the financial position of the subsidiary: declining capital ratios, losses, loss of liquidity, increase in funding costs;</li> <li>- major fraud.</li> </ul> </li> <li>• Major sanctions and exceptional measures taken by competent authorities.</li> <li>• Other matters, paying due consideration to how the group is organised (centralised versus decentralised functions): <ul style="list-style-type: none"> <li>- changes in organisation or senior management that have a significant impact on internal controls, culture, or risk</li> </ul> </li> </ul>

<sup>12</sup> See also CEBS CP 04 (January 2005): CEBS Consultation Paper on the New Solvency Ratio: Towards a Common Reporting Framework; and CEBS CP 06 (April 2005) on Financial Reporting.

	culture, or risk management; - changes in strategy.	management; - changes in strategy.
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### ***Practical framework (group and subsidiary)***

#### Planning and coordination

47. Individual supervisors retain at all times full responsibility for risk assessments, planning of supervisory programmes, and supervisory actions directed at entities for which they have legal responsibility. In accordance with the CRD, the consolidating supervisor shall coordinate the exchange of information and other supervisory activities, with a view to avoiding unnecessary communication and duplication of tasks for both supervisors and supervised institutions.
48. The following tables highlight cross border implications, along each step of a generic risk assessment, as well as the tasks or considerations by the supervisors involved to address these implications. At each step, the coordinating role of the consolidating supervisor in information exchange and in the planning of supervisory activities, in line with the CRD provisions, is kept in mind with a view to avoid unnecessary communication and duplication of tasks for both supervisors and supervised institutions.
49. Those steps are designed as general guidelines that can be adapted by competent authorities on a case-by-case basis according to the concrete needs of co-operation between the parties.
50. *Step 1 – initiation of process*

The consolidating supervisor will undertake a preliminary risk assessment of the group, while the host subsidiary supervisor of will undertake a preliminary assessment of the group's subsidiaries.

Through dialogue with the host supervisors involved in the group's supervision, the consolidating supervisor will design a communication strategy proportionate to the involvement of other competent authorities in the group's supervision.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor <sup>13</sup>
Preliminary assessment of cross-border issues within the	<ul style="list-style-type: none"> <li>Identify the group's structure, key business and control risks, and</li> </ul>	<ul style="list-style-type: none"> <li>Through dialogue with the subsidiary:               <ul style="list-style-type: none"> <li>identify centralised</li> </ul> </li> </ul>

<sup>13</sup> The need to communicate and co-operate with all host supervisors on the basis of proportionality most likely will not prevent that the risk assessment at the group level will most naturally focus on significant subsidiaries.

<p>group</p>	<p>business units.</p> <ul style="list-style-type: none"> <li>• Identify all EU and third-country supervisors involved in the group's supervision.</li> <li>• Through dialogue with the group (or parent undertaking): <ul style="list-style-type: none"> <li>- map the significant foreign subsidiaries to be discussed and agreed with the relevant host supervisors;</li> <li>- undertake a preliminary risk assessment;</li> <li>- identify centralised control arrangements/functions (e.g. IT/central audit);</li> <li>- understand group implementation plans for the advanced approaches and the ICAAP, and how they are intended to be rolled out across the group and its subsidiaries;</li> <li>- identify knowledge gaps concerning foreign businesses and subsidiaries.</li> </ul> </li> <li>• Through dialogue with host supervisors: <ul style="list-style-type: none"> <li>- identify the host supervisors of significant subsidiaries of the group;</li> <li>- identify the sub-consolidated supervisors of the group;</li> <li>- identify information that might need to be communicated to other supervisors;</li> <li>- identify information about significant</li> </ul> </li> </ul>	<p>functions;</p> <ul style="list-style-type: none"> <li>- identify knowledge gaps, especially those potentially linked to the centralisation of the functions mentioned above;</li> <li>- identify any knowledge gaps concerning the position or involvement of a parent company which might be relevant for supervision on a solo or sub-consolidated basis.</li> </ul> <ul style="list-style-type: none"> <li>• Through dialogue with the consolidating supervisor: <ul style="list-style-type: none"> <li>- identify any other supervisors with whom the host supervisor may need to communicate – although all communication should pass through the consolidating supervisor;</li> <li>- identify the information that might need to be communicated to other supervisors;</li> <li>- identify information to be obtained from the consolidating supervisor for local supervision;</li> <li>- agree on information to be gathered locally and shared with the consolidating supervisor.</li> </ul> </li> </ul>
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	subsidiaries to be obtained from host supervisors.	
Establish a communication strategy between all supervisors, proportionate to the involvement of the different supervisory authorities.	<ul style="list-style-type: none"> <li>Establish a communication strategy with all host supervisors, proportionate in term of contents and timeliness.</li> </ul>	
Agreement on significant subsidiaries in the group for the purpose of group and subsidiary supervision.	<ul style="list-style-type: none"> <li>Identify significant subsidiaries, from the consolidating supervisor's perspective, for the purpose of consolidated supervision, and inform the host supervisors of significant subsidiaries accordingly.</li> <li>Consult host supervisors of significant subsidiaries on the relative significance of the subsidiaries.</li> <li>Agree on significant subsidiaries with the host supervisors of significant subsidiaries.</li> </ul>	<ul style="list-style-type: none"> <li>Inform the consolidating supervisor whether the subsidiary is considered significant or not to their supervisory objectives and the criterion for their assessment of significance. They should be prepared to discuss and justify their determination.</li> <li>Agree on significant subsidiaries with consolidating supervisor.</li> </ul>

