Federal Financial Supervisory Authority (BaFin)

BaFin Translation -
The present English text is furnished for information purposes only.
The original German text is binding in all respects.-
Please note that the remuneration provisions of the MaRisk cease to apply (especially section AT 7.1 item 4 et seqq.).
Remuneration provisions are now subject of the Circular on
"Supervisory Requirements for Institutions' Remuneration Systems" of 21 December 2009 (Circular 22/2009 (BA)).

Annex 1: Minimum Requirements for Risk Management (*Mindestanforderungen an das Risikomanagement* – MaRisk) – Regulatory text with notations

AT[1] 1 Preliminary remarks

1 This Circular provides a flexible, hands-on framework for risk management at institutions based on section 25a (1) of the German Banking Act (*Kreditwesengesetz* – KWG). It also specifies the requirements of sections 25a (1a) and (2) KWG (Risk Management at Group Level, Outsourcing). Appropriate and effective risk management that takes account of the institution's risk-bearing capacity includes in particular the definition of strategies, as well as the establishment of internal monitoring procedures. The internal monitoring procedures comprise the internal control system and the internal auditing function. In particular, the internal control system comprises - rules regarding the structural and operational arrangements and - processes for identifying, assessing, treating, monitoring and communicating risks. Risk management creates the basis for the supervisory body to perform its supervisory duties properly and thus also includes its appropriate involvement.	**Branches pursuant to section 53 KWG** Given that branches of enterprises domiciled outside Germany pursuant to section 53 KWG do not have a supervisory body, these institutions instead have to involve their company headquarters as appropriate.
2 The Circular also provides a qualitative framework for the implementation of Articles 22 and 123 of Directive 2006/48/EC (Capital Requirements Directive (CRD)). These provisions state that institutions have to set up appropriate 'robust governance arrangements', as well as strategies and processes that ensure adequate internal capital to cover all material risks ("Internal Capital Adequacy Assessment Process"). The Supervisory Authority shall assess the quality of these processes on a regular basis in accordance with Article 124 of the CRD ("Supervisory Review and Evaluation Process") within the framework of the banking supervisory process. As a result, and taking into account the principle of double proportionality, this Circular shall provide a regulatory framework for the qualitative supervisory system in Germany ("Supervisory Review Process"). With regard to the methods for the calculation of regulatory	

[1] The abbreviations referring to the corresponding parts of the modular structure of the MaRisk are adopted in the English text as given in the original text (AT = General Part; BT = Special Part; BTO = Special Part regarding requirements for the structural and operational arrangements; BTR = Special Part referring to the processes for identifying, assessing, treating, monitoring and communicating certain risks).

	own funds in accordance with the CRD, the requirements of this Circular have been formulated in a neutral manner, to the extent that compliance is possible irrespective of the method chosen.	
3	By way of section 33 (1) of the Securities Trading Act (WpHG) in conjunction with section 25a (1) KWG this Circular also implements Art. 13 of Directive 2004/39/EC (Markets in Financial Instruments Directive) provided it is likewise applicable to credit institutions and financial services institutions. This regards the general organisational requirements pursuant to Art. 5, as well as the risk management and the internal auditing function requirements pursuant to Art. 7 and 8, the requirements relative to the responsibility of senior management pursuant to Art. 9 and to outsourcings pursuant to Art. 13 and 14 of Directive 2006/73/EC (MiFID Implementing Directive). These requirements serve to achieve the objective of the Markets in Financial Instruments Directive, namely to harmonise the financial markets in the European Union in the interests of cross-border financial services and to converge investor-protection standards.	
4	This Circular gives due consideration to the diversity of institutional structures and business activities. It contains several opening clauses which enable simplified implementation depending on the size of the institution, its core business activities and its risk profile. In particular, this permits flexible implementation for smaller institutions. This Circular is open to the ongoing development of risk management processes and procedures, provided that such development does comply with the objectives of the Circular. In this context, the Supervisory Authority will maintain an ongoing dialogue with the industry.	
5	The Supervisory Authority expects audits to be in line with the flexible overall structure of the Circular. As a result, audits have to be performed based on a risk-oriented approach.	
6	The Circular has a modular structure so that any necessary adaptations to individual regulatory sections can be confined to the immediate overhaul of individual modules. A general part (AT module) provides basic principles for risk management. Specific requirements with regard to the organisation of the lending and trading business are set forth in a special part (BT module). Taking due account of risk concentrations, this	

module also lists requirements for the identification, assessment, management, monitoring and communication of counterparty risks, market price risks, liquidity risks and operational risks. This BT module also provides a framework for the internal auditing function of institutions.	

