

**BANKING AND FINANCIAL SUPERVISION**  
*Supervisory Regulations and Policies Department*

# **GUIDE TO SUPERVISORY ACTIVITIES**

**Circular 269 of 7 May 2008**

## **PART 3**

# **PROCEDURES FOR ON-SITE INSPECTIONS**

## FOREWORD

Part 3 of this Guide deals with on-site controls following an innovative approach compared with that of the previous Guides, which were focused on general criteria. To adequately support assessments, this Guide provides a virtually full range of operational guidelines, consistent with the intermediaries' best practices and aligned with the trends of procedures' convergence developed at international level.

Moreover, the wide range of controls endows users with various tools for orientation and consultation which, even if not binding and/or prescriptive, support homogeneity of methodological approaches and enforcement practices.

The reasons for such a change lie in the dramatic increase of complexity noticed in recent years in banking and financial supervision.

To pursue completeness and accuracy, the Analysis Patterns (APs) included in this Part are based on an analytical approach constantly updated in accordance with scenario evolution and operational experience.

Obviously, the verifications actually carried out are much less than those envisaged in the APs, owing to constraints and external factors (e.g. time and resources available; cooperation by the intermediary under examination; timeliness of supervisory action) which fall outside the inspector's discretion.

Therefore, the inspector must identify – regardless of a formal limitation of his/her mandate and in coherence with the above-mentioned constraints and externalities – the key issues (in terms of amount of intensity of risk – "risk-focused approach") to safeguard the sound and prudent management currently and prospectively.

Such approach should be followed starting from the – inevitably selective – knowledge of information and analysis available off-site, seeking full and synergic interaction between the two sides of prudential supervision.

In detecting the relevant risks, inspectors apply APs following the modularity and proportionality principles and also deciding whether and to what extent the proposed path is to be followed.

In the in-depth analysis of risks, the inspector in charge does not replace – and could not realistically do so – the intermediary's internal controls, which ensure the legitimacy of transactions and behaviors. Rather, the inspector carries out an independent and high-level assessment – typical of auditing – on the overall adequacy of internal controls, stimulating their systematic improvement as a safeguard of sound and prudent management of intermediaries and legally protected interests.

As a final stage of the verifications, each AP sets out evaluation criteria, consistent with those outlined in Part 1 of this Guide and aimed at ensuring coherent behaviors in off- and on-site controls. Such criteria enable proper margins of technical discretion within which the inspector sets a point of balance. When inspectors find organizational and operational schemes that do not fit into the proposed standards, they can opt for a different choice and motivate their decision.

In carrying out the sensitive technical evaluation typical of their task, inspectors combine effectiveness of assessment, minimization of burden for intermediaries and overall efficiency of supervision; the purpose is to carry out all the on-site assessments planned, as a tool of effectiveness.

Therefore, unless unforeseen problems occur, the continuous monitoring of time schedules and the use of consistent methodological approaches take on fundamental importance; in this respect, the verifications envisaged in APs will be carried out with an appropriate level of intensity, based on a careful cost/benefit analysis in terms of increased knowledge.

# **SECTION I**

## **GUIDELINES FOR PERFORMING THE ASSESSMENTS**

---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
	Contents

---

## **CONTENTS**

<b>CHAPTER I PERFORMANCE OF ON-SITE INSPECTIONS: BASIC PRINCIPLES.....</b>	<b>1</b>
I.1. FOREWORD .....	1
I.2. CONSOLIDATED APPROACH; FOCUS ON RISK; PROPORTIONALITY.....	2
I.3. EFFECTIVENESS, EFFICIENCY AND FLEXIBILITY .....	3
I.4. FUNCTIONALITY AND INTEGRATION .....	4
I.5. OBJECTIVITY, TRANSPARENCY AND INTERACTION WITH INTERMEDIARIES .....	4
I.6. RESPONSIBILITY AND CONFIDENTIALITY .....	5
I.7. REDUCING THE ADMINISTRATIVE BURDEN FOR THE INTERMEDIARIES .....	6

---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

## **CHAPTER I**

### **Performance of on-site inspections: basic principles**

#### **I.1. Foreword**

In carrying out supervisory functions, the Bank of Italy can inspect:

- banks (Article 54 of the 1993 Banking Law);
- “authorized entities” pursuant to Article 1, subparagraph r) of the Consolidated Law on Finance, which are authorized to provide services and/or investment activities (including investment firms, asset management companies and SICAVs);
- entities supervised on a consolidated basis, in compliance with Articles 68 of the 1993 Banking Law and 12, paragraph 5 of the Consolidated Law on Finance, or on a supplementary basis pursuant to Article 12 of the Legislative Decree 142 of 30 May 2005;
- intermediaries entered into the General and Special Registers referred to in Articles 106 and 107 of the 1993 Banking Law;
- electronic money institutions (EMIs) (Article 114-*quater* of the 1993 Banking Law).

With respect to the wide range of entities that can be inspected, this Part of the Guide provides ad-hoc Analysis Patterns (APs): these contain cross-cutting orientation criteria concerning typical operational processes and the related risks, normally unaffected by the specificities of individual intermediaries <sup>1</sup>.

The guidelines of APs mainly support the on-site application of the principles and methodologies laid down in Part 1 of this Guide, which are the framework for APs.

In this context, the APs propose analysis schemes which exploit the wide range of information immediately available on site, the opportunity to promptly exchange opinions with corporate officers, as well as the possibility to effectively test the reliability of data provided and statements made.

Accordingly, the contents of Part 3 of this Guide are strictly interconnected with those of Part 1. Part 3 is subdivided into three Sections:

- guidelines to perform on-site inspections;
- administrative profiles;

---

<sup>1</sup> Ad-hoc APs exist for certain categories of intermediaries: Italian branches of foreign banks, EMIs, Intermediaries 106. To enforce the principle of proportionality, a specific AP is designed for small banks.

---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

- methodology and analysis procedures.

In Section I (“guidelines to perform on-site inspections”) the impact that the general standards outlined in Part 1 (i.e. consolidated approach, focus on risks, proportionality) have on inspections is discussed; the distinctive scope of application in on-site activities of some general supervisory principles is also examined .

The tasks envisaged in the different steps of the assessment (i.e. early stage, performance and reporting) are described in Section II (“administrative profiles”), defining the contents of the Inspection Report and its revision process.

The assessment methods, the various types of inspections, the criteria for orientation and evaluation, the sampling techniques, along with the contents of each AP (subdivided according to risk categories and cross-cutting processes) are set out in Section III (“methodology and analysis procedures”).

## **I.2. Consolidated approach; focus on risk; proportionality**

Assessment and supervision of intermediaries are based on a consolidated approach, aimed at understanding the overall risks and safeguards of the supervised entities. Accordingly, the scope of application of the APs primarily includes banking groups and investment firm groups subject to consolidated supervision <sup>2</sup>.

With respect to on-site assessments, such principle is to be followed taking into account the limitations connected to the function. As a matter of fact:

- full-scope assessments do not usually concern groups <sup>3</sup>;
- targeted assessments typically focus on specific sectors of operations.

In such cases, on-site assessments shall be made coherent with the operational and risk policies of the group controlling the intermediary under inspection. Furthermore, they feed into the consolidated SREP with respect to the areas under evaluation.

Focus on risk is another basic principle of assessments and controls upon intermediaries.

It is key in the selection of on-site verifications (see Foreword to this Part of the Guide) that need to be concentrated on a thorough study of the problems might entail significant risks, especially when carrying out full-scope assessments.

---

<sup>2</sup> It is to be noticed that if a group’s subsidiary is considered as “significant”, analysis and control activities are also carried out on an individual basis while, for “non significant” intermediaries, the qualitative assessment of risks does not normally apply.

<sup>3</sup> Assessment of all subsidiaries is, however, possible for small groups.

---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

The risk-focused approach also drives the targeted assessments on business or risk areas common to the many subsidiaries of the same group. In these cases, the scope of the examinations – which may include one or more of the group’s undertakings – shall be limited to those areas relevant for a complete assessment of risks and safeguards.

Proportionality is another key factor of on-site assessments.

This criterion applies firstly to the assessments’ planning, impacting on the schedule of controls according to the macro-category the intermediaries fall into (see Part 1 of this Guide) <sup>4</sup>.

APs are based upon the proportionality principle. Their very structure and the analysis techniques suggested are actually tailored to the intermediaries’ specific size and complexity.

Proportionality also drives the performance of assessments. Indeed, inspectors adjust APs according to operational specializations and problems found, adapting the detail of the analysis to the achievement of the goals in terms of risk/controls assessment and verification of compliance with regulations.

### **I.3. Effectiveness, efficiency and flexibility**

The primary objective of inspections is to evaluate the intermediary and/or specific issues to be examined in compliance with the tasks set out in the Assignment Letter.

This objective should be pursued bearing in mind efficiency requirements, optimizing the interaction between the quality of the product and the duration of assessments.

Compliance with the principle of efficiency is functional to both the timely completion of all the scheduled assessments and the positive outcome of the verifications. As a matter of fact, in order to ensure full effectiveness to any corrective measures to be taken, the problems found and the assessments carried out must be promptly reported to the intermediary concerned and to the Supervision respectively.

Bearing this in mind, at the beginning of the assessment, the Head of the inspection team plans the necessary activities, unless any peculiarity of the assignment prevents this from happening. To this end, after having assigned the individual duties to the team members, he/she periodically monitors compliance with the time schedule and updates it to take account of any necessary additional checks.

For the inspection to be fully effective, the flexibility criterion is particularly relevant: it is meant to confer a margin of technical discretion to the inspector so that he/she can choose, for example, the AP to follow, the

---

<sup>4</sup> This schedule concerns, in particular, the different types of inspection (full-scope, targeted, or follow-up assessments) and their frequency (more or less frequent; regular or not).



---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

appropriate sampling criteria, the documentation to be examined, the corporate officers to contact, etc. in order to better support the inspection's objectives.