*51. Step 2 – risk identification and assessment*

The consolidating supervisor and the host subsidiary supervisors complete their respective risk assessments of the group and its subsidiaries by bridging their knowledge gaps.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
<p>Consolidating supervisor and host subsidiary supervisors need to fully understand the risks of the group and its subsidiaries.</p> <p>Information gaps in individual</p>	<ul style="list-style-type: none"> <li>Produce a composite picture of the group based on the consolidating supervisor's own knowledge and input from the host subsidiary supervisors. <ul style="list-style-type: none"> <li>the composite picture should include the essential information noted above (first box).</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Communicate: <ul style="list-style-type: none"> <li>risk assessments of the subsidiary to the consolidating supervisor;</li> <li>the subsidiary's individual objectives, strategies, policies, processes, etc. to the consolidating supervisor;</li> </ul> </li> </ul>

<p>supervisors' knowledge need to be plugged.</p> <p>Identify shared/common risks to objectives.</p> <p>Identify significant areas for local discretion.</p>	<ul style="list-style-type: none"> <li>• Communicate a provisional overall assessment of the group and of centralised operations to all host subsidiary supervisors, including: <ul style="list-style-type: none"> <li>- group objectives, strategies, policies, and processes;</li> <li>- identification of significant areas of focus for the on-site assessment.</li> </ul> </li> <li>• The extent of the provisional assessment will vary depending upon the significance of the subsidiary (host supervisors of significant subsidiaries should receive more information than others).</li> <li>• Discuss the provisional assessment with host supervisors of significant subsidiaries, for example by convening a meeting or by bilateral or written procedure with the aim of agreeing on key risks and objectives.</li> <li>• Establish a process to deal with local discretions.</li> </ul>	<ul style="list-style-type: none"> <li>- on-site inspection programmes for significant subsidiaries, if requested by the consolidating supervisor.</li> <li>• Discuss their provisional assessments with the consolidating supervisor with the aim of agreeing on key risks and objectives.</li> </ul>
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*52. Step 3 - Planning supervisory action*

Supervisors plan their supervisory actions (e.g. on-site inspections and other procedures) in response to the risks and objectives identified in the risk assessment stage.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
<p>Identification of supervisory tasks, with the aim of eliminating duplicate tasks.</p>	<ul style="list-style-type: none"> <li>• Initiate a consultation process with host supervisors of significant subsidiaries to identify opportunities to coordinate their respective tasks: <ul style="list-style-type: none"> <li>- identify areas of mutual interest and</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Participate in the consultation initiated by the consolidating supervisor with the aim of reaching a consensus on common tasks.</li> </ul>

