

Circular

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Inspections

Legal basis - Scope

This circular covers inspections carried out by the Bank, in its capacity of prudential supervisor with respect to the following institutions:

- credit institutions¹,
- insurance companies²,
- reinsurance companies³,
- stockbroking firms⁴,
- payment institutions⁵,
- electronic money institutions⁶,
- settlement institutions and institutions equivalent to settlement institutions⁷,
- Belgian branches of those institutions which are governed by the law of a state which is not a member of the European Economic Area (EEA)⁸,
- branches of those institutions established in another European Economic Area (EEA) Member State⁹,
- Belgian branches of those institutions which are governed by the law of a European Economic Area (EEA) Member State, within the limits of the Bank's supervisory powers as they result from the law of the European Union,
- financial holding companies¹⁰,

¹ Article 46, paragraph 5, of the Law of 22 March 1993.

² Article 21, § 1 *bis*, paragraph, 4 of the Law of 9 July 1975.

³ Article 37 of the Law of 16 February 2009.

⁴ Article 92, § 4, of the Law of 6 April 1995.

⁵ Article 25, paragraph 4, of the Law of 21 December 2009.

⁶ Article 81, § 2, paragraph 2, of the Law of 21 December 2009.

⁷ Article 21, paragraph 4, of the Royal Decree of 26 September 2005.

⁸ Article 81 of the Law of 22 March 1993 (reference to Article 46 of the same Law), Article 36 of the Royal Decree of 26 September 2005 (reference to Article 21 of the same Decree), Article 65 of the Law of 16 February 2009 (reference to Article 37 of the same Law), Article 21, § 1 *bis*, paragraph 4 of the Law of 9 July 1975, Article 101 of the Law of 21 December 2009 (reference to Article 81 of the same law) and Article 22 of the Royal Decree of 20 December 1995 (reference to Article 92 of the Law of 6 April 1995).

⁹ Article 48 of the Law of 22 March 1993, Article 21, § 1 *bis*, paragraph 5, of the Law of 9 July 1975, Article 39 of the Law of 16 February 2009, Article 94 of the Law of 6 April 1995 and Articles 27 and 83 of the Law of 21 December 2009.

- financial services groups headed by a regulated company under Belgian law¹¹ or by a mixed financial holding company¹², and
- insurance or reinsurance groups¹³.

As regards credit institutions, the scope of this circular will be reviewed in due course to reflect the Single Supervisory Mechanism established by Regulation 1024/2013 of the Council of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, as well as the regulations, guidelines and instructions to be adopted by the European Central Bank under Article 6 of said Regulation.

Provisions to which reference is made in notes 1 to 13 form the legal basis under which the Bank has prerogatives as regards inspection in respect of the aforementioned institutions.

As a reminder, the NBB may also, in accordance with Article 36/19 of the Law of 22 February 1998 establishing the Organic Statute of the NBB, require all necessary information from those who carry out operations or engage in activities covered by the laws and regulations the application of which it monitors, and from any third party that enables or facilitates carrying out such operations or engaging in such activities. The NBB may verify or have verified in the books and documents of interested parties, the accuracy of the information communicated to it.

Information-gathering assignments carried out on site by inspectors of the NBB are not inspections and are not covered by this circular.

This circular replaces with immediate effect section 5 of Circular D1 99/2.

¹⁰ Article 49, § 2, paragraph 6, of the Law of 22 March 1993.

¹¹ Article 49*bis*, § 2, paragraph 7, of the Law of 22 March 1993, Article 91*octies decies*, § 2, paragraph 7, of the Law of 9 July 1975 and Article 98, § 2, paragraph 6, of the Law of 16 February 2009.

¹² Article 49*bis*, § 3, of the Law of 22 March 1993, Article 91*octies decies*, § 3, of the Law of 9 July 1975, Article 95*bis*, § 3, of the Law of 6 April 1995 and Article 98, § 3, of the Law of 16 February 2009.

¹³ Article 91*septies* of the Law of 9 July 1975 and Article 87 of the Law of 16 February 2009.

