



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

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# **Governance and Boards' effectiveness**

***A view from the ECB***

ecoDa EBF event

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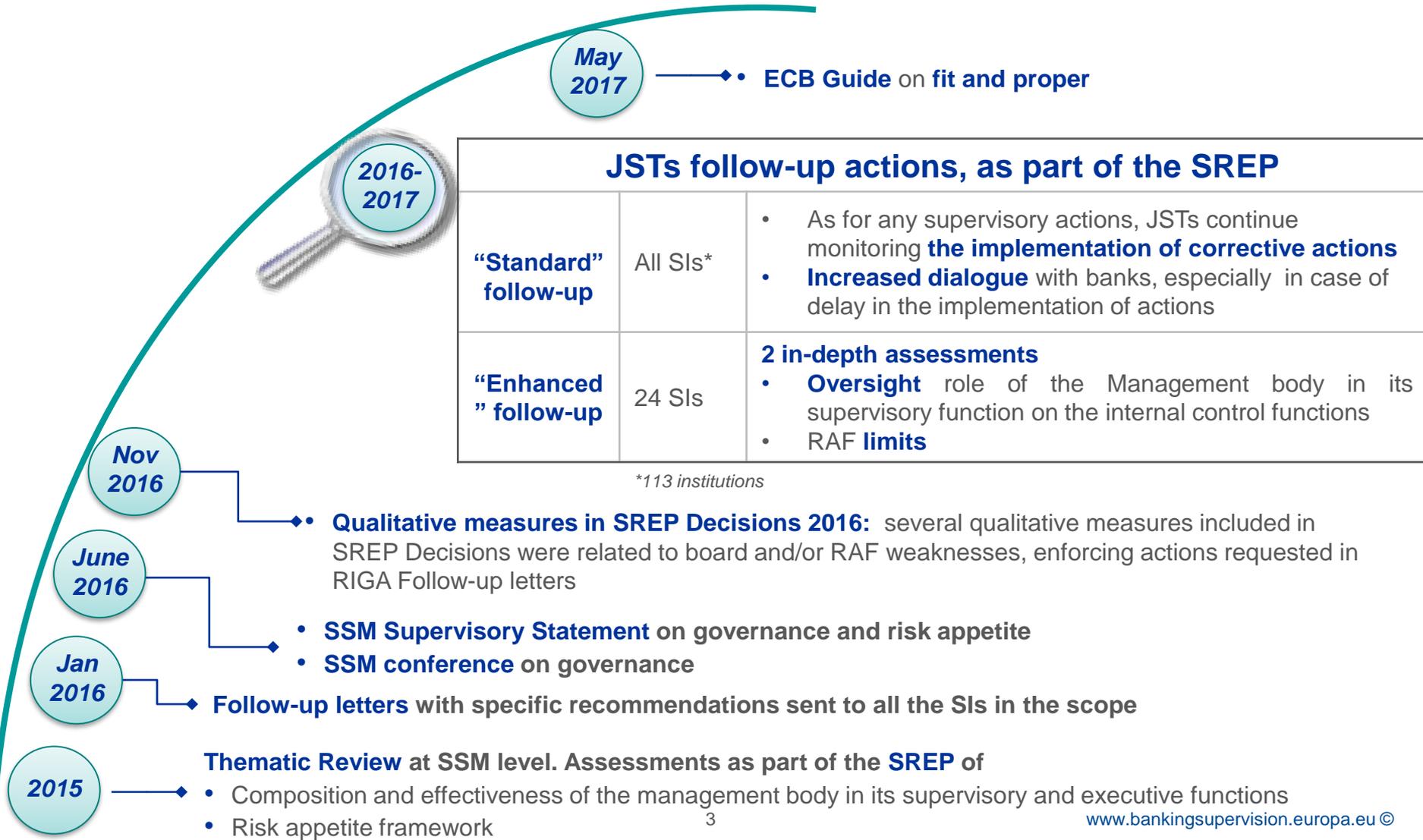
## Sound governance and risk management arrangements are all the more important in the current changing financial landscape

- Developments in the **macro-financial, economic, competitive and regulatory landscape** affecting sustainability of banks' business models
- **Subdued profitability** reflects a number of cyclical and structural factors.
- **Scope of consolidation** as the European banking union sets the scene for banks to merge across borders.
- **Lingering portfolio vulnerabilities** as high stocks of NPLs remain a concern for a number of euro area countries
- Still a lot remains to be done to achieve the level of business model transformation needed, also in view **progressing digitalisation**.