	<p>common tasks: on-site inspections, compliance requests, data requests, senior management concerns, audit concerns, quality of earnings concerns, etc;</p> <ul style="list-style-type: none"> <li>- identify where joint inspections might be more efficient.</li> </ul>	
<p>Allocation of tasks to achieve more effective supervision (if no common tasks are planned or identified).</p>	<ul style="list-style-type: none"> <li>• Identify tasks that the consolidating supervisor may wish to allocate to host supervisors of significant subsidiaries, and initiate discussions with them.</li> <li>• Discuss tasks that the consolidating supervisor could undertake on their behalf of the host supervisor (e.g. in relation to centralised functions such as internal audit).</li> <li>• Identify cross-border tasks that should be accomplished exclusively at group level.</li> </ul>	<ul style="list-style-type: none"> <li>• Discuss whether to undertake tasks on behalf of the consolidating supervisor if requested.</li> <li>• Identify tasks that may be allocated to the consolidating supervisor, and initiate discussions with the consolidating supervisor. The host supervisors of significant subsidiaries will need to justify to the consolidating supervisor why these tasks need to be performed.</li> </ul>
<p>Planning mutually agreed individual supervisory tasks</p>		
<p>Determine the most appropriate collaborative model for planning individual supervisory tasks.</p> <p>Matters to plan:</p> <ul style="list-style-type: none"> <li>- division of tasks;</li> <li>- resourcing (perform or perform by a single supervisor);</li> <li>- operational lead;</li> </ul>	<ul style="list-style-type: none"> <li>• Initiate consultation with the host supervisor of significant subsidiaries as to which model should be adopted (e.g. bilateral, multilateral, or a combination of the two). The consolidating supervisor ultimately decides on the co-operation model to be adopted.</li> <li>• If a multilateral approach is adopted, the consolidating supervisor should organise and chair the process. <ul style="list-style-type: none"> <li>- invite all host supervisors of significant subsidiaries to a meeting;</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Enter into consultation with the consolidating supervisor and possibly other host supervisors.</li> <li>• Choose whether to participate in a multilateral procedure.</li> <li>• Lead the work on subsidiaries (planning and operational lead): <ul style="list-style-type: none"> <li>- if invited by the consolidating supervisor to assist with centralised functions, host supervisors of significant subsidiaries can choose whether to accept.</li> </ul> </li> </ul>

<ul style="list-style-type: none"> <li>- prioritisation;</li> <li>- timetable.</li> </ul>	<ul style="list-style-type: none"> <li>- send out a draft agenda (including objectives) for the meeting;</li> <li>- communicate the outcome of this dialogue to all host supervisors of significant subsidiaries.</li> <li>• Lead work on centralised functions (planning and operational lead): <ul style="list-style-type: none"> <li>- decide to invite host supervisors of significant subsidiaries to assist in work on centralised functions;</li> <li>- choose to participate in work on subsidiaries, but the host supervisor of significant subsidiaries has the day-to-day operational lead.</li> </ul> </li> </ul>	
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53. *Step 4 - Performing supervisory tasks*

The respective supervisors undertake on-site inspections and other procedures in response to their risk assessment of the group and its subsidiaries. These inspections and procedures will include matters specific to the group or individual subsidiaries in addition to matters of mutual interest.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
<p>Consider unexpected issues identified during on-/off-site work</p> <p>Consider if unexpected issues require revisions to the original plan.</p>	<ul style="list-style-type: none"> <li>• Communicate on a timely basis to other supervisors to whom such issues may be relevant.</li> <li>• Lead a review of the issue and consider implications if the issue is related to centralised functions.</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate on a timely basis to the consolidating supervisor if these issues are deemed relevant.</li> </ul>
<p>Complete tasks</p>	<ul style="list-style-type: none"> <li>• Collate the findings based on the consolidating supervisor's own work and input from host supervisors of significant</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate key findings to the consolidating supervisor in accordance with the agreed plan.</li> </ul>



	subsidiaries.	
Discuss the implications of the on-site and off-site work performed	<ul style="list-style-type: none"> <li>Initiate discussions with the relevant host supervisors of significant subsidiary as to the conclusions that can be drawn from the findings.</li> </ul>	<ul style="list-style-type: none"> <li>Enter discussions with the consolidating supervisor if the issue is deemed relevant.</li> </ul>