Summary/Purpose

This circular aims to inform the institutions under supervision of the NBB's methodology for carrying out inspections, of the inspection process and of the behaviour that is expected from the institutions under supervision.

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Dear Madam,
Dear Sir,

After the transfer of powers from the former CBFA to the NBB, the NBB revised its methodology for carrying out inspections. In order to ensure a transparent approach and an efficient operation of the inspection process, it is essential that one single document be made available to the institutions under supervision to allow them to have a clear understanding of the NBB's approach to inspection.

This circular aims to inform the institutions under supervision of the purpose of inspections (Chapter 2), and of the inspection process (Chapter 3), and conveys the NBB's expectations regarding inspections, in particular the behaviour it expects from the institutions, their managers and their staff (Chapter 4). Finally, this document deals with the co-operation between authorities as regards inspections (Chapter 5).

This circular will have to be reviewed in due course to reflect the Single Supervisory Mechanism. It may also in due course be supplemented by addenda on joint missions as part of the consolidated supervision exercised by the home-country supervisor, and by any other relevant matter for which additional explanations are deemed necessary by the NBB.

1. Introduction

1. The purpose of the prudential supervision exercised by the NBB is in essence to guarantee financial stability and to ensure that the institutions under supervision operate in compliance with the requirements of a sound and prudent management. To this end, the NBB:

- defines standards at national level, within the European regulatory context,
- implements such standards by means of appropriate tools, monitoring activities and inspections,
- identifies and monitors systemic risks,
- addresses identified risks and takes corrective measures,
- ensures a level playing field.

2. It should be remembered that it is in the first place the responsibility of the management of the institutions to ensure a sound and prudent management. No form of supervision can or may replace good governance.

2. Purpose of inspections

Objective of inspections and operation of the inspection process

3. Inspections are carried out by specialized staff, i.e. inspectors. Inspectors may be accompanied by other NBB staff and/or external specialists.

4. Inspectors objectively assess the manner in which the institutions organize their activities and manage their risks, taking into account the financial, business and reputational impact, and make recommendations in order to remedy the identified shortcomings. In doing so, inspectors apply the NBB inspection methodology and procedures.

5. Inspections are carried out as follows:

- **action-oriented**: inspectors issue opinions and make recommendations relating to the subject matters examined, and attribute individual ratings to these subject matters, in order to tackle the identified shortcomings in a targeted way,
- **risk-focused**: inspectors apply the NBB inspection methodology, which is based on the generally accepted audit principles and techniques, and on an analysis of the risk exposure. The listing of the risks the institution is exposed to and the manner in which the institution monitors or does not monitor its risks, are of particular relevance.
- **forward-looking**: the subject matters examined are linked to the overall risk management system which supports future (financial) performances,
- **intrusive**: the adequate audit evidence is actively tracked¹⁴.

6. This makes inspections a powerful supervisory tool that allows the NBB to take swift corrective measures where deficiencies are reported. For the overall assessment of the risk profile of the institutions, the inspection reports are also an essential source of information.

7. The NBB sets up the necessary framework to ensure that its staff performs its tasks with the greatest integrity and professionalism. NBB staff must respect the ethical code of the NBB. It is also reminded, insofar as necessary, that any person participating or having participated in the inspection process is bound by professional secrecy¹⁵.

¹⁴ The conclusions of the inspector, which serve as a basis for the opinion and the recommendations issued by him, are based on this information.

¹⁵ Articles 35 and 36/15 of the Law of 22 February 1998.

Inspection universe

8. Besides the financial characteristics of the institution and the economic and sectoral context in which it operates, the more qualitative elements in the overall risk management system of the institution must be adequately assessed and processed, especially the way in which the institution determines its strategy, assigns powers and responsibilities, defines, assesses and monitors its risks (whether or not through internal models), supports the activities and processes (including through IT systems), and reports on these subjects. These elements are of vital importance for institutions to be able to (continue to) deliver sustainable performances, in order to ensure a sound and prudent management.