AT 2 Scope of application

1 The institutions' compliance with this Circular's requirements is intended to contribute to the elimination of deficiencies in the banking and financial services industries which may jeopardise the security of the assets entrusted to the institutions or impair the proper conduct of banking transactions or financial services, or which may create substantial disadvantages for the economy as a whole. When performing securities services and ancillary securities services the institutions must also comply with the requirements subject to the proviso that they protect the interests of the securities service customer.	

AT 2.1 Affected institutions

1 The requirements of this Circular are to be observed by all institutions within the meaning of sections 1 (1b) or 53 (1) KWG. They also apply to the foreign branches of German institutions. They do not apply to branches of companies domiciled in another state of the European Economic Area pursuant to section 53b KWG. The requirements of the AT 4.5 module of this Circular are to be applied at group level by the superordinated enterprise or the superordinated financial conglomerate enterprise of a group of institutions, a financial holding group or a financial conglomerate.	
2 Financial services institutions and securities trading banks have to	

comply with the requirements of the Circular to the extent that this appears necessary, based on the size of the institution and the nature, scale, complexity and risk content of its business activities, in order to ensure compliance with the statutory obligations in accordance with section 25a KWG. This applies in particular to the AT 3, AT 5, AT 7 and AT 9 modules.	

AT 2.2 Risks

The requirements set forth in this Circular relate to the management of material risks of the institution. In order to assess whether or not a risk is to be deemed material, management has to obtain an overview of the institution's risks at regular intervals and on an event-driven basis (overall risk profile). The risks are to be identified at the level of the institution as a whole regardless of in which organisational unit the risks were caused. In principle, at least the following risks are to be deemed material: a) counterparty risks (including country risks), b) market price risks, c) liquidity risks and d) operational risks. Risk concentrations associated with material risks must be taken into account. In addition, risks resulting from off-balance sheet company structures (e. g. risks associated with special-purpose vehicles exempt from consolidation) must be taken into account. Appropriate arrangements are to be implemented for risks that are considered immaterial.	**Treatment of other risks** Depending on the institution's concrete overall risk profile, other risks such as, for example, reputational risks or placement risks (the risk that an institution cannot place certain parts of an issue in the market in the case of securitisation transactions) may also have to be classified as material.

AT 2.3 Transactions

1	In general, lending transactions within the meaning of this Circular include all transactions in accordance with section 19 (1) KWG (balance sheet assets and off-balance-sheet transactions entailing a counterparty risk).	**Lending transactions** Classification as a lending transaction applies regardless of whether the material positions are supposed to be securitised or not.
2	Lending decisions within the meaning of this Circular include all decisions on new loans, loan increases, participating interests, the exceeding of limits, the determination of borrower-related limits, as well as counterparty and issuer limits, prolongations and changes to risk-relevant circumstances on which the lending decision was based (e.g. security, loan purpose). The issue as to whether the decision was taken by the institution alone or together with other institutions (syndicated lending) is immaterial.	**Prolongations** The term "prolongations" does not distinguish between external and internal loan period extensions (e.g. internal extension of external loans payable on demand (*b.a.w.-Kredite*)). Internal "loan monitoring files", which serve only to monitor the loan during its term, are not classed as prolongations and, as a result, are not considered to be lending decisions within the meaning of this Circular. **Interest rate adjustments** Any interest rate adjustments made after interest rate lock-in periods (that do not coincide with the original term) have expired can be considered part of the overall loan agreement, which have been assessed before the loan is granted. In principle, this means that such decisions are not considered separate lending decisions within the meaning of this Circular. **Deferments of payment** Payment deferments do not constitute scheduled changes to the original lending agreement. They are designed, e.g. to provide short-term bridging for the period leading up to a reorganisation, and, as a result, constitute lending decisions within the meaning of this Circular.
3	As a general rule, "trading business" covers all activities based on a a) money market transaction, b) securities transaction, c) foreign exchange transaction,	**Issuing business** In general, the initial offering of securities is not classed as a trading activity within the meaning of this Circular. On the other hand, first-time acquisition from an initial offering does constitute a trading transaction within the meaning of this Circular. A simplified procedure may be used with regard to assessment of compliance with market conditions for first-time acquisitions (see comments