#### 54. Step 5 – Evaluation

Following completion of on-site and off-site work, the supervisors will determine their supervisory programme for the group and individual subsidiaries. The consolidating supervisor is responsible for defining the programme at a consolidated level, and host subsidiary supervisors are responsible for defining the programme at the subsidiaries' level. These programmes will include any remedial action that has to be undertaken, any reporting requirements, and any follow-up procedures planned by supervisors.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Communicate supervisory response to findings, proportionate to significance.	<ul style="list-style-type: none"> <li>Initiate an information process with host supervisors of significant subsidiaries, to identify opportunities for coordinating their respective supervisory programmes.</li> </ul>	<ul style="list-style-type: none"> <li>Communicate proposed supervisory programmes to the consolidating supervisor.</li> </ul>
Plan and coordinate the overall supervisory programme: As in step 3	<ul style="list-style-type: none"> <li>As in step 3.</li> </ul>	<ul style="list-style-type: none"> <li>As in step 3.</li> </ul>

#### 55. Step 6 – ongoing supervision

The consolidating supervisor and host subsidiary supervisors will monitor progress on achieving the agreed goals of the supervisory programmes and on responding to any other issues in the process of day-to-day supervision.

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Matters arising from the supervisory programme	<ul style="list-style-type: none"> <li>Communicate to host supervisors of significant subsidiary if the matter is relevant to their</li> </ul>	<ul style="list-style-type: none"> <li>Consult consolidating supervisor if the matter is relevant to their supervisory objectives.</li> </ul>

	supervisory objectives.	
Obligations to other supervisors (e.g. if issues arise that are of relevance to other supervisors)	<ul style="list-style-type: none"> <li>• Communicate any relevant matters to the affected host supervisors of significant subsidiary.</li> <li>• Disseminate any information that has been communicated by host supervisors of significant subsidiaries that may be relevant to others.</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate any relevant matters to the consolidating supervisor.</li> </ul>

**X. What are your views on the general description of the process as set out in the tables above? Does it depict a logical, workable and comprehensive approach?**

**XI. Do you see additional potential for streamlining the process of co-operation, under the present legal provisions? What suggestions do you wish to make in this respect?**

### **Practical framework (group and branches)**

56. The relationship between the consolidating supervisor and host branch supervisors should aim at ensuring a free exchange of information.
57. The legal obligations of host branch supervisors differ from those of host subsidiary supervisors. These obligations need to be respected at all times. Taking fully into account the allocation of responsibilities between host branch supervisors and the consolidating supervisor (or the home supervisor of the foreign branch, when it is not at the same time the consolidating supervisor), the consolidating supervisor should nevertheless take into account the benefits that the proximity of host branch supervisors in the case of systemically relevant branches could bring to each stage of the risk assessment. Especially for systemically relevant branches, a more active involvement of the relevant host supervisors in the supervisory process – in full respect of the consolidating supervisors responsibility – might help the latter in ensuring effective supervision over these branch(es) and enhance awareness with both supervisors of the local market’s exposure to its (their) financial situation. Given the legal allocation of responsibilities, the intervention of host branch supervisors can only pertain to the conventional performance of specific tasks normally entrusted to the consolidating supervisor on explicit demand of the latter; his intervention should never entail any additional burden on the group or the entity concerned.<sup>14</sup>

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<sup>14</sup> See also Para 38 above.

58. The following tables identify additional cross-border issues specific to branches which can arise at each step in a generic risk assessment. The steps are intended as general guidelines that can be adapted by competent authorities on a case-by-case basis according to the practical needs of co-operation between the parties.

59. *Step 1 – initiation of process*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
Agreement on systemically relevant branches in the group.	<ul style="list-style-type: none"> <li>Identify systemically relevant branches for the purpose of consolidated supervision, and consult with the respective host supervisors on that decision.</li> <li>Consult host branch supervisors on the relative systemic importance of branches.</li> <li>Agree on systemic importance of branches with the host supervisors of systemically relevant branches.</li> </ul>	<ul style="list-style-type: none"> <li>Inform the consolidating supervisor whether the branch is considered systemically relevant and the criterion for the assessment of systemic importance. Be prepared to discuss and justify their determination.</li> <li>Agree on systemically relevant branches with the consolidating supervisor.</li> </ul>
Establish a communication strategy with the host branch supervisors of significant branches	<ul style="list-style-type: none"> <li>Establish a communication strategy with the host supervisors of systemically relevant branches, which should call on the expertise and the proximity advantage of the host branch supervisors.</li> </ul>	<ul style="list-style-type: none"> <li>Agree on the communication strategy in consultation with the consolidating supervisor.</li> </ul>