9. The NBB uses an internal reference model: the "Prudential Internal Control Standardized Model" or PRISM, which identifies 5 priority areas of the overall risk management system and displays them in the form of a pentagon:

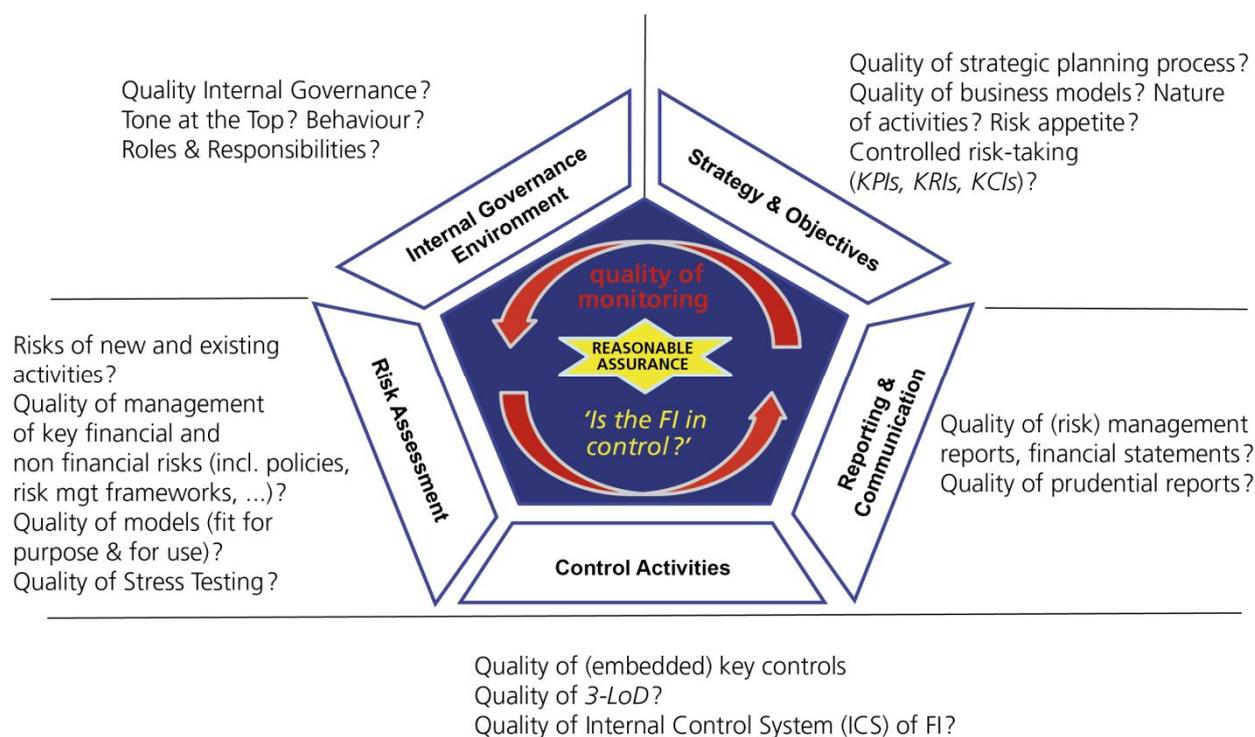


fig. 1 PRISM

- PRISM is based on one simple question, i.e. whether the institution is 'in control'. PRISM is based on COSO and on good practices from a prudential perspective.
- PRISM focuses on five areas (or dimensions) relating to internal control in the broad sense: the setting of a strategy, the quality of the administrative and organizational structure, the quality of the risk management processes (including the correct use of internal models), the efficiency and effectiveness of the implementation of the activities, and the reliability and quality of reporting and communication.
- The quality of the monitoring process is essential for maintaining the adequacy of the overall risk management system.

10. PRISM is a tool for creating the inspection universe, which includes the subject matters inspectors focus on and which must comply with norms/standards/good practices. PRISM also promotes a comprehensive approach to a subject matter, taking into account the objectives of the mission, and supports the issuance of an overall opinion (see paragraph 28).