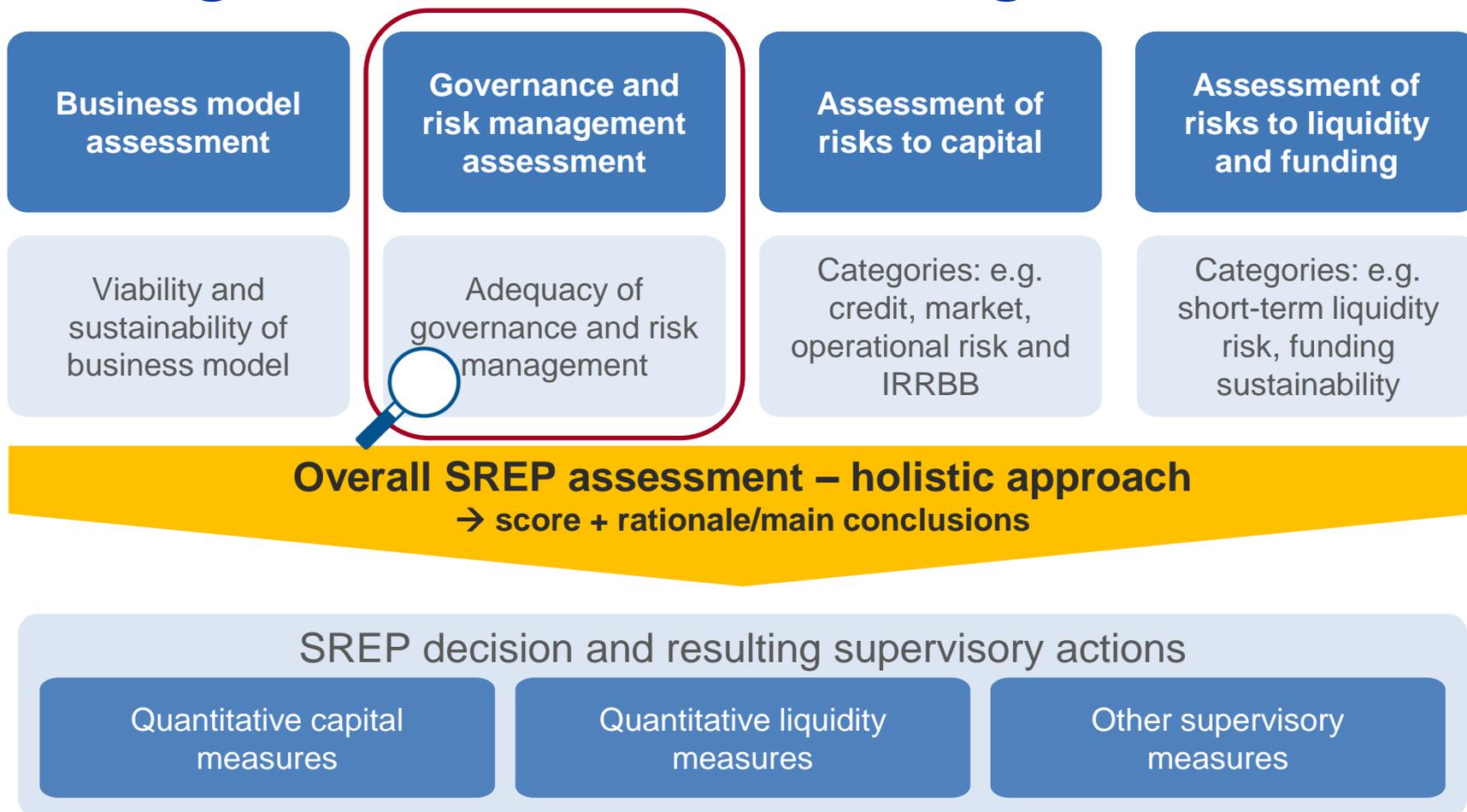
Sound governance and risk management arrangements

- Adequate **composition** and **effective organisation** of the **management body** of institutions
- Appropriate **governance arrangements**, with strong **internal control functions** .
- **Sound risk management practices**, with a clearly articulated **risk appetite framework**
- Effective **risk data aggregation** capabilities and **risk reporting practices**