60. *Step 2 – risk identification and assessment*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
Consolidating supervisor and host branch supervisors need to fully understand the risks of the group and its	<ul style="list-style-type: none"> <li>Produce a composite picture of the group based on the consolidating supervisor’s own knowledge and input from the host supervisors of systemically relevant branches.</li> </ul>	<ul style="list-style-type: none"> <li>Communicate to the consolidating supervisor if requested: <ul style="list-style-type: none"> <li>assessments of market developments which might influence the group;</li> </ul> </li> </ul>

branches.  Information gaps in individual supervisors' knowledge need to be plugged.	<ul style="list-style-type: none"> <li>• Communicate an overall assessment of the group and of centralised operations to hosts supervisors of systemically relevant branches. The extent of the assessment communicated will vary depending upon the systemic relevance of the branch.</li> </ul>	<ul style="list-style-type: none"> <li>- the branch assessment derived from liquidity and other statutory reporting.</li> </ul>
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*61. Step 3 – planning supervisory action*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
Possible allocation of supervisory tasks to host branch supervisors	<ul style="list-style-type: none"> <li>• Consider in the interest of effectiveness and efficiency the possibility of asking the host supervisors of systemically relevant branches to undertake work or provide assistance in supervising branches.</li> <li>• Discuss whether work might be undertaken by the host supervisor of systemically relevant branches. The consolidating supervisor (or the home supervisor of the foreign branch, when it is not at the same time the consolidating supervisor) retains responsibility for planning and seeks to ensure that work is performed to its satisfaction.</li> </ul>	<ul style="list-style-type: none"> <li>• Consider whether to undertake work on behalf of the consolidating supervisor (or the home supervisor of the foreign branch, when it is not at the same time the consolidating supervisor) with respect to branches if requested. The host supervisor of systemically relevant branches: <ul style="list-style-type: none"> <li>- assumes no statutory responsibilities as a result of its assistance; and</li> <li>- performs no work on its own initiative except where permitted within its own statutory remit (e.g. with respect to liquidity).</li> </ul> </li> </ul>

*62. Step 4 – performing supervisory tasks*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
Completion of	<ul style="list-style-type: none"> <li>• Collate the findings of the host supervisor of</li> </ul>	<ul style="list-style-type: none"> <li>• Report the findings of any tasks to the consolidating</li> </ul>

tasks	<p>systemically relevant branches, and draw conclusions.</p> <ul style="list-style-type: none"> <li>Share findings of work with the host supervisor of the systemically relevant branch.</li> </ul>	<p>supervisor on a timely basis and in accordance with any agreed instructions.</p>
Reporting of conclusions	<ul style="list-style-type: none"> <li>Report significant conclusions to the host supervisors of systemically relevant branches.</li> </ul>	

### 63. Step 5 – Evaluation

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
Further work in the branch	<ul style="list-style-type: none"> <li>Communicate to the host supervisor of systemically relevant branches if further work is planned for the specific branch. Any further work would then follow step 3.</li> </ul>	

### 64. Step 6 – ongoing supervision

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor of systemically relevant branches
On going obligations of supervisors (predominately in the area of information exchange).	<ul style="list-style-type: none"> <li>Report any significant matters that arise during the ongoing supervision of the branch that may be relevant to a host supervisor of systemically relevant branches.</li> <li>With regard to the extended exchange of information the consolidating supervisor should plan, coordinate, and organise supervisory action and communicate its determinations regularly to the host supervisors of systemically relevant branches.</li> </ul>	<ul style="list-style-type: none"> <li>Report any matters that come to its attention that may be relevant to the consolidating supervisor’s supervision of the branch.</li> </ul>

**XII. What are your views on the general description of the process as set out in the tables above? Does it depict a logical, workable and comprehensive approach?**