## **I.4. Functionality and integration**

On- and off-site assessments contribute to the supervisory review and evaluation process.

They are inspired by functionality, i.e. the collection of information necessary to support the SREP. Functionality relates to:

- the validation role of verifications;
- the ability to supplement the available data by providing a quantitative and qualitative analysis and a close knowledge of the intermediary's operations which could not be gained otherwise;
- the verification of the initiatives undertaken by the intermediaries to implement any corrective measures requested by the Supervision.

The integration of on- and off-site controls substantially supports the achievement of functionality.

As underlined in Part 1 of this Guide, this is connected with methodologies to be used as well as with operational aspects.

As to the former (methodological integration), it is envisaged that the same Analysis Schemes are adopted in both forms of control.

As for the latter (operational integration), different stages of interaction are envisaged (before, during and after the completion of the assessments) aimed at facilitating supervision; in this respect, the collection, in the pre-inspection phase, of all available information is particularly important (see Part 3, Section II).

## **I.5. Objectivity, transparency and interaction with intermediaries**

In compliance with the national and international regulatory framework, objectivity and transparency are reference values in the performance of banking and financial supervision.

Objectivity of inspections is essential to enforce the findings against the intermediaries, to use the assessments within the SREP context, to ensure homogeneity in supervisory actions.

In implementing the principle of objectivity, facts should be distinguished from evaluations.

The significance of facts has to be judged according to the general regulatory framework, the purposes of the assessment, the intermediaries' type of business and to the scenario coming out from the verification.

---

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

With respect to assessments, which are intrinsically subjective, it is essential to minimize the risk of undue differences; such a risk typically materializes in the evaluation of qualitative aspects, especially when these are not yet associated with tangible risk manifestations.

This Guide tends to reduce this risk by setting up standard parameters. However, the situation examined could be different from the one assumed by the parameters. In such situations, the inspector shall adjust the assessment standards to the specific situation, also considering how similar instances are dealt with and resorting to a dialogue within the inspection team and the intermediary examined.

Transparency towards the intermediary and interaction with corporate officers are institutional duties as well as essential opportunities for supervision. These tools actually enable to accurately verify the assumptions made during the assessments and to supplement the information available with new data still to be considered.

Moreover, the dialogue – in the mutual respect of the roles played and without anticipating provisional evaluations – enables intermediaries to better understand the remarks and observations expressed, paving the way for a prompt implementation of corrective measures.

Any inappropriate influence on their entrepreneurial decisions has to be avoided in the interaction with corporate officers. The indication of presumably optimal strategies, managerial decisions or organizational solutions falls outside the scope of banking supervision – which is aimed instead at identifying significant risks and corresponding safeguards.

## **I.6. Responsibility and confidentiality**

The use of objectivity and transparency standards as well as the support of detailed guidebooks cannot replace the traditional – and opportune – margins of discretion typical of inspections.

Discretion is counterbalanced by the corresponding responsibility taken on by inspectors, who are the only persons required to ascertain the findings<sup>5</sup>.

Inspectors are legally qualified as “public officials” and this determines powers and duties with respect to the intermediaries inspected.

Methodology and duration of assessments are also relevant; they have to be prudently considered by the Head of the inspection team.

Finally, the sensitivity of supervision requires a conduct constantly inspired by confidentiality and prudence. Within this framework, inspectors ensure the full compliance with the safe-keeping of the inspection report (see below).

---

<sup>5</sup> According to a well-established judicial practice, the facts described in the inspection report are considered true and only a lawsuit for perjury could prove the contrary.

Part 3	Procedures for on-site inspections
Section I	Guidelines for performing the assessments
Chapter I	Performance of on-site inspections: basic principles

---

## **I.7. Reducing the administrative burden for the intermediaries**

Inspectors have the power to access all the information available at the intermediaries premises, so as to get the documentation needed for the assessments.

The effective functioning of on-site inspections often requires to exert this power intensely, analyzing a considerable amount of data and information and dealing with many corporate officers.

However, on-site assessments shall be carried out avoiding any unnecessary administrative burdens for the intermediaries.

In particular, the actions (e.g. request for documentation, meetings with officers) which entail the lowest burden for the intermediaries – given the requested level of effectiveness – should be preferred.

To minimize the assessments' impact, requests should be carefully pondered, assessing their consistency with the objectives of supervision and balancing expected benefits and related costs, also considering the intermediaries' capacity of response.

To this end, the best possible use of the information available should be pursued, limiting additional verifications to a minimum and exploiting the possibilities of electronic data processing.

## **SECTION II**

# **ADMINISTRATIVE PROFILES OF INSPECTIONS**

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
	Contents

---

## **CONTENTS SECTION II**

<b>CHAPTER I THE PRE-INSPECTION PHASE .....</b>	<b>1</b>
I.1.    INSPECTION PLANNING .....	1
I.2.    DEFINITION OF THE MANDATE .....	1
I.3.    ASSIGNMENT OF THE MANDATE.....	1
I.4.    PRELIMINARY ACTIVITIES.....	2
<b>CHAPTER II ASSESSMENTS MANAGEMENT .....</b>	<b>1</b>
II.1.    EARLY STAGES OF THE INQUIRY .....	1
II.2.    MANAGEMENT METHODOLOGY .....	1
II.3.    COMMUNICATION WITH SUPERVISION DEPARTMENTS AND BRANCHES.....	1
II.4.    TIME REFERENCES .....	2
II.5.    THE INSPECTION TEAM .....	2
II.6.    DUTIES TO BE ACCOMPLISHED AT THE END OF THE ASSESSMENTS .....	3
<b>CHAPTER III THE INSPECTION REPORT .....</b>	<b>1</b>
III.1.    CONTENTS .....	1
<b>CHAPTER IV THE POST-INSPECTION PHASE .....</b>	<b>1</b>
IV.1.    THE REVIEW PHASE .....	1
IV.5.    PRESENTATION OF THE “REMARKS AND OBSERVATIONS” SECTION .....	2

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter I	The pre-inspection phase

---

## **CHAPTER I**

### **The pre-inspection phase**

#### **I.1. Inspection planning**

Inspections of supervised entities are coordinated according to an annual planning described in Part 1 of this Guide.

#### **I.2. Definition of the Mandate**

Once the decision to start an inspection is taken, the designated Head of the inspection team and the Head of the Division responsible for off-site supervision (only in the case of targeted or follow-up assessments) jointly examine and limit the scope of the inspection Mandate and inform the Heads of the Supervision Departments or the Director of the competent Branch so that the subsequent steps can be taken (see Part 1 of this Guide).

#### **I.3. Assignment of the Mandate**

Inspections <sup>1</sup> are carried out by Bank of Italy staff (see par. II.5); legislation envisages the possibility, in certain situations, to mandate other authorities <sup>2</sup>.

Inspections start with a Letter of Assignment which conforms in principle to a standard scheme (see [hypertext Appendix n. 1](#)) and is signed by the Governor or a deputy <sup>3</sup>.

---

<sup>1</sup> As outlined in Part 1 of this Guide, any meetings taking place at the intermediaries' premises between off-site analysts and managers in charge of the operational divisions to focus on specific issues do not qualify as on-site inspections.

<sup>2</sup> See Article 54 and 68 of the 1993 Banking Law, Article 12 of Legislative Decree n. 142 of 2005 and the Memorandum of Understanding between the Bank of Italy and the CONSOB. Furthermore, verifications on Intermediaries 106 can be delegated to the Finance Police.

<sup>3</sup> Pursuant to the Bank of Italy's Statute, inspections at banking and financial intermediaries subject to the off-site supervision of the Bank's Head Office are assigned through a letter signed by the Governor, after consultation of the other members of the Directorate, when the inspector is a senior officer (cf. Article 24 of the Statute); the letter is signed by the Director General, after consultation of the other members of the Directorate, when the inspector is an officer or a coadjutor (cf. Article 25 of the Statute). The obligation to inform in advance the members of the Directorate who do not sign the Letter of Assignment is complied with by the Head of the Supervision Inspectorate through a report sent by means of an encrypted digitally-signed internal e-mail (PKI). On-site assessments at intermediaries supervised by the Bank of Italy's Branches which are carried out according to the inspection plan approved yearly by the Central Manager for the Banking and Financial Supervision Area and the Directorate, are started by a Letter of Assignment signed by the competent Branch Manager (see Part 1 of this Guide).

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter I	The pre-inspection phase

---

Any subsequent modifications to the set-up of the inspection teams are requested through a letter jointly signed by the Head of the Supervision Inspectorate and the Central Manager for Banking and Financial Supervision, in the case of the inspections planned by the Supervision Inspectorate, or by the competent Branch Manager for those scheduled on a de-centralized basis.

Inspections aimed at the authorization of internal risk measurement systems for calculating capital requirements, which have limited and pre-determined duration and are repeated over a period of time, are based on the initial Letter of Assignment; inspection teams are modified following the ordinary procedure laid down above.

#### **I.4. Preliminary activities**

Inspections are preceded by an analysis of the information available to the Supervision units of the Head Office or Branches.

The analysis of all the information available to the Supervision and the exchange of data and assessments between the inspectors and the Department/Branch holding such information is key to focus the inspection on the relevant aspects.

From this data the inspectors in charge draw out elements to steer the verifications, as accurately described in Section III of this Part of the Guide.

## **CHAPTER II**

### **Assessments management**

#### **II.1. Early stages of the inquiry**

The inquiry starts with the presentation of the Letter of Assignment to the legal representative or to the managing director of the intermediary to be inspected or, in case of absence or impediment, to someone acting on their behalf.

*(text omitted)*

#### **II.2. Management methodology**

As a rule, inspections must be carried out at the intermediary's head office and, where necessary, at coexistent branches.

Visits to de-centralized offices, located in other Italian cities, or inspections of subsidiaries within the consolidated scope of the inquiry and located in Italy, must be agreed in advance with the Supervision Inspectorate.