d) transaction in negotiable receivables (e.g. trading in borrowers' notes). e) transaction in commodities f) transaction in derivatives and which are concluded in the institution's own name and for its own account. Securities transactions also include transactions with registered bonds and securities lending, but not the initial issue of securities. Trading transactions also include – regardless of the underlying – any form of repurchase agreement.	in BTO 2.2.2 item 5). **Classification of receivables as trading transactions** With regard to d): receivables are classed as trading transactions if the institution intends to trade them. The institution has to establish appropriate criteria for this purpose. **Commodities transactions** With regard to e): Commodities transactions include, in particular, trading in precious metals and raw materials, as well as CO_2 trading and electricity trading. In analogy with section 296 (2) of the Regulation governing the Capital Adequacy of Institutions, Groups of Institutions and Financial Holding Groups (Solvency Regulation – *Solvabilitätsverordnung*), commodities transactions within the meaning of this Circular do not include commodities transactions which constitute matched positions for the entire duration of the transaction as a result of outright agreements to accept or deliver of the commodity in question at the time of performance. **Traditional commodities business of semi-public credit cooperatives** An analogous implementation of the requirements for the trading business may be appropriate for the traditional commodities business of semi-public credit cooperatives (*gemischtwirtschaftliche Kreditgenossenschaften*) depending on the type, scope and risk content of these business activities.
4 Transactions in derivatives include forward transactions with prices which derive from an underlying asset, a reference price, a reference interest rate, a reference index or an event defined in advance.	**Guarantees/bank guarantees** Guarantees/bank guarantees and similar instruments are not classified as derivatives within the meaning of this Circular.

AT 3 Overall responsibility of senior management

1	All senior managers (section 1 (2) KWG) are responsible – irrespective of their internal responsibilities – for ensuring that the company has a proper business organisation and that this organisation is developed further. This responsibility encompasses all material aspects of risk management and has to take into account outsourced activities and processes. The senior managers are only capable of meeting this responsibility if they are able to assess the risks and take the necessary measures to limit them. The senior managers of a superordinated enterprise of a group of institutions, a financial holding group or a superordinated financial conglomerate enterprise are also responsible for the proper business organisation within the group and, thus, also for appropriate and effective risk management at group level (section 25a (1a) KWG).	

AT 4 General requirements for risk management

AT 4.1 Risk-bearing capacity

1	On the basis of the overall risk profile, the institution has to ensure that the material risks are covered by the risk-taking potential at all times, taking into account any correlation between risks where appropriate, and that the institution is therefore able to bear its material risks.	
2	The institution is required to establish an internal process to ensure its risk-bearing capacity. An institution’s risk-bearing capacity has to be taken into account when determining strategies (AT 4.2) and adjusting these strategies. Appropriate processes for identifying, assessing, treating, monitoring and communicating risks (AT 4.3.2) also have to be established in order to implement the strategies and guarantee the institution’s risk-bearing capacity.	

3	Institutions have to define all material risks which are not included in the assessment of their risk-bearing capacity. Institutions have to state in a comprehensible way why they do not include such risks and such non-inclusion is only possible if the corresponding risk cannot be meaningfully limited by additional risk-taking potential due to its nature (e.g. usually liquidity risks). Institutions have to ensure that the processes for identifying, assessing, treating, monitoring and communicating risks give appropriate consideration to such risks.	
4	If an institution does not have suitable procedures for the quantification of individual risks that should be included in the risk-bearing capacity concept, then a risk amount should be specified for these risks based on a plausibility check. The plausibility check may be carried out on the basis of a qualified expert assessment.	
5	The individual institution is responsible for selecting the methods employed to determine its risk-bearing capacity. The assumptions on which the methods are based have to be explained in a comprehensible way. The responsible employees have to examine the methods at least once a year to assess their suitability.	