**XIII. Do you see additional potential for streamlining the process of co-operation, under the present legal provisions? What suggestions do you wish to make in this respect?**

### **Practical framework (model approval)<sup>15</sup>**

65. Article 129(2) of the CRD introduces a specific requirement that supervisors must work together to determine whether or not to grant permission to a group to use its internal rating systems (IRB) or operational risk measurement systems (AMA) for regulatory purposes, when the group has submitted a single application covering both the consolidated and solo requirements of the group.
66. In view of this legal requirement, this specific section on the pre-application, approval and post-approval process elaborates usefully upon the general guidance given in the following areas:
- the specific steps in the approval process;
  - the explicit requirement for a formal consultative process;
  - time limits in which this process should lead to a common decision;
  - the specific role of the consolidating supervisor in this consultation period.
67. The new legal requirements relating to the approval process do not justify or require any departure from the general guidance for supervisory co-operation on a cross-border basis. The general principles set out above remain therefore valid and relevant for supervisory co-operation on the approval process.
68. To facilitate a common decision within the six-months period specified in Article 129(2) of the CRD supervisors have agreed on a common understanding on the pre-application, the approval and the post-approval phase.
69. A group may enter into exploratory discussions with the consolidating or host supervisors about the use of internal models for all or parts of its business. While there is no formal requirement to do so, supervisors are advised to communicate the outcome of these discussions to other relevant supervisors; and to inform the group of

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<sup>15</sup> This part is taken from CEBS CP 10 (11 July 2005): Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) approaches (CEBS CP 10).

the nature of the approval framework and that applications will be coordinated through the consolidating supervisor.

70. However, as soon as a group expresses a clear intention to move towards the advanced approaches, even before an application is made, it is essential that the pre-application process be centralised with the consolidating supervisor, acting as the coordinator and the central point of contact for the group.
71. Supervisors have a relatively tight timeframe of six months after receipt of a complete formal application in which to reach a decision on the approval. The pre-application period becomes thus an important step in ensuring that the approval process for both the group and its supervisors is conducted in an efficient, coordinated and effective manner.
72. During this pre-application period it is essential that:
  - i. supervisors understand the extent and nature of the intended use of internal rating and operational risk management systems (for example: which risks, entities and exposures are to be covered; how internal models are being rolled out across the group, governance and risk management arrangements, data collection and management, and testing);
  - ii. all supervisors concerned be consulted to establish a co-operative and consultative framework. This framework needs to encompass the following:
    - which supervisors are to be involved, their respective roles and responsibilities, and the allocation of specific tasks;
    - a communication strategy and escalation process; and
    - procedures to ensure, that a consensus can be reached among supervisors;
  - iii. supervisors develop an overall supervisory plan of action that covers each of the steps in the approval process and which includes priority issues and a timetable;
  - iv. the group familiarises itself with the approval framework and the requirements and standards concerning the information that it will need to submit;<sup>16</sup>
  - v. there is early identification and communication of any specific group or local concerns or issues that need to be factored into the process;
  - vi. supervisors seek to identify potential areas of disagreement;
  - vii. supervisors agree, after due consultation with the group, the format and timescale for the submission of the formal

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<sup>16</sup> For more details on the information to be submitted see Section 2.2. of CEBS CP 10.

application and the planning of the assessment to be undertaken by supervisors;<sup>17</sup>

viii. supervisors likewise agree on the way that the eventual implementation of the rating and operational risk measurement systems will be structured and monitored.<sup>18</sup>