As for inspections of foreign branches and subsidiaries, a specific authorization procedure is envisaged.

In the case of full-scope or targeted assessments involving a group the inspection starts, apart from well-motivated exceptions, at the head office of the parent undertaking. Moreover, in such cases the parent undertaking's corporate officers are normally the inspectors' counterparts, while the corporate bodies are the primary recipient of the "Remarks and Observations" part of the Report.

#### **II.3. Communication with Supervision Departments and Branches**

During the inspection, the communication between the inspector in charge and the Supervision Departments or the competent Branch takes place according to the provisions laid down in Part 1 of this Guide.

In particular, whenever situations endangering the stability of the inspected intermediary or requiring an immediate evaluation are noticed, the Supervision Inspectorate or the Branch Director should be timely informed in the most appropriate way.

The Branch having jurisdiction on the territory where the intermediary's registered office is located assists the inspectors in carrying out their duties.



---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter II	Assessments management

---

## **II.4. Time references**

Inspections aim to draw a framework for analysis and evaluation based on up-to-date information, in line with the standards laid down in the "schemes" and "paths" illustrated in Part 1 and 3 of this Guide. To this end, the time references of inspections are usually set according to the following criteria:

- the income capacity is gathered in the relevant AP with reference to the last financial year "closed" <sup>1</sup> at the end of the assessments; the income analysis can be extended, if necessary, to longer periods;
- the capital adequacy is assessed according to (possibly unofficial) data as of the latest prudential reporting deadline before the end of the inspection and the latest ICAAP report sent by the intermediary to the Supervision;
- credit risk is assessed on the basis of the most recent end-of-month data available at the beginning of the inspection, taking account of significant changes that may have occurred during the assessments;
- the checks on the intermediary's accounting refer to the closing date of financial statements for significant adjustments as well as to the most recent end-of-month data available at the beginning of the inspection for the reliability of prudential returns.

## **II.5 The inspection team**

Inspections are normally conferred to at least two people of the Supervision Inspectorate ("inspection team") and the Letter of Assignment identifies the team leader. For inspections decided by the Bank of Italy's Branches, such task is normally assigned to the Branch personnel.

With respect to inspections aimed at the authorization of internal risk measurement systems, the on-site activity <sup>2</sup> is conferred to a specially appointed group, determined by the Head of the Supervision Inspectorate, partly composed by members of the Recognition Group (see Part 2 of this Guide).

---

<sup>1</sup> For the purposes of the inspection's verifications, the financial year is considered "closed" when the assessments closing date is near or subsequent to the 31<sup>st</sup> December and reliable data, even from preliminary statements, is available.

<sup>2</sup> Part 2 of this Guide describes the process of inspections both in the initial stage, which precedes the application for formal authorization (when the Supervision asks the intermediaries interested in 'the authorization for information on the progress made so far on projects and on relevant 'applicative knots') and in the second (more formal) stage when the presence of the necessary requirements is verified by the Supervision. Inspections of the first type have essentially a "survey-style", their aim being the investigation of the state of development of projects and their impact on operations and organisation, to anticipate the necessity of any corrective actions.

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter II	Assessments management

---

Pursuant to Article 5, paragraph 5 of the Bank of Italy's Personnel Regulations, "inspection duties are carried out regardless of any hierarchical order".

The Head of the group is accountable for the Inspection Report and is its sole signatory. It is his/her duty:

- to set the most suitable management strategy to achieve the goals of the assessment;
- to guide and coordinate the members of the inspection group;
- to optimize the trade-off between the assessments' duration and the quality of results.

The Head of the group must take care of keeping his/her deputy <sup>3</sup> constantly informed of the inspection progress to ensure the indispensable operational continuity in case of his/her absence or impediment.

He/she assigns the tasks to be carried out among the team members according to principles of effectiveness and efficiency, with the aim of assuring the proper completion of the assigned activities; also to this end, the Head of the group encourages an appropriate circulation of information.

## **II.6 Duties to be accomplished at the end of the assessments**

With regard to inspections planned by the Head Office of the Bank of Italy, the Head of the group must inform the Head of the Supervision Inspectorate of the expected closing date as well as (by e-mail) of the actual conclusion of the inspection.

Similarly, with regard to inspections planned by the Branches, the Head of the group must report the expected closing date as well as the actual conclusion of the inspection to the Head of the competent Bank of Italy's Branch, who takes care of the consequent communications to the Supervision Inspectorate.

---

<sup>3</sup> The Deputy Head of the team, if not indicated in the Letter of Assignment, is the employee highest in rank (exclusively among the members of the team who belong to the Supervision Inspectorate if the inspection is commanded by such Department).

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter III	The Inspection Report

---

## CHAPTER III

### The Inspection Report

#### III.1. Contents

##### III.1.1 Editorial standards

**(text omitted)**

Three standard Inspection Reports are envisaged, corresponding to the types of inspection (“full-scope”, “follow-up”, “targeted/thematic”), applicable to all intermediaries subject to prudential supervision.

With respect to “follow-up” and “targeted/thematic” inspections the attached standard reports should be adapted to the inspections' features through the analogical application, wherever possible, of the guidelines provided for “full-scope” inspections.

For Intermediaries 106, which are subject to peculiar supervisory regulations, an ad-hoc pattern <sup>1</sup> is provided (see Annex n. III/1 d) and hypertext Appendix n. 5).

In the case of assessments aimed at the authorization of internal risk measurement systems, usually the Report does not include – given its peculiar nature – any remarks directed to the corporate officers and its layout is free, tailored to the specific needs of reporting the problems emerged to the Supervision <sup>2</sup>.

Although a standard Report size is not envisaged, it is strongly recommended to limit its extent as much as possible – for brevity's sake – whilst taking into account the intermediary's significance and the issues being dealt with.

In certain cases and/or for some intermediaries the aggregation of different paragraphs might be advisable (e.g. “Strategic risk and Governance”).

---

<sup>1</sup> For this kind of intermediaries, the “Remarks and Observations” section of the Report consists exclusively of remarks identifying anomalies which might determine the cancellation of the intermediary from the General Register (lack of requirements or serious violations of law) or relevant for an administrative evaluation of sanctions. Furthermore, the confidential Section includes simplified information consistently with the limited scope of the assessments. In particular, the evaluation given in the “Summary remarks” should be articulated into three levels only: good, broadly satisfactory and weak; the first represents full compliance with regulatory requirements; the “weak” evaluation implies serious violations of law.

<sup>2</sup> Purely as an indication, the Report, initialled and signed by the Head of the team, should consist of a summary (drafted by the officer in charge of the inspection and explaining the methodological choices, the main profiles examined, the key problems emerged and the suggested actions) as well as of monographic studies (prepared by the team specialists, which should normally deal with statistical-quantitative aspects, organization and IT systems).

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter III	The Inspection Report

---

Irrelevant chapters/paragraphs or those for which there are no further remarks in addition to what is already known to the Supervision should not be drafted.

### **III.1.2. Remarks and Observations**

Typically, the Report is divided into “Remarks and Observations” and “Confidential Information”.

The “Remarks and Observations” section is addressed to the corporate bodies and aims to report the inspection’s overall results and the specific problems found, possibly supplemented by a brief outline of the strengths and/or of the external factors in which the weaknesses of the whole intermediary or of its specific area under examination are rooted; it also refers to the subsequent sections of the Report for a more detailed discussion of the specific problems found.

For a better understanding of the reference framework, at the beginning of the “Remarks and Observations” section the inspector in charge anticipates the outcome of the assessments, briefly and according to standard drafting rules.

The difference between “remarks” and “observations” permits to properly calibrate the Report contents.

In particular, the “remarks” focus upon lack of compliance with regulations, or malfunctioning and deficiencies which need to be corrected and/or removed promptly as they are risks affecting the intermediaries’ sound and prudent management. The “observations” concern management profiles susceptible of negative developments or needing improvement, to prevent the weakening of the sound and prudent management conditions.

Although conceptually distinct, remarks and observations may coexist within the same reference point, whenever appropriate for the attainment of efficient communication.

The “Remarks and Observations” section is divided into two sub-sections, concerning respectively:

- corporate governance and risk control processes susceptible of improvement or corrective actions (“Governance profiles”);
- possible lack of compliance with law/regulations which might be worthy of sanctions (“Compliance profiles”).

Whenever necessary, documents or analyses may be annexed to the “Remarks and Observations” section to better substantiate the problems found. Standard schemes are also envisaged to highlight remarkable deviations from prudential returns.

***(text omitted)***

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter IV	The post-inspection phase

---

## **CHAPTER IV**

### **The post-inspection phase**

#### **IV.1. The review phase**

Normally, by the end of the assessments, the inspector in charge draws up a draft Inspection Report which is subsequently forwarded to the Supervision Inspectorate for review. This process also applies in case of verifications carried out under de-centralized plans.

Within the Supervision Inspectorate, the review is carried out by the Division for Administrative Management of Inspection Reports (AMIR) which supplies technical and secretarial assistance and ensures a common administrative conduct. With regard to this activity, the Head of the Supervision Inspectorate may delegate specific coordination and oversight tasks to Inspectorate's experienced senior managers. The review is carried out by one or more inspectors <sup>1</sup> appointed by the Head of the Supervision Inspectorate or by the above-mentioned delegated manager.

In coordination with the inspector in charge of the assessment (who may be helped by the other members of the Inspection Team, when necessary) and without prejudice to his/her specific prerogatives, the mandate is performed reading the draft report to provide, for co-operation purposes, a critical evaluation of any issues concerning:

- clarity and relevance of the aspects to be discussed with the intermediary's corporate bodies;
- completeness of the evaluations and of the information contained in the two sections of the Report;
- compliance with the common editing standards;
- completeness of the "Summary of the inspection results" which will be subsequently submitted to the Governor (see hypertext Appendices nr. 4 and 6);
- the fulfillment of other administrative duties (statistics, etc.).