Categories of inspections

Inspections are either pre-programmed in the inspection plan, or conducted in specific circumstances.

11. Risk driven inspections: the so-called "control missions", which result from an inspection plan and which focus on a specific subject matter (see paragraph 10) for the institution concerned or for various institutions (thematic mission). This plan is drawn up according to a risk-based approach, in which inspections mainly focus on those subject matters where the NBB has evidence of an increased risk¹⁶. Examining files concerning the use of models also falls under this type of inspections.

12. '*Event driven inspections*': the so-called "special investigations", which are conducted in specific circumstances involving specific action (not originally planned), e.g. where irregularities are discovered or are supposed to have occurred¹⁷.

Scope

13. The depth of an inspection is determined during the planning phase of each mission and affects the duration and means of the inspection. The depth is the extent to which audit evidence is collected and the extent to which tests are performed.

14. Except in cases where the NBB acts under Article 36/19 of the Law of 22 February 1998, it may, when exercising supervision of a financial holding company on a consolidated basis or when exercising supplementary supervision of a financial services group or of an insurance or reinsurance group, carry out, within the limits of its competence, inspections on the premises of all companies (regulated or not) included, respectively, in the consolidation or in the supplementary supervision of the group concerned¹⁸
19.

¹⁶ The evidence of an increased risk stems from the other supervisory tools (see fig. 2)

¹⁷ The NBB reserves the right, when circumstances require so, to carry out surprise inspections, i.e. to carry out on - the-spot verifications without having previously informed the institution under supervision.

¹⁸ See the legal references in footnotes 9 to 12 above.

¹⁹ As regards the supervision of insurance companies, Article 21, § 1^{ter}, of the Law of 9 July 1975 also allows the NBB, within the limits of its competence and subject to fulfilment of certain conditions, to extend the scope of its inspections.

3. Inspection process

Life-cycle

15. The NBB has numerous monitoring tools for gathering financial and non-financial information on the institution under supervision, which is processed in standardized risk tables ('scorecards'). The NBB decides on the action plan for the institution, on the basis of the risk assessment exercise. One of the actions may be to conduct an inspection at the premises of the institution. Following the inspection, the NBB draws up an inspection report. This inspection report will enable the NBB to assess whether it should take immediate action, and to adjust the overall risk profile of the institution during the periodic risk assessment.