73. Responsibility for organising and coordinating these pre-application tasks and more generally for the overall approval process, shall reside with the consolidating supervisor. This responsibility cannot be delegated to another supervisor, although certain tasks – including practical coordinating aspects – may be allocated to other supervisors involved. Thus, for example, while it is expected that the consolidating supervisor will lead the assessment of the centrally developed models and the assessment of the group's governance and centralised risk management functions, host supervisors could lead the assessment of locally developed models and local implementation of centrally developed models. The effective coordination of practical work on specific models (e.g. for certain business lines) can, under the responsibility of the consolidating supervisor, be entrusted to the supervisor best placed to ensure the efficient running of the process. This can also refer to centrally developed aspects of the models.
74. Consolidating supervisors should liaise with host branch supervisors of systemically relevant branches to determine the extent to which the latter can contribute to the efficiency of the process. For example, by virtue of their proximity host branch supervisors can offer valuable insights into the impact of local market conditions on models, or can assist in the assessment of data.
75. Special attention should be given to ensuring that information is exchanged upon receipt of a formal application and to coordinating work on assessing the completeness of the application.
76. Upon reaching a decision, the consolidating supervisor shall coordinate the drafting of a communication in which the supervisory decision is, in accordance with Article 129 of the CRD, duly documented. The consolidating supervisor should seek an appropriate procedure for formalizing the adherence of all concerned supervisors to the decision.<sup>19</sup>
77. The CRD specifies that the consolidating supervisor shall make the final determination in the event that supervisors cannot reach a consensus. This is regarded as an exceptional circumstance. Supervisors should try to avoid this outcome by identifying potential areas of disagreement early in the process and prioritising them for early discussion.

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<sup>17</sup> See Section 2.2.1. of CEBS CP 10 for details on format and timeframe of applications. Additional information on the assessment of applications can be found in Section 2.2.2. of CEBS CP 10.

<sup>18</sup> Section 2.2.5. of CEBS CP 10 provides details on the post-approval process

<sup>19</sup> For more details concerning the decision see Section 2.2.3. of CEBS CP 10.



78. Those steps are designed as general guidelines that can be adapted by competent authorities on a case-by-case basis according to the concrete needs of co-operation between the parties.

79. *Step 1 – Pre-application*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
The group has exploratory discussions with individual supervisors about the use of models.	<ul style="list-style-type: none"> <li>• There is no formal requirement that other supervisors need be informed at this stage. However, supervisors are advised to communicate the outcomes of their exploratory discussions.</li> </ul>	<ul style="list-style-type: none"> <li>• There is no expectation that other supervisors need be informed at this stage, though, at a minimum, informal contact with the consolidating supervisor would be advisable.</li> </ul>
The group expresses a clear intention to move towards the advanced approaches.	<ul style="list-style-type: none"> <li>• The consolidating supervisors should advise the relevant host supervisors.</li> </ul>	<ul style="list-style-type: none"> <li>• Inform the consolidating supervisor that local institutions are contemplating the use of internal models.</li> </ul>
Consultative framework.	<ul style="list-style-type: none"> <li>• Plan and organise a consultative framework to include:               <ul style="list-style-type: none"> <li>- a communication strategy for all supervisors; and</li> <li>- a mechanism enhancing a common agreement among supervisors.</li> </ul> </li> </ul>	
Understanding the extent and nature of the groups' intentions.	<ul style="list-style-type: none"> <li>• Discuss with the group the intentions to implement an internal models approach.</li> <li>• Produce a preliminary assessment of the group's proposals, including:               <ul style="list-style-type: none"> <li>- the readiness of the group; and</li> <li>- the adequacy of plans.</li> </ul> </li> <li>• Communicate the salient features to the supervisors likely to be affected by the group's intentions, and inform other supervisors of the group's plans in accordance with the general communication strategy.</li> </ul>	<ul style="list-style-type: none"> <li>• Communicate concerns and issues with the proposed approach.</li> <li>• Need to identify potential disagreements so that supervisors can have an early plan to address.</li> </ul>

	<ul style="list-style-type: none"> <li>• Collate the concerns and issues of other supervisors with the proposed approach and produce a summary of the principal issues.</li> </ul>	
Supervisory plan of action.	<ul style="list-style-type: none"> <li>• Draw up the supervisory plan in consultation with other relevant supervisors and in co-operation with the group. The plan should include: <ul style="list-style-type: none"> <li>- identification of significant models and proposed roll-out plans;</li> <li>- the allocation of workload with respect to the significant models;</li> <li>- priority issues;</li> <li>- a timetable;</li> <li>- standards by which to judge the completeness and the accuracy of the application; and</li> <li>- standards for reaching agreement on a final decision;</li> </ul> </li> <li>➤ Communicate the salient points of the supervisory plan to the group.</li> </ul>	