AT 4.2 Strategies

1	Senior management has to define a sustainable business strategy and a consistent risk strategy. The risk strategy has to take into account the objectives and plans of the institution's material business activities as set forth in the business strategy, as well as the risks of material outsourcings (AT 9 item 2). Responsibility for the determination of these strategies cannot be delegated. Senior management is required to ensure the implementation of the strategies. The level of detail contained in the strategies depends on the scope and complexity, as well as the risk content of the planned business activities.	**Audits by external auditors or the internal auditing function** Senior management bears sole responsibility for determining the content of the business strategy – this does not form part of audits either by external auditors or the internal auditing function. The business strategy is to be used to assess the institution's risk strategy in order to ensure that both strategies are consistent with each other. The question as to whether or not the risk strategy may be integrated into the business strategy remains at the discretion of the institution.
2	The risk strategy has to contain the objectives of risk management with regard to the institution's material business activities. It may be divided into sub-strategies where appropriate (e.g. a strategy for counterparty risks). Risk concentrations must be taken into account also with regard to the institutions revenue situation (revenue concentrations).	**Presentation of the risk strategy** The institutions are free to decide on the manner in which they wish to present the risk strategy. In addition to a summarised version in one document, the strategy can also be presented in several documents, provided that there is a consistent interrelationship between the various documents. The level of detail

	of these sub-strategies may vary.
3 Senior management has to review the strategies at least once per year and adjust them as appropriate. The supervisory body of the institution has to be notified of all strategies and given an opportunity to discuss them.	**Supervisory body committees** As a general rule, the strategies should be provided to every member of the supervisory body. To the extent that the supervisory body has formed committees, the strategies can also be passed on to a committee for discussion there. This is subject to the prerequisite that a corresponding resolution has been passed on the establishment of the committee, and that the chairperson of the committee reports to the entire supervisory body on a regular basis. Furthermore, each member of the supervisory body still has to be given the right to view the strategies passed to the committee in question.
4 The content of the risk strategy as well as any amendments thereto, together with the business strategy where appropriate, have to be communicated in a suitable manner within the institution.	

AT 4.3 Internal control system

1 Depending on the nature, scale, complexity and risk content of its business activities, each institution has to a) set forth regulations regarding the structural and operational arrangements and b) establish processes for identifying, assessing, treating, monitoring and communicating risks.	**Structure and organisation of operations** The requirements with regard to the structural and operational arrangements also apply to the processes for identifying, assessing, treating, monitoring and communicating risks.

AT 4.3.1 Structural and operational arrangements

1 When determining the structural and operational arrangements, the institution has to ensure that incompatible activities are performed by different employees.	
2 Processes, as well as the related tasks, competencies, responsibilities, controls and communication channels have to be clearly defined and attuned to one another. This also applies to the interface between the	

institution and material outsourcings.	

AT 4.3.2 Processes for identifying, assessing, treating, monitoring and communicating risks

1	The institution has to establish appropriate processes for identifying, assessing, treating, monitoring and communicating risks which ensure that material risks and associated risk concentrations can be a) identified, b) assessed, c) treated and d) monitored and communicated. These processes should be included in an integrated risk-return management system (overall bank control system ("*Gesamtbanksteuerung*"))	**Inclusion in "*Gesamtbanksteuerung*"** The inclusion of the processes for identifying, assessing, treating, monitoring and communicating risks in an integrated risk-return management system ("*Gesamtbanksteuerung*") is a Supervisory Authority's recommendation, as is expressed by the use of the word "should".
2	The processes for identifying, assessing, treating, monitoring and communicating risks have to ensure that material risks – including those arising from outsourced activities and processes – can be identified at an early stage, captured completely and presented in an appropriate manner. The processes have to take any correlations between the various types of risk into account.	
3	Appropriate stress tests must be carried out at regular intervals for material risks. This must be done on the basis of the main risk factors identified for the corresponding risks. The stress tests also have to take special account of risk concentrations and risks resulting from off-balance sheet company structures. The stress tests must also be carried out at the level of the institution.	**Stress tests** The term "stress test" is used below as a generic term for the different methods applied by the institutions to monitor their susceptibility to losses including with respect to exceptional, but plausibly possible events. This also includes, e.g. sensitivity analyses (in which only one risk factor is changed) or scenario analyses (in which several or all risk factors which are subject to change due to a pre-defined event are changed simultaneously).
4	The stress tests also have to show exceptional, but plausibly possible events. Suitable historical and hypothetical scenarios are to be represented. The selection of the scenarios has to take account of the	