In the case of inspections carried out by Branches of the Bank of Italy, reviews fall within the broader context of assistance and consultancy provided by the Supervision Inspectorate during the examination carried out by Branch staff. In such a case these duties are usually performed by

---

<sup>1</sup> Officials working in a Division of the Supervision Inspectorate may also participate in the review. As the verifications aimed at the authorization of internal risk measurement systems are strictly functional to the issue of administrative decisions, the review usually follows a hierarchical process and is entrusted to the Head of the Supervision Inspectorate who, in turn, may delegate these duties to one or more members of the department.

---

Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter IV	The post-inspection phase

---

the Inspectorate-Branches Coordination Unit, led by a manager delegated by the Head of the Supervision Inspectorate. A Unit – the Cooperation and Support to De-centralized Inspections Unit, set up for this purpose within the AMIR Division – deals with the administrative and technical aspects, ensures the communication with the Branches and takes care of relations with the coordinators, providing them with any support needed in the performance of their duties.

***(text omitted)***

## **IV.5 Presentation of the “Remarks and Observations” Section**

### **IV.5.1. General procedure**

The presentation of the Report’s “Remarks and Observations” Section, including its annexes, by the inspector in charge of the assessments (or, whenever he/she is unable to do so, by the deputy) occurs during a meeting – specifically convened, usually at the premises of the examined intermediary – of the supervisory and management bodies, in the presence of the members of the control body (or the members of other bodies in any way charged with control duties), as well as the managing director <sup>2</sup>.

The Head – or a delegate – of the Bank of Italy’s Branch in whose territory the intermediary has its registered office attends the meeting.

In the case of inspections of intermediaries subject to centralized supervision, the meeting can also be attended by the Central Manager for Banking and Financial Supervision and the Head of the competent Supervision Department, who has the power to delegate an official ranking at least on a par with that of the Head (or his/her alternate) of the Division responsible for off-site supervision on the intermediary concerned.

Regardless of the number of participants, the Report is validly presented if the session is attended by both the legal representative of the inspected entity and a member of the control body. Should either of them be absent, the official in charge will contact the Supervision Inspectorate for instructions.

During the meeting, the inspector in charge explains the remarks and clarifies, if necessary, any controversial issue.

At the end of the presentation, the inspector, the legal representative, the chairman of the control body and the managing director (or the CEO) of the

---

<sup>2</sup> For institutions adopting the two-tier model and whose bylaws distribute the supervisory and the management functions between the management and the supervisory boards, the presentation is made to the management board integrated at least by the chairman of the supervisory board or the chairman of the internal control committee, if existing, whenever the articulation of the bodies does not facilitate a joint session. When the functions of direction and management are concentrated in one person (for example, in the case of the general managers of branches of foreign banks) the report should be presented to this person.



Part 3	Procedures for on-site inspections
Section II	Administrative profiles of inspections
Chapter IV	The post-inspection phase

---

intermediary initial all the pages and annexes of the "Remarks and observations" Section in three copies and sign the delivery record where the participants' names are clearly indicated. The last page of the document is available to record any points the corporate officers wish to make immediately, in writing, about the inspection's observations.

Upon signing, the corporate officers acknowledge receipt of the document and pledge to submit it to the supervisory, management and control boards at a forthcoming meeting whose minutes will be sent to the competent offices of the Bank of Italy.

Should one of the participants refuse to sign the document, the inspector will record his/her name on the last page and specify any reasons given for refusal.

***(text omitted)***

#### **IV.5.2. Presentation of the assessments concerning Intermediaries 106**

The "Remarks and Observations" Section of the Report and its Annexes are sent by the competent Division of the Supervision on Special Intermediaries (SSI) Department to the inspected intermediary within 90 days of the end of the inspection, following the usual procedures for sending confidential documents.

Any notification of irregularities subject to sanction and other actions is made through the Branches' network.

If the verifications have not found irregularities serious enough to imply that the "Remarks and Observations" Section of the Inspection Report be drafted, the conclusion of the inspection is communicated by the above-mentioned SSI Division by means of a standard letter (see hypertext Appendix nr. 7).

# **SECTION III**

## **METHODOLOGY AND ANALYSIS PATTERNS**



## **SECTION III/I**

# **METHODOLOGY AND ANALYSIS PATTERNS: general features**

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general features
	Contents

---

## **INDICE SECTION III/I**

<b>CHAPTER I TYPES OF INSPECTION AND ANALYSIS PATTERNS.....</b>	<b>1</b>
I.1.    FOREWORD .....	1
I.2.    TYPES OF INSPECTIONS .....	1
I.3.    THE ASSESSMENT OF RISK AND CROSS-CUTTING PROFILES BY PROCESS: THE ANALYSIS PATTERNS (APs) .....	3
I.4.    “NAVIGATION TIPS” .....	5
<b>CHAPTER II PRELIMINARY ASSESSMENT OF THE INTERMEDIARY AND ORIENTATION OF VERIFICATIONS .....</b>	<b>1</b>
II.1.    FOREWORD .....	1
II.2.    THE INTERMEDIARY'S PRELIMINARY ASSESSMENT .....	2
II.3.    ORIENTATING OF ASSESSMENTS .....	3
II.5.    PLANNING THE INSPECTION .....	10
<b>CHAPTER III JUDGMENTAL AND STATISTICAL SAMPLING .....</b>	<b>1</b>
III.1.    FOREWORD .....	1
III.2.    THE JUDGMENTAL SAMPLING .....	1
III.3.    STATISTICAL SAMPLING .....	2
<b>CHAPTER IV THE EVALUATION METHODOLOGY.....</b>	<b>1</b>
IV.1.    FOREWORD .....	1
IV.2.    QUANTITATIVE EVALUATION .....	1
IV.3.    QUALITATIVE EVALUATION.....	2
IV.4.    INTEGRATING QUALITATIVE AND QUANTITATIVE EVALUATIONS .....	2

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general outline
Chapter I	Types of inspection and Analysis Patterns

---

# CHAPTER I

## Types of inspection and Analysis Patterns

### I.1. Foreword

This Section describes the guidelines to be followed when carrying out inspections and is divided in two parts: the first provides general information on inspection methodologies and use of the Analysis Patterns (APs); the second describes the APs in detail, following the risk/cross-cutting areas of Part 1 of this Guide.

The first four chapters (Section III/I), focused on general methodological aspects, describe the different types of inspection, the structural features of the Patterns, the ways to combine them ("Navigation Tips") and the orientation criteria for examinations, statistical sampling and statement of judgments.

### I.2. Types of inspections

Prudential regulations envisages the following types of inspection:

- full-scope;
- targeted/thematic;
- follow-up.

#### I.2.1 **Full-scope inspections**

Full-scope inspections are designed to analyze the intermediary's situation on the whole.

This kind of verification may concern not only a single intermediary, but also a group in its entirety<sup>1</sup>.

In accordance with the principle of focalization, the area of full-scope inspections neither extends to any aspect of corporate operations nor implies all-embracing evaluations; it rather deals only with risks (and cross-cutting profiles) relevant for the pursuance of supervisory objectives.

---

<sup>1</sup> For large conglomerates, an in-depth analysis of each risk/cross-cutting profile – in due time and with the resources normally available – may however prove unfeasible. Rather, an accurate assessment of strategies, governance and macro-organization can be performed on these groups, in due time and with the resources normally available; however, these examinations cannot be regarded as "full-scope" but instead as "targeted".

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general outline
Chapter I	Types of inspection and Analysis Patterns

---

### **I.2.2. Targeted/thematic inspections**

“Targeted” inspections relate to specific activity sectors, risk areas, management profiles or technical aspects (or to their combination) and may concern many intermediaries belonging to the same group.

The activity sectors are usually exposed to many risks whose analysis requires several APs, i.e. the Patterns concerning specific business areas as well as those concerning the risk/cross-cutting relevant profiles.

Risk areas concern sectors (or sector segments) subject to a specific type of risk: strategic, credit, financial and operational/reputational.

The inspections centered on the compliance with sectoral regulations (e.g. disclosure on banking transactions and services; anti-money laundering; usury; C.A.I.) may be included among those concerning risk areas exposed to operational/reputational risks. “Targeted” assessments are also those for the authorization of internal risk measurement systems, described in Part 2 of this Guide (Section III).

When “targeted” inspections concentrate on specific operational or technical profiles, the inspectors assess the applicability of properly adjusted parts of the APs.

A particular kind of targeted inspection is the “thematic” one, which is directed at many intermediaries (or groups) to verify the existence of systemic risks or collect information useful to enhance the supervisory action. The fact-finding purpose of these particular verifications does not rule out their assessment nature; accordingly, if necessary, “Remarks and Observations” can be made to the intermediaries.

### **I.2.3. Follow-up inspections**

Follow-up inspections are intended to control the results of corrective actions taken by the intermediaries or urged by the Bank of Italy.

Like “targeted” assessments, follow-up inspections have a well-defined scope. They result from the detection of faults and/or dysfunctions – autonomously by the intermediaries or, more often, by the Supervision – followed by the adoption of corrective actions whose effects have to be monitored on-site.

In follow-up assessments, the problems that triggered the corrective actions, the removed deficiencies/dysfunctions and those being fixed or still to be dealt with/solved have to be examined in depth; those not yet resolved should be brought to the intermediary's attention in the “Remarks and Observations” Section. Besides, in this context inspectors – while acknowledging the specific issues that have been fixed – shall urge the corporate officers to implement in due time the corrective measures still pending.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general outline
Chapter I	Types of inspection and Analysis Patterns

---

### **I.3. The assessment of risk and cross-cutting profiles by process: the Analysis Patterns (APs)**

#### **I.3.1. Purposes and general features of APs**

Analysis and evaluation of risk and cross-cutting profiles are driven by ad-hoc Patterns, applicable to all kinds of inspection <sup>2</sup>, intended to suggest one or more paths for the in-depth examination of issues relevant to intermediaries by going through their typical processes.