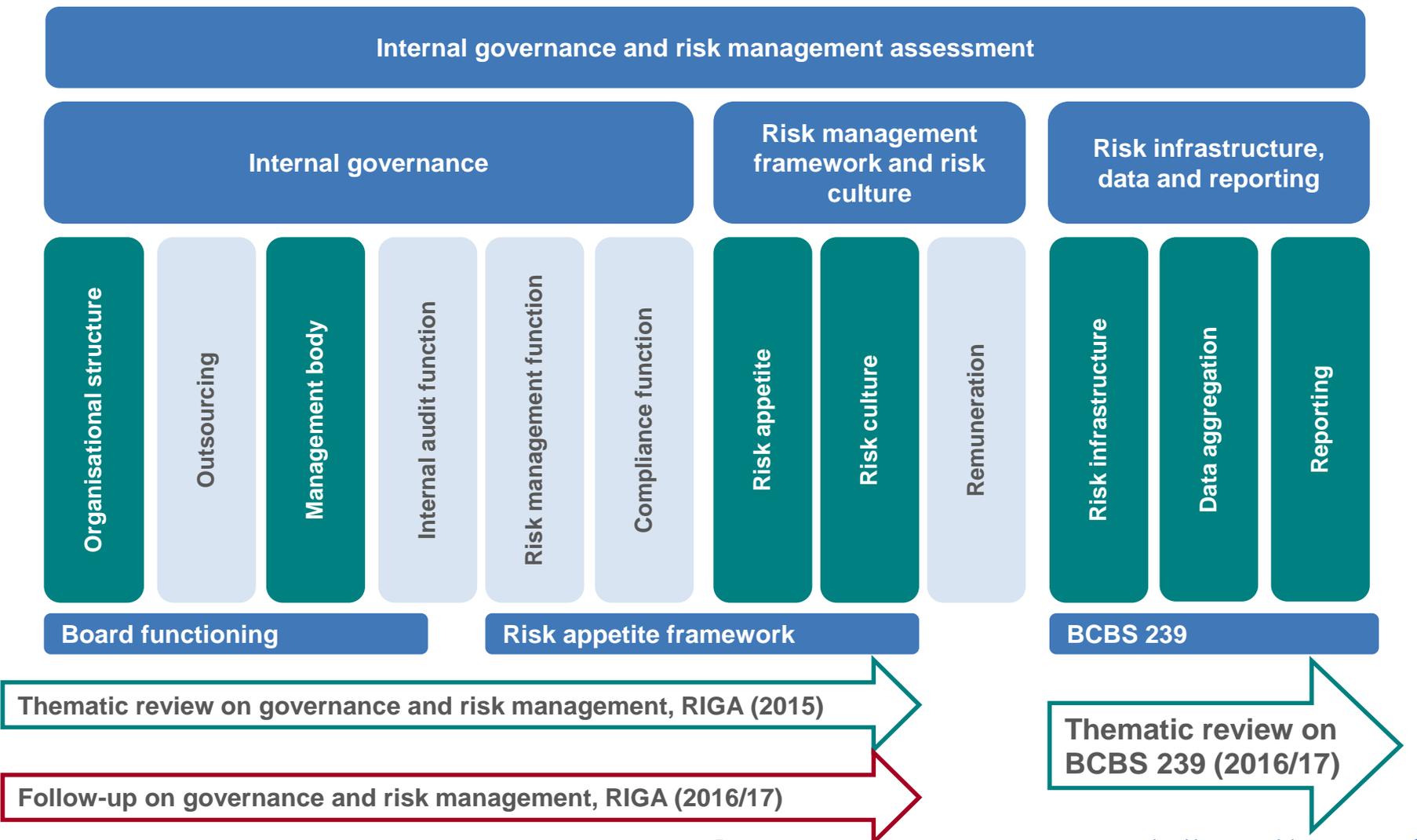
# Internal governance and risk management on the top of the SSM priorities



## The Supervisory review and Examination Programme (SREP) provides the framework to assess governance and risk management