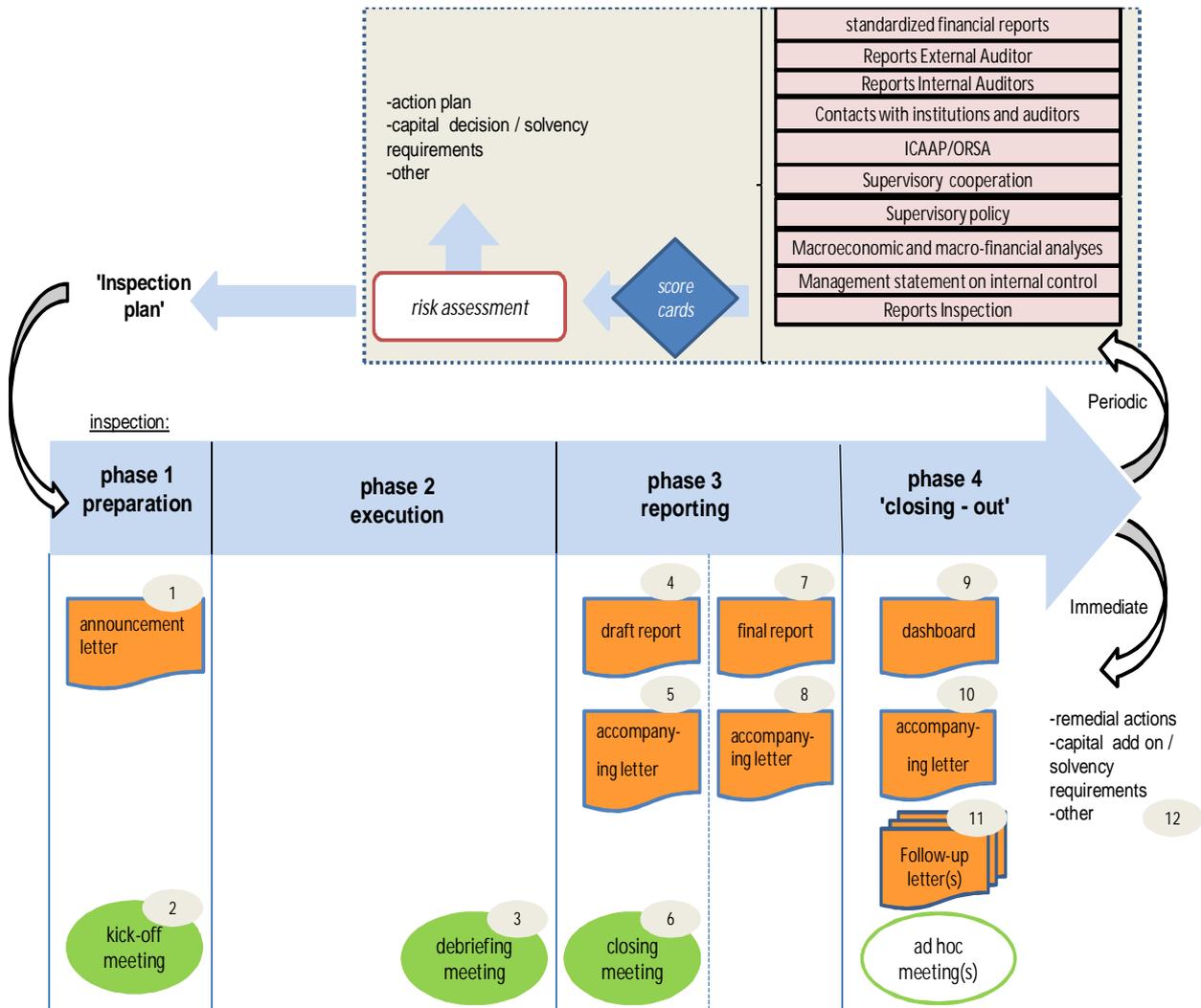


fig.2 Life-cycle

Standard process

16. The NBB has written a procedure manual describing how inspections must be organized. The procedure manual describes the minimum steps the inspectors are expected to take, without jeopardizing the critical attitude and flexibility required for carrying out a mission. Thus, a standardized implementation process has been developed that serves as good practice for inspections.

17. The inspection process typically consists of four successive phases: preparation, execution, reporting and closing-out:

Phase 1: preparation

1

Preparation of an announcement letter

18. Each inspection must be formally notified to the institution (chairman of the board of directors and chairman of the audit committee, if there is one²⁰) by means of an announcement letter. The announcement letter contains the subject matter and objectives of the inspection, the names of the inspectors charged with the mission, the examination period and the confirmation of the agreed date for the kick-off meeting (see paragraph 22).

19. The accredited auditor and the head of the internal audit department of the institution receive a copy of the letter.

20. Inspectors have various tools to prepare and carry out their missions. At the start of the mission, the inspectors take note of all the relevant information contained in the file that is kept by the NBB.

21. During the preparatory phase, the inspectors contact the accredited auditor and the head of the internal audit department of the institution in order to consult and exchange information.

2

Kick-off meeting

22. All inspections start with a kick-off meeting. This formal entrance conference is the first face-to-face contact between the inspectors and the senior management of the institution within the framework of the mission. The main purposes of the kick-off meeting are the following :

- introduce the inspectors,
- present the subject matter, scope and objectives of the inspection,
- present the different phases and the target dates of the inspection,
- identify key contacts and desired communication channels (within the NBB as well as within the institution),
- agree on information sharing and organizing interviews.