The logic underlying the APs is closely integrated with that of the supervisory review and evaluation process. The Patterns actually enforce the proportionality and focalization principles – whilst taking into account the need for interaction between off- and on-site supervision – and pursue flexibility, objectivity and transparency.

APs hinge on the inspections' specific strengths: direct access to the entire documentation useful for supervisory purposes; immediate contact with the corporate officers having the best knowledge of the problems to be assessed; verification of the actual compliance with regulations; check on the effectiveness of processes and accuracy of returns/statements.

As for the above-mentioned factors, which do not normally occur in off-site monitoring, APs – although appropriate for specific needs of close examination – should always be used with caution for purposes other than inspections.

The Patterns' contents are consistent with those of the Analysis Schemes. The scope of the inquiry and the evaluation criteria are the same, except for the adjustments made necessary by any differences between the actual operations and those envisaged in the Analysis Schemes or made appropriate by the opportunity to assess on site the prospective extent of corporate risks/safeguards. Besides, the examination's insight changes, especially in qualitative terms, to fully exploit the on-site fact-finding potential.

Having said this, the APs:

- aim to incorporate the best practices in use for inspections;
- are a tool, not a goal, for the performance of inspections; they support but do not replace the Inspection Report whose contents, consistently with the findings of the analyses suggested by the Patterns, meet the requirements envisaged in the inspection mandate. Therefore, it is not required to mention the APs used in the Report or to attach them to it;

---

<sup>2</sup> In order to carry out the assessments aimed at authorizing the internal risk measurement systems, inspection teams stick to the guidelines set out in Part 2 (Section III) of this Guide.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general outline
Chapter I	Types of inspection and Analysis Patterns

---

- do not cover all cases and therefore may not include indications useful to study certain issues; it is the duty of the examiners to set the assessments' depth, judging the APs' applicability and diverging from them when needed;
- tend to become obsolete, more or less quickly; inspections ensure their evolutionary maintenance through the inspectors' feedback, preserving their functionality over time.

### **I.3.2. APs' typical contents and structure**

APs are usually subdivided into the following paragraphs:

- "goals and fact-finding needs" aimed at setting goals, contents and scope of application of the assessments;
- "orientation: additional indications", aimed at completing, if necessary, the general guidelines provided in Chapter II of this Section;
- "quantifying the exposure: adjustments" intended to highlight the typical quantitative adjustments to the Analysis Schemes for measurable risks and for profitability and capital;
- "analysis of macro-processes; governance, management and control" (so-called "Profiles Under Analysis" – PUA), aimed at setting the paths for close examination of qualitative aspects;
- "evaluation", aimed at integrating the general criteria outlined in Chapter IV of this Section, by identifying the best/worst market practices the observed scenario is to be compared with.

### **I.3.3. "Question points" and "information sources"**

PUAs also include "question points" which, in the form of a check list, guide the analysis together with the goals and the fact-finding needs on the basis of a sequential flow. The related answers enable to direct the formulation of the "Remarks and Observations", the attribution of a score, the identification of the issues to be pointed out to Supervision.

The analysis path is backed by the non-exhaustive identification of the sources from which all the information needed to properly address the "question points" can be drawn.

### **I.3.4. Annexes and hypertext appendix**

The Patterns include the guidelines strictly necessary to perform the inspection; any operational details need to be included in the annex.

The Report's detailed scheme, the standard Letter of Assignment, further technical information, handbooks on the procedures, regulatory and information material are all included in the "hypertext appendices"

Part 3	Procedures for on-site inspections
Section III/I	Methodology and Analysis Patterns: general outline
Chapter I	Types of inspection and Analysis Patterns

which can be retrieved from the Pattern's text through specific functions.

## I.4. “Navigation Tips”

### I.4.1. Foreword

The Patterns applied by examiners for the performance of inspections are quite complex due to the diversity of operations carried out by intermediaries and their different exposure to many types of risk, along with the different extent and goals of the various types of inspection.

With few exceptions, the Analysis Patterns are not specifically designed for particular classes of intermediaries, but rather in relation to risks, business areas or cross-cutting profiles.

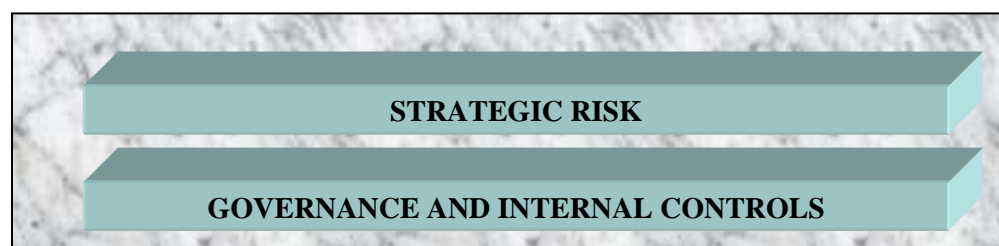
Therefore, in some cases it may be sufficient to apply one single pattern or part of it (e.g. for targeted assessments on particular technical aspects or operational profiles); in other instances, many Patterns are necessary (e.g. for full-scope examinations on multi-sectoral banking groups).

In the following paragraphs standard instructions are given to “navigate” among Patterns, according to different types of inspection and/or intermediary.

### I.4.2 Full-scope assessments on groups with multi-sectoral operations

The APs envisaged for “strategic risk” and “governance and internal controls” can be applied generally to the groups with multi-sectoral operations (see the following table).

Table nr. 1



As for the risk areas, the Patterns to be applied are those concerning the risks included in the “maps” of table 2 (credit risk), 3 (financial risks) and 4 (operational and reputational risks) the intermediaries are subject to.