*80. Step 2 – Formal application*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Formal application submitted.	<ul style="list-style-type: none"> <li>• Determine promptly if the application is obviously incomplete (e.g. significant omissions of specified information): <ul style="list-style-type: none"> <li>- if so, communicate to the group that the application is incomplete, setting out the reasons why and what further information the group may need to submit;</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Assess those aspects of the application that the host is best able to comment on (e.g. relating to locally developed models) and communicate the results of the assessment to the consolidating supervisor.</li> </ul>

	<ul style="list-style-type: none"> <li>- inform the other supervisors that an application has been received, that it is incomplete, and that the group has been asked to provide further information.</li> <li>• If not, inform the other supervisors promptly that an application has been received, and distribute the application form, in whole or part, as previously agreed.</li> <li>• Assess the completeness and accuracy of the application against pre-agreed standards and in consultation with the host supervisors with respect to local models.</li> <li>• Communicate the final results of the assessment to the group and to other supervisors: <ul style="list-style-type: none"> <li>- if the application is found to be incomplete, communicate that finding to the group, setting out the reasons why and what further information the group may need to submit;</li> <li>- if the application is complete, inform the other supervisors that the six-month period has started, and initiate the next step in the process.</li> </ul> </li> </ul>	
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*81. Step 3 – Model assessment*

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Performing the work.	<ul style="list-style-type: none"> <li>• Lead the assessment of centralised models and some local models (where agreed), the governance of the group, the role of the Board and Senior</li> </ul>	<ul style="list-style-type: none"> <li>• Lead the assessment of local models (where agreed), the governance of the local entities, and local risk management functions.</li> </ul>

	<p>Management and centralised risk management functions.</p> <ul style="list-style-type: none"> <li>• Assess compliance with the Use Test.</li> <li>• Assess self-assessment.</li> <li>• Assess the roll-out plan, if applicable.</li> </ul>	<ul style="list-style-type: none"> <li>• Assess compliance with the Use Test with respect to local models.</li> </ul>
Reporting the results of work performed.	<ul style="list-style-type: none"> <li>• Collate progress reports and assess the overall level of progress.</li> <li>• Assess whether the supervisory plans need to be revised.</li> <li>• Report overall progress to host supervisors in accordance with the agreed supervisory plan.</li> </ul>	<ul style="list-style-type: none"> <li>• Provide the consolidating supervisor with progress reports on the work, in accordance with the agreed supervisory plan.</li> <li>• Inform the consolidating supervisor immediately in the event of: <ul style="list-style-type: none"> <li>- significant failings identified in the model application process;</li> <li>- if there is a risk, that deadlines will not be met.</li> </ul> </li> </ul>

#### 82. Step 4 – Decision

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Agreement on the decision.	<ul style="list-style-type: none"> <li>• Agree on decisions.</li> <li>• Agree on any terms and conditions to be attached to the decision.</li> <li>• Agree on the process for handling roll-out.</li> <li>• Agree on the timeframe for implementing the decision.</li> </ul>	<ul style="list-style-type: none"> <li>• Agree on decisions.</li> <li>• Agree on any terms and conditions to be attached to the decision.</li> <li>• Agree on the process for handling roll-out.</li> <li>• Agree on the timeframe for implementing the decision.</li> </ul>
Communication of decision.	<ul style="list-style-type: none"> <li>• Draw up the fully reasoned decision document in accordance with agreed principles for convergence.</li> </ul>	

#### 83. Step 5 – Implementation

Cross-border implications	Tasks or considerations for the consolidating supervisor	Tasks or considerations for the host supervisor
Implementation of decision.	<ul style="list-style-type: none"> <li>• Implement the decision in accordance with national legislation.</li> </ul>	<ul style="list-style-type: none"> <li>• Implement the decision in accordance with national legislation.</li> </ul>

Planning, assessing and reporting.	Follow similar procedures to step 3.	Follow similar procedures to step 3.
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*84. Step 6 – On-going review*

The on-going review of the continuing appropriateness of the models in use shall be conducted within the Pillar 2 framework. The framework for supervisory co-operation should follow the steps outlined above.

***XIV. Do you see any serious obstacles to the smooth process of model approval stemming from the proposed tasks executed by the consolidating supervisor and the host supervisors? If yes, what are they and how to remove them?***

# Appendix I – Overview of SREP