Phase 2: execution or fieldwork

23. During the implementation phase of the mission, during which the fieldwork is being conducted, inspectors perform the necessary checks in order to gather the appropriate audit evidence, such as interviews with the management and staff of the institution, analyzing relevant documents and reports, conformity assessment (walkthrough), review of internal control measures (tests of control), substantive tests (micro controls and analytic procedures) and taking and assessing samples (whether or not statistically drawn).

²⁰ If no audit committee exists, the letter may be sent to the chairman of the board of directors.

Debriefing meeting

24. The fieldwork is followed by a debriefing meeting between the inspectors and the executive management of the institution, which is responsible for the subject matter examined, in order to discuss the findings²¹. The purpose of this meeting is:

- to give the inspectors and the institution the opportunity to identify any missing elements or misinterpretations in findings or observations.
- to give the inspectors the opportunity to explain the remaining steps of the inspection process.

25. The purpose of the debriefing meeting is not to discuss recommendations or an overall opinion. This is done at the closing meeting (see paragraph 31). The discussion is based on the debriefing note which has been drawn up by the inspectors at the end of the fieldwork. This note is not made available at the debriefing meeting, but it is presented orally.

26. Any critical items are discussed separately with the accredited auditor.

Phase 3: reporting

The draft report

27. After every inspection, a report is drawn up by the inspectors. This inspection report includes a summary (executive summary), the general context and the nature of the research activities (depth), the overall opinion and the assigned rating, the findings of the mission and the resulting recommendations, and the assigned rating (medium, high, critical).

28. The inspector forms an opinion ("audit opinion") on the subject matter examined, based on the following assessment scale:

Rating	Opinion	Description
1	Good to very good	the impact of the identified shortcomings exposes the subject matter examined to a minimal level of (aggregated) risk
2	Needs minor improvement	the impact of the identified shortcomings exposes the subject matter examined to a limited level of (aggregated) risk
3	Needs significant improvement/overall weak	the impact of the identified shortcomings exposes the subject matter examined to a serious level of (aggregated) risk
4	Substantial non-compliance/overall unsatisfactory	the impact of the identified shortcomings exposes the subject matter examined to an unacceptable level of (aggregated) risk

This opinion concerns the situation identified during the inspection. The opinion does not take account of possible positive effects of the actions planned by the institution that cannot be fully guaranteed at the date of the inspection report.

29. Recommendations are specific advices/action points in the inspection report which are designed to address the causes of significant deficiencies. Recommendations receive a medium, high, critical rating, depending on the impact of the findings. This rating is a measure of the vulnerability (or risk exposure) of the institution and is based on the quantitative and qualitative effects of the identified shortcomings.

²¹ The senior management and representatives of the internal audit department may, on their own initiative or according to the procedures applicable within the institution, attend the debriefing meeting.

Letter accompanying the draft inspection report

30. The purpose of this letter is to send the draft inspection report to the institution with a view to organizing the closing meeting with the senior management of the institution. The project report must be sent to the institution at least one week before the agreed date of the closing meeting.

Closing meeting

31. The closing meeting is an exit conference between the NBB and the senior management of the institution. At this meeting, the findings of the mission are presented to the senior management. A specific focus will be given to the criticality of the recommendations and the rating of the overall opinion resulting from the mission. During this meeting, the NBB takes note of the views and comments of the institution.²².

The final NBB inspection report

32. The inspectors finalize the report. The final inspection report includes the comments of the senior management of the institution on the draft report.

Letter accompanying the final NBB inspection report

33. The purpose of this letter is to send the final NBB inspection report to the institution (chairman of the board of directors and chairman of the audit committee, if there is one) and to ask the institution to send an action plan to the NBB within a set time limit (as mentioned in its letter). This action plan must be adapted to the criticality of the recommendations and must contain:

- the measures the institution intends to take in order to implement the recommendations of the inspection report,
- the person responsible within the institution for monitoring the implementation process, and
- the calendar.

34. The letter is signed by a member of the board of directors of the NBB.

35. The accredited auditor and the head of the internal audit department of the institution concerned receive a copy of the letter and of the final report.