# Focus on governance and risk management: Thematic reviews feed back into the SREP



### 1. Effectiveness of the management body

#### MAIN FINDINGS IN 2015

- Insufficient challenging capacity
- Insufficient risk perspective

#### SUPERVISORY IMPACT

- The review **raised awareness, triggered self-reflection and actions** to address the root causes of the findings
- Improvements in the **composition, documentation** and **organisation** of the management body

#### REMAINING AREAS OF ATTENTION

- The implementation of actions to enhance the Board's challenging capacity **takes some time**, due to the inherent nature of the changes to be implemented.
- The same applies for **adjustments in the board composition**. FAP assessments can provide key input

### 2. Risk appetite framework

#### MAIN FINDINGS IN 2015

- RAF relatively recent for many SIs
- Heterogeneity in the RAF design, comprehensiveness and implementation

#### SUPERVISORY IMPACT

- Significant improvement in the **comprehensiveness** of the risks types and metrics included in the RAF
- Implementation of **risk appetite dashboards**
- Performance of RAF **independent reviews**

#### REMAINING AREAS OF ATTENTION

- RAF **deployment**
- RAF **interplay** with key other **strategic processes** (budget, recovery plan, remuneration process...)

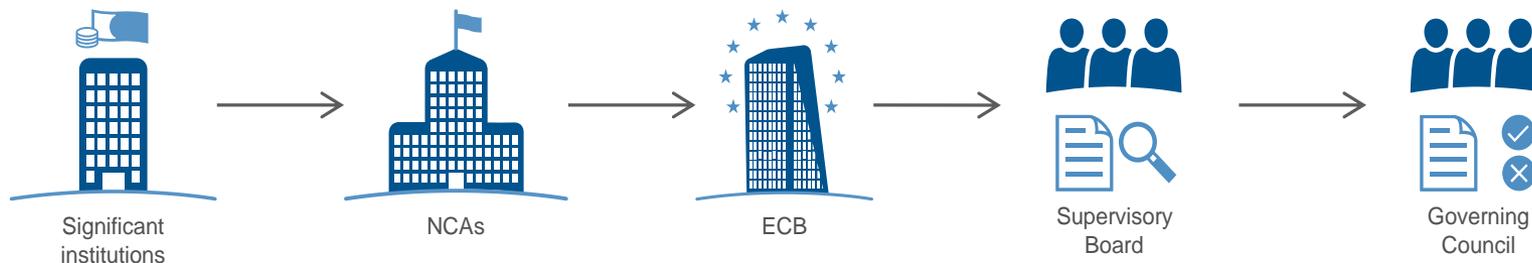
### The oversight of the management body in supervisory function on the internal control functions is not strong, especially on risk and compliance

<p><b>1.</b> The <b>design for oversight</b> of the internal control functions has improved. It is still however not always aligned with international best practices.</p>	<ul style="list-style-type: none"> <li>• Following the 2015 TR, improvements in the design of oversight on the <b>risk function</b>. However, in a few banks, the <b>CRO</b> does not have a direct access to the board.</li> <li>• Institutions need to enhance the access of the <b>Chief Compliance Officer (CCO)</b> to the board.</li> <li>• The design of the oversight <b>IA</b> functions is adequate for almost all institutions.</li> </ul>
<p><b>2.</b> The <b>oversight</b> on internal control functions needs to be enhanced, especially on risk and compliance.</p>	<ul style="list-style-type: none"> <li>• <b>Independent challenging capacity</b> better on IA than on risk and compliance</li> <li>• The <b>evaluation</b> of the internal control functions by the board is not sufficient.</li> <li>• Institutions need to strengthen the oversight framework for <b>conduct risk</b>.</li> </ul>
<p><b>3.</b> Confirmation that <b>the quality of the oversight does not depend on the board structure (single-tier, two-tier...)</b></p>	<p>Drivers of <b>efficient oversight</b> relate more to</p> <ul style="list-style-type: none"> <li>• Board's <b>composition</b>: collective knowledge, recent / upcoming changes in the board, confirming the relevance of FAP processes</li> <li>• <b>Time</b> dedicated to debate</li> <li>• Quality of <b>interaction</b> with the functions</li> </ul>