Table nr. 2

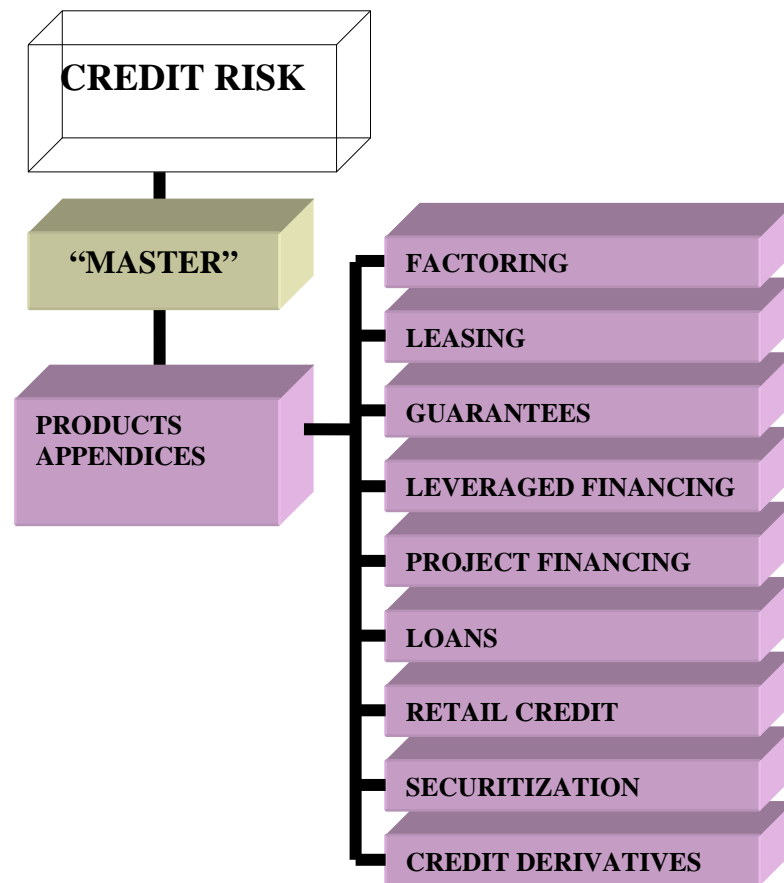


Table nr. 3

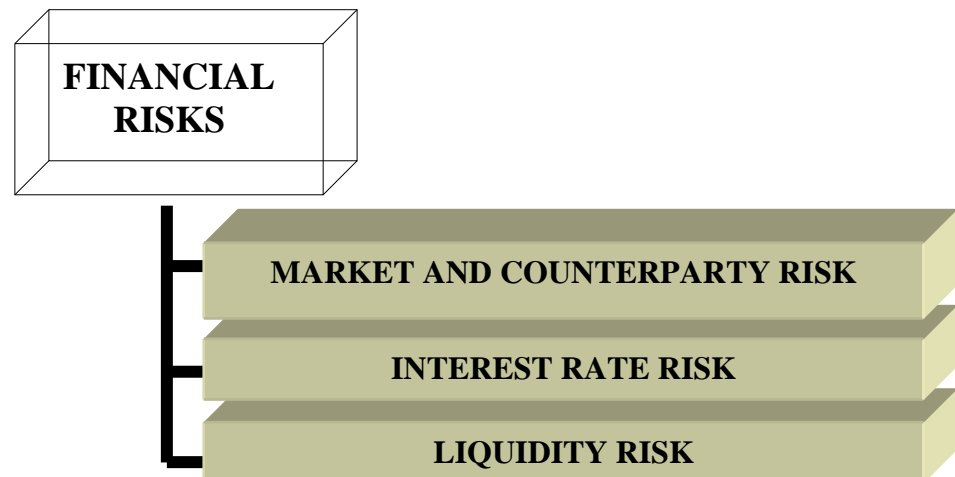
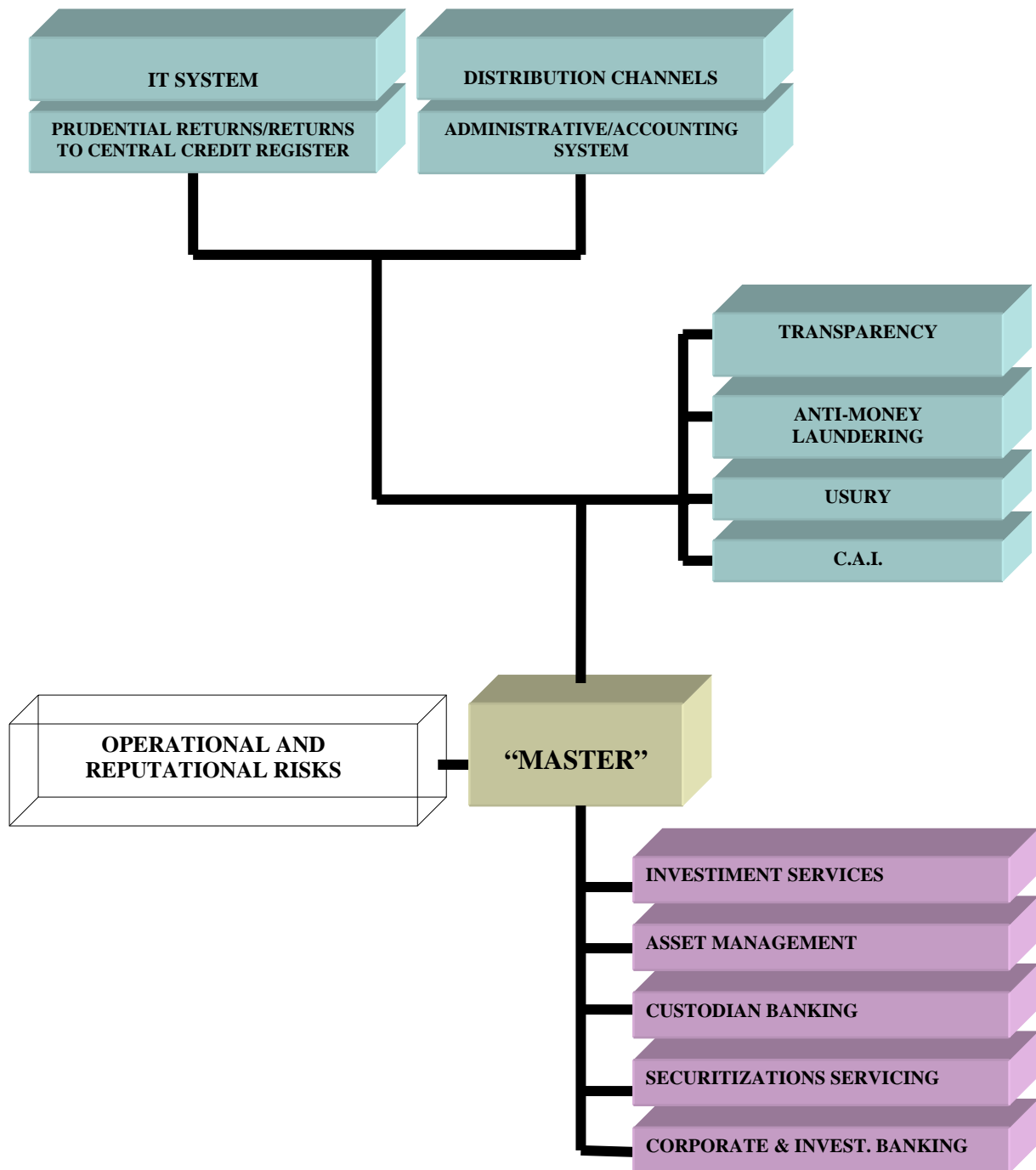




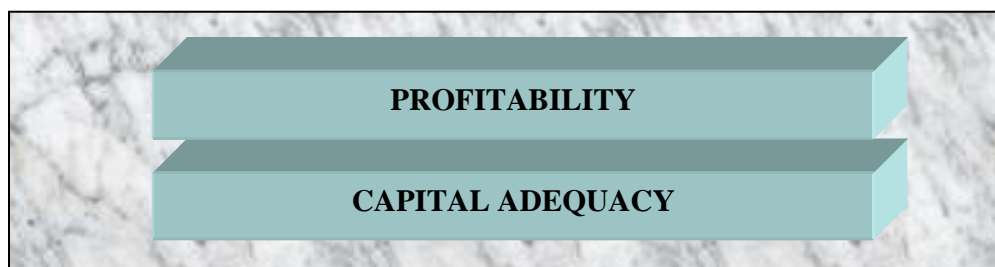
Table nr. 4



Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter I	Types of inspection and Analysis Patterns

The analysis is concluded by the Patterns included within the area of profitability and capital adequacy, which are shown in the following table.

Table nr. 5



Further information on the methodology for the combination of the aforementioned Patterns and the attribution of the related scores is provided below.

#### **I.4.3. Targeted or full-scope inspections on specialized intermediaries**

The following APs are used for full-scope inspections on specialized individual intermediaries or groups:

- governance and internal controls (table 1) and profitability/capital adequacy (table 5);
- those related to cross-cutting processes falling in the operational/reputational risks areas (table 4: information and administrative-accounting systems; prudential reporting; distribution channels; compliance).

APs concerning the intermediary's most significant activities (see tables 2 and 4) or relating to considerable risks related to the activities carried out (see tables 2, 3 and 4) should also be selected on a case-by-case basis.

For targeted assessments, one or more Patterns among those included in tables 2, 3 and 4 apply; it may also be advisable to refer to the contents of the cross-cutting Patterns (see tables 1 and 5).

#### **I.4.4. Inspections of minor banks and entities subject to specific regulation**

Specific paths are designed for inspections of minor banks and entities subject to specific regulation (i.e. branches of foreign banks, e-money institutions, Intermediaries 106). Instructions are given in these patterns on the possible need to apply additional APs.

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

## CHAPTER II

### Preliminary assessment of the intermediary and orientation of verifications

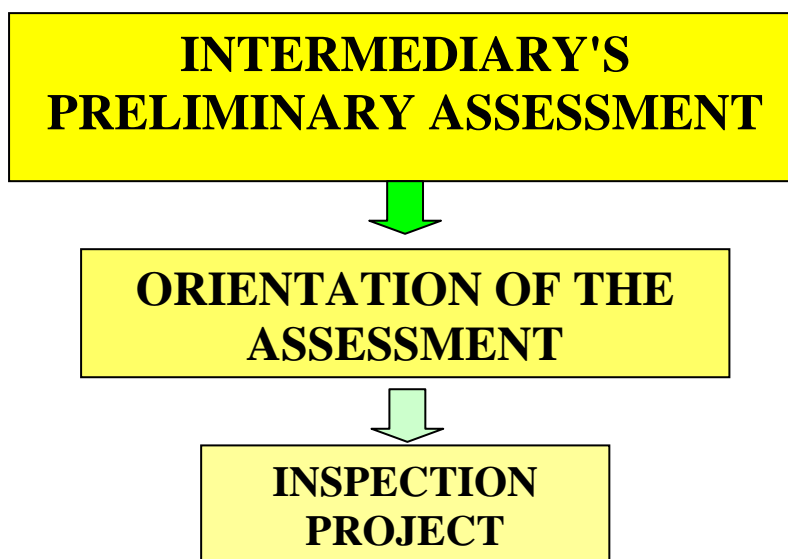
#### II.1. Foreword

The optimization of the time/quality trade-off implies the prior definition of the scope of the assessment and the identification of the orientation and depth of the assessments (“inspection project”).

To this end it is necessary to conduct the intermediary’s preliminary assessment, in order to identify its main features also to better define the scope of the assessment. Once the mandate is decided, the inspector starts the assessment orientation phase, useful to identify the segments to be examined and obtain preliminary indications on the detail of the assessments to be made.

These stages can be described as follows:

Table nr. 6



Usually, the intermediary’s preliminary assessment is carried out mainly off-site, whereas the orientation phase takes place principally on-site. However, if the inspection has to be started urgently or important preliminary information is only available on-site, the above-mentioned steps can be carried out at the intermediaries’ premises.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

These steps anticipate some parts of the APs; however, they have general fact-finding objectives, to be later confirmed during the inspection.

The fact-finding needs of the pre-inspection phase can be met through a dialogue between the inspectors and the competent analysts as well as through a selective and accurate reading of both the documentation available off-site and the relevant disclosures.

**(text omitted)**

## **II.2. The intermediary's preliminary assessment**

This step satisfies the need to gain an initial knowledge of the intermediary/group to be inspected, which is useful regardless of the assessment's objective.

The activities to be performed imply the analysis of:

- the level of complexity;
- the competitive position.

### **II.2.1. Objectives and fact-finding needs**

#### **Level of complexity**

The first stage is aimed at finding out the level of complexity (high-medium-low) of the intermediary, considering three aspects:

- a. size;
- b. complexity;
- c. orientation towards innovation.

As for a), the size of the main financial aggregates (intermediated/traded/managed assets), capital and/or gross income and the main "physical" indicators (e.g. number of employees and financial salesmen) are taken into account.

With respect to b), the following aspects have to be considered:

- corporate structure, looking at the number of parent and subsidiary undertakings and their variety by business area;
- organization (structure of the head office and branch network);
- operational structure, intended as the level of diversification of the product range;
- commercial structure (diversification of the production process – ranging from the production-focused entities to the distribution of own or third parties' products – markets of operation, customers and distribution channels).

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

The c) segment can be gauged from the innovation/sophistication level of the following:

- the contents of products placed, instruments held in portfolios and/or traded (product innovation);
- the production, distribution and organization techniques (process innovation).

### **Competitive positioning**

In the second stage, the intermediary's preliminary assessment satisfies the need to qualify the undertaking to be inspected in terms of competitive positioning (e.g. improving; stable; deteriorating).

The preliminary assessment of such aspect is based on the study of the trend of market shares over the last three years in terms of intermediated/traded assets and/or assets under management or of other distinctive indicators of the intermediaries' typical business. To this end, data provided by the industry associations might prove useful. Should the intermediary be active on one or more regulated markets, the assessments may be supported by information collected from qualified providers.

