

## Bank's supervisory board and risk appetite framework: ECB's expectations

In practice, there are many questions around the composition and governance of a bank's supervisory body and risk appetite framework (RAF). On 21 June 2016, the European Central Bank (ECB) published its expectations on board governance and RAF for banks under the Single Supervisory Mechanism (SSM) ([here](#)).

Although currently most Dutch banks likely meet many of the ECB's expectations, the ECB has a few less common expectations. In this Q&A, we recommend to assess whether your supervisory board and RAF is organised according the ECB's expectations.

### ➤ What is the status of the ECB document?

The '*SSM supervisory statement on governance and risk appetite*' reflects on the results of a thematic review on bank's governance undertaken by the ECB in 2015. This involved an assessment of the management bodies and RAF of all significant institutions (SIs) subject to the ECB's direct supervision. The statement sets out the ECB's expectations regarding a bank's non-executive, supervisory, board (*raad van commissarissen*) and RAF. The ECB concludes that most SIs need to improve their governance and RAFs, in line with the expectations (and has sent SIs individual follow-up letters). The ECB's expectations are relevant for SIs but also for less significant banks.

### ➤ What does the ECB expect regarding a bank's supervisory board?

The ECB has (among other things) the following expectations regarding a bank's supervisory board:

- **Composition:** A bank should compose its supervisory board in a way that facilitates effective and independent challenging and oversight of management.
  - For example, the ECB expects an independent chairman of the supervisory board. The ECB states that all members of the audit committee and at least half of the members of the risk committee should be formally independent.
  - Also, the supervisory board should formalise a succession process. This means that the bank documents how it ensures the adequate transition and continuity of activity of supervisory board members.
- **Open debate:** Banks should have measures in place to allow open and critical debate on the supervisory board.
  - For example, the frequency of meetings of the risk and audit committees should be six - eight times per year for larger SIs and quarterly for other banks. Also, practices to facilitate interaction and reporting among the different committees should be developed in order to reduce information asymmetries among supervisory board members.
  - Also, the supervisory board should prepare clear documentation supporting discussions and maintain appropriate minutes of its deliberations and decisions.



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- **Oversight control functions:** A bank's supervisory board should have adequate access to internal control functions.
  - For example, each SI should have a chief risk officer (**CRO**), who is responsible for monitoring the risk management framework across the entire organisation. Furthermore, the CRO should report to the supervisory board (in a two tier board structure). Also, three lines of defense model is expected. The chief compliance officer and the internal audit function are expected to be independent and to have direct access and direct reporting lines to the supervisory board.

### ➤ What does the ECB expect regarding a bank's RAF?

The ECB has the following expectations regarding a bank's RAF:

- **Design:** Banks should formalise their RAF in order to enable effective implementation.
  - For example, banks should formalise a risk statement tying all risk policies together in one holistic view of the bank's risk appetite.
  - Banks should develop a risk appetite dashboard, which compares the risk exposure and risk limits to the appetite for both financial and non-financial risks.
  - Also, banks should establish risk appetite limits and ensure that a process for regularly monitoring and reviewing those limits is in place.
- **Implementation:** Banks should integrate and embed the RAF more closely into other structural processes.
  - For example, banks should link variable remuneration to some risk factors (such as consequences in the event of non-compliance with key risk indicators) in order to guide behaviour towards risk awareness.
  - Also, the RAF should be established for specific business lines and affiliates as well, in order to ensure that the risk limits align with the institution-wide risk appetite statement.

### ➤ What steps will the ECB and national competent authorities take next?

The findings of the thematic review will be used to identify follow-up supervisory actions for 2016. The ECB will perform deep-dive investigations within individual banks on a sample of SIs on specific governance areas. Each SI's annual SREP will assess the implementation of the measures and action plans institutions have communicated in order to remedy the relevant findings. The ECB will use its expectations in its review of the quality of the bank's supervisory board and RAF.

### ➤ What do you need to do?

We expect that many Dutch banks already meet most of the ECB's expectations. For instance, independence and supervisory board governance have been a DNB focus area in recent years. We do recommend however to assess whether your supervisory board is organised according the expectations of the ECB. A number of the expectations are not commonly observed for Dutch banks. Further we recommend to bring the RAF in line with the expectations of the ECB. Not all expectations need to be followed as strict requirements, but they do indicate the aspects that the supervisory authority may highlight and demand in its day-to-day supervision.

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