### The deployment, governance and embedment of risk appetite limits at business line level remain areas of concern

*Assessment performed based on 1 material business line- credit risk*

<p><b>1. RAF deployment and set-up</b> at business line (BL) level is not comprehensive enough</p>	<ul style="list-style-type: none"> <li>• The <b>setting of risk appetite limits</b> at BL level is still a major area of attention for many institutions.             <ul style="list-style-type: none"> <li>○ Several institutions are still missing <b>country or sectoral limits</b></li> </ul> </li> <li>• <b>Limits do not sufficiently constrain risk taking</b> within the risk appetite for many institutions</li> <li>• The RAF deployment is more challenging for younger RAFs.</li> </ul>
<p><b>2. The governance of the limits framework</b> is an area of concern</p>	<ul style="list-style-type: none"> <li>• Weaknesses in the <b>RAF set-up hampers the limit monitoring</b></li> <li>• The <b>involvement of the risk function</b> still needs to be improved</li> <li>• A majority of institutions within the scope face issues regarding the <b>reporting of limit breaches</b></li> </ul>
<p><b>3. RAF embedment is insufficient</b></p>	<ul style="list-style-type: none"> <li>• Institutions do not use sufficiently the limits and RAS as a tool to promote <b>discussion</b> at business line level for.</li> <li>• Institutions need to improve the implementation of <b>corrective actions</b> in a timely manner.</li> </ul>



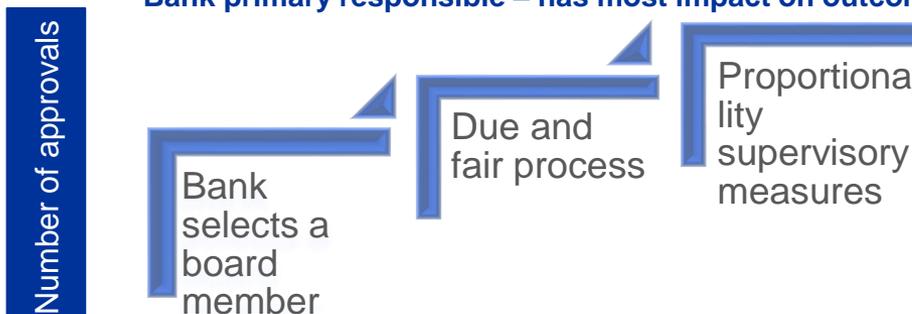
## Individual suitability is a prerequisite for collective suitability



## Main areas of attention about the board composition as a whole

- Insufficient formal independence as a whole
- Insufficient collective knowledge
- Insufficient framework to manage conflicts of interest
- Succession planning not sufficiently formalised

Bank primary responsible – has most impact on outcome



## The Guide as an harmonisation and transparency tool

### Aim and applicability of the guide

- The guide aims at (1) harmonising FAP assessments to achieve common supervisory practices and (2) increasing transparency on how SSM conducts FAP assessments.
- The guide is not a legally binding document.

### Content of the guide

- The guide explains in greater detail the policies, practices and processes applied by the ECB when assessing the suitability of members of the management bodies of significant credit institutions:
  - Legal framework
  - Principles and scope of the fit and proper assessments
  - Assessment criteria
  - Internal organisation and assessment procedure
  - Types of decisions and supervisory measures



Guide to fit and proper assessments



Thematic Review follows a principle by principle analysis on main gaps and good practices identified:

Governance & infrastructure		Risk data aggregation capabilities				Risk reporting practices				
Principle 1	Principle 2	Principle 3	Principle 4	Principle 5	Principle 6	Principle 7	Principle 8	Principle 9	Principle 10	Principle 11
Governance	Data architecture and IT infrastructure	Accuracy and Integrity	Completeness	Timeliness	Adaptability	Accuracy	Comprehensiveness	Clarity and usefulness	Frequency	Distribution



Main themes investigated



Identified areas of concern



Observed good practices and sound practices



Main supervisory expectations



*Developing adequate risk data aggregation and reporting capabilities in order to ensure a safe and sound risk management is **primarily under institutions senior management's responsibility** (Principle 1, Governance)*



*The ECB expects the observed good practices and sound practices listed in the Report to be implemented and periodically assessed*



*the ECB will continue fostering the implementation of data aggregation and reporting principles for all **SIs**, taking into account size, business model and complexity of institutions under the proportionality principle*



*The ECB will continue relying – wherever relevant – on the criteria defined in the BCBS 239 Principles to assess risk data aggregation and risk reporting capabilities for producing **external reporting**\**

\* BCBS239 itself encourages application of the Principles to regulatory & financial reporting