#### **II.2.2. Information sources**

The following main information sources support the intermediary's preliminary assessment:

- the intermediaries' information file;
- the financial statements for the last two fiscal years;
- the last strategic plan;
- the ICAAP;
- the corporate governance project;
- the bylaws and general internal regulations;
- the organization and functions charts (general and sectoral);
- the data downloaded from the intermediary's website or collected from primary providers and industry associations.

### **II.3. Orientating of assessments**

#### **II.3.1 Objectives and fact-finding needs**

The orientation stage of the assessment is useful to improve the "inspection project", contributing to a better definition, in certain instances, of the inspector's mandate.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

General guidelines are illustrated in this paragraph; they have to be supplemented with those specific of APs. The variety of possible objects of targeted/thematic/follow-up assessments and the remarkable differences among intermediaries do not allow for an extensive standardization of this phase and determine its duration and level of analysis.

However, on the whole the orientation activities imply the examination of the following aspects:

- appetite for/exposure to risk;
- reliability of prudential reporting;
- organization and corporate culture.

### **Appetite for/exposure to risk**

Appetite for risk may be gauged from the intermediary's capital/economic objectives and strategies.

Ambitious profitability targets, emphasis on volumes' growth, signs of strategic discontinuity, decisions to enter new markets (in terms of geographical areas, customers and products) show a high attitude for risk.

On the other hand, a limited risk appetite can be deduced from economic targets in line with those of the past, from a conservative approach in the identification of volumes' growth targets, aimed at preserving the assets quality, and from substantial strategic continuity.

Exposure to risk needs to be determined firstly from the quantitative off-site assessment, which can be found in the intermediary's information file.

Such data is to be supplemented by an initial analysis of the structure and dynamics of credit and financial portfolios and their processes.

Useful elements for this examination can be drawn, off-site, from the intermediary's information file, the procedures implemented by the Planning Division of the Supervision Inspectorate Department (for example the MARC electronic procedure) as well as from any other information from the macro-prudential analysis of the relevance of systemic risks for the intermediary under examination. To achieve a complete information framework requires in any case an accurate integration with the data collected at the intermediaries' premises.

The following factors shall be analyzed in the portfolios examined:

- with regard to credit risk, the trend of non-performing loans, internal rating transition matrices (where available), the policies adopted on value adjustments;
- with regard to financial risks, the type of counterparties, the evolution of synthetic measures of the portfolio risk and of the

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

interest rate risk for the whole balance sheet; the liquidity situation at the beginning of the assessment;

- with regard to operational risk, the whole of the processes exposed to this risk (emerging from ad-hoc “mapping” available, in various forms, at the intermediaries’ premises) and internal evidence of malfunctioning or errors.

In this context, critical points are represented by:

- increasing volumes of non-performing loans (not in line with data recorded on average in peer groups and characterized by sizeable value adjustments;
- the presence of sizeable and continuing devaluation of the instruments held and a high share of illiquid, unrated or non-investment grade securities;
- significant malfunctioning of processes detected by the internal audit, deterioration in the structure of operational losses databases, increase in the synthetic risk measures calculated by AMA intermediaries, high volume of complaints filed by customers, sanctions for violations of sectoral rules, mistakes in the calculation of CIUs values, systematic breaching of operational limits.

Once the relevant documents have been analyzed, the inspectors in charge meet the corporate executives to get information on:

- strategic priorities and their reasons;
- factors causing the evolution of risk in the last two years;
- performance objectives and their feasibility with respect to the competition framework;
- possible discrepancies between set strategies and actual operations.

According to the general information mentioned above, inspectors can identify the level of appetite for/exposure to risk (high; average; low).

### **Reliability of prudential returns**

Reliability in prudential reporting is a specific element of the overall reliability, that is the intermediary’s attitude to correctly represent the key quali-quantitative features and overall implementation of the administrative events.

This condition allows to rule out the possibility that the data submitted to the Supervision might have caused misinterpretations in the evaluation of the intermediaries’ risk profile.

Accounting and extra-accounting measurement processes are therefore the object of the analysis, as they generate prudential

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

reporting and year-end accounting records, together with the administrative activities impacting on the significance of data.

For this purpose, the following different organizational, accounting and risk factors are taken into account:

- the most recent actions by the intermediary's supervisory, management and control boards in terms of general and periodical assessment of operations as well as setting accounting principles and evaluation criteria;
- the reports submitted to the Supervision on the organization and the reconciliation of internal accounting and statistical returns;
- the methodologies to record, classify and monitor credit risk on the largest credit exposures.

Any sizeable inconsistencies possibly resulting from the following activities shall also be assessed:

- from the off-site examination of both the analysis on reporting consistency prepared by the Planning Division of the Supervision Inspectorate and the adjusted bad debts;
- from the on-site evaluation of the statements included in the corporate governance plan, in the ICAAP report and in the processes self-assessment (where available), to be compared with the organization as it appears, inter alia, from the preliminary meetings with corporate officers.

Such verifications should enable the inspectors to draw a preliminary assessment of the supposed reliability of information submitted to the Supervision (full, average, poor).

### **Corporate culture**

The third step of the orientation phase consists in the identification of the organizational model as well as in a preliminary analysis of the corporate culture, formed by the general values and practices underlying the intermediary's conduct.

In the preliminary assessment the inspectors have examined the ownership structure, the group articulation and the organization. For orientation purposes, in close connection with such information, inspectors also assess the following:

- the strategic, management and operational autonomy within the group and from the shareholders;
- the extent and intensity of any forms of outsourcing, especially those concerning core activities;
- the methods for the coordination of the units operating on the markets, those with selling tasks and those providing specialized



---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

services, whilst taking into account the level of portfolio diversification by business area <sup>1</sup>.

The analysis of such aspects aims to appraise the ability to match the granted/achieved management/operational autonomy margins with the effectiveness of controls.

Once they have established the role of the sector/entity inspected within the intermediary/group it belongs to and its position within the production/distribution network, inspectors draw a first mapping of the structure of IT and administrative/accounting systems <sup>2</sup>. Moreover, in connection with the strategies pursued by intermediaries, inspectors study the reorganization projects in progress by identifying the latest significant changes and any M&A operations planned.

On the basis of the information so gathered, the inspectors meet the corporate officers and discuss *inter alia* the following points :

- ways of coordination among different organizational units;
- reasons and potential risks of any outsourcing;
- organizational solutions adopted to balance business development and control of risk;
- reasons for significant changes introduced in policies, internal procedures, staff and controls over the last two years and main projects of organizational innovation;
- general guidelines for the assessment of performance and staff compensation schemes.

To improve the understanding of the organizational model and of the related corporate culture, inspectors also meet the officers performing internal auditing and compliance functions to discuss the coherence between expected and actual behaviors, carefully studying any reports by the monitoring units that highlight specific problems.

The above-mentioned verifications allow the inspector to identify the main features of the organizational model in terms of:

- expected complexity, in terms of intensity of coordination needs, related to the degree of diversification, control and decentralization;
- stability of organization, taking into account the number and pervasiveness of observed changes.

These analyses should also lead to an initial identification of the values underlying the corporate culture. In this respect, the schemes

---

<sup>1</sup> For example, retail/corporate commercial banking, specialized distribution channels, investment banking, asset management, investment services, depository bank, cross-border operations.

<sup>2</sup> In targeted inspections, the mapping focuses on the software supporting the operations under examination.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

described below, aimed at identifying the typical elements of the various forms of corporate culture, may be useful:

A) “value-oriented and control-based”:

- a firm adhesion to sound corporate values (e.g. focus on long-term results, responsiveness to market changes, corporate spirit) and key principles such as recognition of merit, responsibility and skill can be noticed in the documentation and in practice;
- the officers contacted attach a real, consistent and uniform importance to these principles/values;
- the monitoring bodies find a small number of divergences from corporate values;

B) “oriented to formal compliance with rules”:

- the documentation is highly detailed and the observed practice shows a close attention to the simple execution of tasks rather than the attainment of results;
- the officers contacted refer more to compliance with rules than adherence to principles;
- the control functions find a small number of divergences from regulations;

C) “oriented to short-term results and scarcely supportive of control”

- documentation is short and the internal regulation is incomplete;
- the officers contacted emphasize efficiency of processes and growth targets, underestimating the need for consistent safeguards;
- internal controls find a small number of failures and play down their relevance, as they do not intend to hinder the expansion of business;

D) “unfocused”:

- the documentation examined is unsatisfactory in the definition of both expected behaviors and responsibilities; alternatively, the documentation is formally complete, but disregarded in practice;
- the officers contacted express contradictory and/or conflicting views;
- internal controls find many failures and anomalous behaviors, also related to staff unfaithfulness; the failures are not addressed with adequate measures.

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

Briefly, the ideal situation is described under A); C) and D) are the worst scenarios, conducive of significant risks; an intermediate situation is described under B).

With respect to the aforementioned interpretation schemes, it has to be noted that, in practice, all of the above mentioned aspects are rarely observed with reference to one single model; usually elements of one model combine with parts of another, leading to a picture whose “reading”, often difficult, tends to become clearer in the course of the examination. Besides, a well-pondered and accurately documented judgment on corporate culture can only be stated at the end of the inspection; during the preliminary phase, however, initial opinions may be expressed. These might prove useful at a later stage of the inspection, but may be subject to radical modifications during the inspection.

### **II.3.2. Information sources**

Together with the resources listed with reference to the preliminary assessment phase, the orientation phase draws on all or part of the following information sources, to be used more or less broadly taking account of the proportionality principles and the type of inspection to be carried out:

- the budget of the last financial year, with a retrospective analysis of deviations, and the current budget;
- structure of delegations;
- main formal corporate policies (for credit/financial areas, management of clients' assets, compliance and management of human and technical resources);
- recent minutes (last six months) of the supervisory, management and control boards;
- recent minutes (last six months) of any committees on credit, finance, risk, ALM, etc.;
- periodical reports to the supervisory, management and control boards by the risk management, internal auditing and compliance functions and those in charge of planning and/or management control;
- recent evaluations (last two years) by consulting firms on strategies and organization improvement;
- possible budgets for organizational change projects and related final analyses;
- mapping of the main operational processes;
- surveys of the outsourced activities and their suppliers;

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

- inventories of the main risk positions (e.g. the largest 100 borrowers), broken down by customer type, classification and/or rating;
- development of staff over the last three years;
- systems for staff selection, evaluation and incentives;
- evidence drawn from the MARC application.