Phase 4: closing-out (of the recommendations)**Closing-out dashboard**

36. The NBB assesses the contents of the action plan of the institution in the form of a closing-out dashboard, and establishes a closing-out calendar. The NBB will intervene according to this closing-out calendar in order to assess based on sufficient audit evidence whether or not open recommendations may be closed.

²² In the interest of clarity and according to the nature of its comments, the institution will assess whether it is appropriate to address them in writing to the NBB.

Letter accompanying the closing-out dashboard

37. The NBB informs the institution of the planned actions based on the closing-out dashboard, referred to in its letter. The NBB relies in this respect on the institution's reporting on progress in the status of the recommendations and on the results of its follow-up assessment (see paragraph 36). The NBB expects such progress reports to be followed up by the head of the internal audit department and systematically discussed in the institution's Audit Committee, if there is one.

Follow-up letters

38. The NBB informs the institution of the status of the recommendations by means of follow-up letters, and, if necessary, during ad hoc meetings.

39. The accredited auditor and the head of the internal audit department receive a copy of the follow-up letters.

NBB actions

40. If necessary, the NBB takes such measures as it deems appropriate in accordance with the powers available to it under the regulations applicable to the case.

4. Expectations regarding inspections

Inspections can only be conducted properly if both the institutions under supervision and the NBB meet the expectations set out below.

Ensuring logistical support

41. The institution under supervision is expected to provide the inspectors, who conduct a large part of the activities at the premises of the institution itself, with adequate logistical support, to ensure that the inspection is conducted properly.

Providing all information and documents

42. The institution under supervision is expected to provide the inspectors with access to all information, to the extent necessary for the performance of their task, in accordance with the applicable legislation²³. The institution is expected to take all measures to ensure an efficient transfer of information. "Efficient" means that the requested documents and files are delivered quickly, having regard to the limitations of the institution and the necessity not to delay the inspection process needlessly. The documents are preferably exchanged in electronic format, unless the inspectors wish it otherwise or unless this is contrary to the general policy on electronic data transfer of the institution. To this end, clear arrangements have to be made during the kick-off meeting. With a view to an efficient supply of information, the institution under supervision is also expected to facilitate contacts with the appropriate persons.

Behaviour of the managers of the institution under supervision and its staff

43. The requests for information made to the managers of the institution and their staff must be answered with careful consideration. This means that the said persons must inform the inspectors about any relevant information²⁴ available to them, even if it is not explicitly requested by the inspectors, at the latest before the start of the debriefing meeting.

The managers of the institution and their staff are expected to take a neutral, courteous and professional attitude in replying to the questions asked to them.

²³ See footnotes 1 to 13 above.

²⁴ This information, if known, can be expected to influence the assessment of the inspectors.

Interviewing all staff members

44. Inspectors must have access to all staff members of the institution to the extent necessary for the performance of their mission. Inspectors may summon any person deemed useful individually and interview this person to obtain information. The institution is expected to take all necessary measures to ensure that the interviews are organized efficiently. The institution is also responsible for the efficient organization of meetings with external consultants or external service providers.

Informing about the activities and the results of inspections

45. The NBB informs the institution about the start of the inspection activities at the kick off meeting, confronts the institution with the findings at the debriefing meeting and discusses the draft report at the closing meeting (see section 3). The head of the internal audit department is always invited to such meetings.

Receiving information about the follow-up actions relating to the inspections

46. The chairman of the board of directors of the institution and the chairman of the audit committee (if there is one) are informed of the follow-up actions taken following an inspection. The accredited auditor and the head of the internal audit department are also informed of these actions.

5. Inspections conducted in the context of the co-operation between authorities

47. The principles and guidelines set out in this document apply to all inspections carried out on behalf of the NBB.

48. Where the NBB entrusts another authority (e.g. in the context of European co-operation) with the responsibility for carrying out an inspection abroad on its behalf, the NBB principles and guidelines must also be followed.

A copy of this circular is sent to the accredited auditor(s) of your institution.

Yours faithfully,

Luc Coene
Governor