***(text omitted)***

## **II.5 Planning the inspection**

Once the preliminary assessment and orientation activities are concluded, inspectors have an assessment “matrix” and the related methodological options, broken down as follows:

Table n. 7

P R E L. A S S E S.	LEVEL OF COMPLEXITY	LOW	MEDIUM	HIGH
	COMPETITIVE POSITIONING	IMPROVING	STABLE	DETERIORATING
O R I E N T A T I O N	APPETITE FOR/ EXPOSURE TO RISK	LOW	BALANCED	HIGH
	RELIABILITY OF PRUDENTIAL RETURNS	FULL	AVERAGE	POOR
	CORPORATE CULTURE	A	B	C & D
		↓	↓	↓
METHODO- LOGICAL OPTIONS	APPROACH	TOP-DOWN	MIXED	BOTTOM-UP
	SAMPLE SIZE	LIMITED	AVERAGE	WIDE

On the basis of this first general description, which needs to be continuously tested during the examination, the inspectors decide the focus of the assessment and broadly plan the inspection's activities to allocate the resources to the priority needs (i.e. "inspection project").

In general, whenever the inspectors believe to be in a situation characterized by high risk appetite, poor reliability of prudential returns and an unfocused culture or one oriented to short-term results, the verifications should be analytical and based on an extensive sampling so as to determine the actual level of risk and check that an adequate governance, management and control of risk is ensured.

On the other hand, in case of low appetite for risk, satisfactory reliability of prudential returns and a value- or compliance-oriented culture, the inspection's approach may be mainly top-down – with

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter II	Preliminary assessment of the intermediary and orientation of verifications

---

limited sampling to substantiate the final evaluations of the processes' analysis – to be adjusted on the operational and organizational complexity found.

In short, the inspector in charge, considering the purposes of the “inspection project”, plans on-site assessments by deciding:

- the APs to be used;
- the verifications' priority order;
- the approach (analytical/synthetic; deductive/inductive) to be followed;
- the accuracy of surveys and the most suitable techniques to satisfy the information needs;
- the estimated schedule for the assessments;
- the allocation of tasks among the team's members, considering their co-ordination and information sharing needs, necessary to understand the inter-connections among the various activities and risks.

***(text omitted)***

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter III	Judgmental and statistical sampling

---

## **CHAPTER III**

### **Judgmental and statistical sampling**

#### **III.1. Foreword**

The analysis of governance, management and control macro-processes, and the quantification of risks should be bolstered by verifications of the intermediary's actual activity. To this end, the inspector in charge observes a set of analytical items (sample) whose extent depends on the balance between fact-finding requirements and limitation of inspection time and cost.

The selection of samples to be examined can be made through two different methodologies, not mutually exclusive, chosen on the basis of object, goals and framework of the assessment.

The first option consists in selecting transactions by means of criteria determined by the inspector on the basis of his/her experience and of the guidelines provided in this Chapter and in each AP ("judgmental sampling"). For example, in order to correctly assess the size of deteriorated assets, the positions which – in the inspector's opinion, based on pre-set qualitative and quantitative features – may not have been correctly classified and may have a significant impact on the measurement of the intermediary's riskiness should be identified.

The second methodology is based on statistical sampling which – resorting to statistical techniques – enables to evaluate, to a certain level of probability, the reliability of the operational process to be checked by extending the results obtained through the analysis of a randomly selected sample to the whole area under examination.

In this Chapter, in the Annexes and in each AP there are general indications on "whether and when" to apply techniques of this kind, without prejudice to the identification by inspectors of further situations requiring the application of the same techniques.

#### **III.2. The judgmental sampling**

Inspectors apply this method when interested in the selection of units having pre-set characteristics, deemed significant for specific assessments.

Such approach is to be used when ample information on the population to be examined is available and the analysis' objectives allow for a targeted selection.

This approach might also prove useful whenever information on "typical" or "extreme" elements has to be obtained quickly or when –

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter III	Judgmental and statistical sampling

---

given tight deadlines and scarce resources – it is necessary to analyze very small samples which nonetheless shall include units with specific characteristics.

The ensuing result depends on the opinion of the inspectors conducting the assessment and does not allow to draw conclusions regarding the rest of the population. However, if the available information is correct and accurate, this examination can prove extremely effective with respect to the specific analysis' objectives and, when sufficiently extensive, can lead to well-grounded indications on the scenario assessed.

In Annex III/1, some criteria which can be used in the assessment of financial intermediation can be found, along with the main features of the supporting procedure on credit risk analysis (i.e. "MARC"), which also allows the selection of judgmental samples.<sup>11</sup>

### **III.3. Statistical sampling**

#### **III.3.1 Main features**

This approach, based on the use of probability testing, has the advantage to extend – within a set confidence level – the outcome of polls to the entire population.

In applying this methodology, sampling risk should be taken into account, i.e. the probability that the selected sample may not be representative of the entire population. Furthermore, the upshot is strongly influenced by the choice the inspector made with regard to the parameters feeding the statistical model (expected error, confidence and accuracy levels).

It is therefore advisable to use the results with caution and start a dialogue with the intermediary, to whom the applied methodology should also be explained (see below).

Two methods of statistical sampling are described in Annex III/2: the "simple random" and the "proportional to size" ones. These may be used to assess the overall adequacy of the inspected intermediaries' operational processes; in both methodologies the number of registered exceptions in the sample is compared with the level of anomalies deemed acceptable, in order to assess the operational process under review (the so-called "sampling by acceptance").

The main difference between these two kinds of sampling lies in the probability to include items in the sample: in the "proportional to size" method, it is not the same for each item because the larger the item, the higher the probability of its inclusion. The "proportional to size" sampling is therefore useful whenever the intention is to privilege the

---

<sup>11</sup> About MARC, see also Part 1, Section III, Chapter IV.



Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter III	Judgmental and statistical sampling

---

analysis of large-amount transactions in the operational segment under study.

***(text omitted)***

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter IV	The evaluation methodology

---

## CHAPTER IV

### The evaluation methodology

#### IV.1. Foreword

Consistently with the type of assessment and the objectives of the verification, the evaluation to be made in inspections may cover the following aspects or subjects:

- one or more risk-related areas, cross-cutting processes, compliance issues;
- an intermediary – carrying out a multi-sectoral activity or specialized in a few sectors – considered as a whole;
- one banking or financial group subject to supervision, analyzed on a consolidated basis or through targeted assessments of the parent company and/or one or more subsidiaries.

Whatever the inspection's purpose, evaluation methodologies for off-site supervision and on-site inspections do not differ from one another, as indicated in Part 1 of this Guide.

Since the reasons underlying the adjustments made and the evaluations stated should be indicated in the inspection report, some instructions are provided below to facilitate the actual application of such a principle.

#### IV.2. Quantitative evaluation

In order to assign a score to risk exposure and income and capital adequacy (from 1 to 6 or, only with regard to strategic risk, low/medium/high), inspectors should:

- verify the main items included in the automatic scoring indicators and the supplementary schemes (considered relevant in the off-site scoring) of the relevant Analysis Scheme;
- rectify the wrong data and the unacceptable evaluations made by the intermediary provided that, as a consequence of these adjustments, the quantitative evaluation will substantially change<sup>11</sup>.

---

<sup>11</sup> As an exception to this principle, the differences between corporate and inspective quantitative evaluations of deteriorated assets and related losses modify the relevant schemes (credit risk, profitability, capital adequacy) only if the set materiality thresholds are exceeded (see Section III/III, Chapter I.3.1).

---

Part 3	Procedures for on-site inspections
Section III/I	Methodology and assessment procedures: general outline
Chapter IV	The evaluation methodology

---

If the quantitative evaluation made off-site refers to a date distant from that of the inspection, the inspector updates it provided that significant changes have occurred in the intermediaries' situation since that date. Such an updated version is the object of quantitative assessments based on the same evaluation standards as those mentioned in the relevant Analysis Scheme.

Whenever peculiarities of the inspected intermediary make the Analysis Scheme partly or fully unsuitable to reflect its actual risk profile, the inspectors modify their quantitative evaluation by resorting to corporate internal models (where available), even if these are not recognized by the Supervision. Additional information thus collected by the inspectors is handled, for the purpose of releasing the quantitative assessment, just like the integrative schemes: they therefore allow to correct by one notch the quantitative score given off-site, unless wider modifications, to be properly justified, appear essential.

### **IV.3. Qualitative evaluation**

In order to assign a score (i.e. from 1 to 6 or, only with regard to strategic risk, low/medium/high) to the quality of organizational safeguards, governance and internal control systems, inspectors should:

- consider the outcome of the analyses made and the answers given to the questions envisaged for each of the governance, management and internal control sub-profiles (or for the components of the governance and control systems) in relation to their distance from the theoretically best/worst scenarios outlined in the APs;
- supplement the sub-profile (or component) results by giving them – and their strengths/weaknesses – a weight proportional to their relevance and consistent with the intermediary's features.<sup>2</sup>

### **IV.4. Integrating qualitative and quantitative evaluations**

The profile score (i.e. from 1 to 6) is set by integrating quantitative and qualitative assessments, i.e. by giving to these components – and to their strengths/weaknesses – a weight proportional to their relevance and consistent with the intermediary's features.

**(text omitted)**

---

<sup>2</sup> In the report, the inspector does not have to indicate the scores possibly assigned to governance, management and control sub-profiles or to the components of the governance and control systems. He/she should however explain the logic behind his/her qualitative assessment and highlight the information deemed most relevant.