	institution's strategic orientation and its economic environment	
5	The suitability of the stress tests as well as their underlying assumptions have to be reviewed at regular intervals, but at least once a year.	
6	Due heed must also be paid to the results of the stress tests when evaluating the risk-bearing capacity.	**Critical Review** The results of the stress tests must always be subjected to a critical review. This review should establish to what extent action needs to be taken (e.g. capital backing, closer monitoring of risks, modifications to business policy). If certain risks are quantified when the risk-bearing capacity is analyzed using stress-test results, then the institution has to assess its risk-bearing capacity on this basis.
7	Senior management has to require submission of a report on the risk situation and the results of the stress tests at appropriate intervals. The risk report has to be written in a form that is comprehensible and meaningful, and has to contain both a description and an assessment of the risk situation. In particular, the report has to set out the results of the stress tests and their potential effects on the risk situation and the risk-taking potential. The report also has to set out the main assumptions on which the stress tests are based. Suggested actions, e.g. to reduce risk, are also to be included in the risk report where required. Details on risk reporting can be found in BTR 1 to BTR 4.	**Notes on risk reporting** The risk reports submitted to senior management can also be complemented by concise summary reports (e.g. a management summary) where the institution believes this to be appropriate. If there are no relevant changes to the information already communicated in previous reports, the current report may refer to the earlier information. Since risk aspects have to be addressed within the context of income and cost aspects, the latter can also be included in the risk report. In principle, there is no reason why suggested actions cannot be discussed with the responsible units either, provided that care is taken to ensure that the information contained in the risk report and/or the suggested action is not improperly distorted.
8	Information which is important from a risk point of view has to be communicated immediately to senior management, the responsible members of staff and, where appropriate, the internal auditing function, so that appropriate measures and/or audits can be initiated at an early stage. A suitable procedure has to be established for this.	**Duty to provide information to the internal auditing function** In the event that a unit identifies deficiencies that are relevant from a risk point of view, ascertains that material losses have occurred, or has a concrete suspicion that irregularities have occurred, it has a duty to inform the internal auditing function.
9	Senior management has to submit an appropriate written report on the institution's risk situation to the supervisory body on a quarterly basis. The report has to be written in a form that is comprehensible and meaningful and has to contain both a presentation and an evaluation of	**Supervisory body committees** As a general rule, the risk reports have to be provided to every member of the supervisory body. To the extent that the supervisory body has formed

	the risk situation. The report has to deal separately with special risks for business performance and the measures planned by senior management. Important information for the supervisory body from the risk point of view has to be passed on immediately by senior management. Senior management has to establish a suitable procedure for this jointly with the supervisory body.	committees, the communication of information can also be limited to one particular committee. This is subject to the prerequisite that a corresponding resolution has been passed on the establishment of the committee, and that the chairperson of the committee reports to the entire supervisory body on a regular basis. Furthermore, each member of the supervisory body still has to be given the right to view the risk reports passed to the committee in question.
10	The processes for identifying, assessing, treating, monitoring and communicating risks have to be amended to reflect any changes in the overall situation as soon as possible.	

AT 4.4 Internal auditing function

1	Each institution must have a functioning internal auditing function in place. The functions of an internal auditing function may be carried out by a senior manager if it would be disproportionate with respect to the size of the institution to establish an internal auditing function.	
2	The internal auditing function as an instrument of senior management is under its direct control and has to report to senior management. It can also be subject to the direct control of one senior manager, who should, if possible, be the chairperson. This notwithstanding, it has to be ensured that the chairperson of the supervisory body in consultation with senior management may obtain information directly from the head of the internal auditing function.	**Access to information by the chairperson of the supervisory body** If the institution has set up an audit committee, it alternatively may be ensured that the chairperson of the audit committee can obtain information from the head of the internal auditing function.
3	The internal auditing function has to examine and assess, in a manner which is risk-focused and independent of individual processes, the effectiveness and appropriateness of “risk management in general”, and the internal control system in particular, as well as the orderliness of all activities and processes regardless of whether these are outsourced or not. This does not affect BT 2.1 item 3.	
4	In order to enable it to perform its duties, the internal auditing function has to be granted a full, unlimited right to information. This right has to be ensured at all times. In this respect, the internal auditing function has to be immediately provided with the necessary information, the required documents and an opportunity to review the institution’s activities, processes and IT systems.	

5 The internal auditing function has to be informed of any senior management instructions and resolutions that could be relevant to its activities. It has to be informed of any material changes to the risk management in a timely manner.	

AT 4.5 Risk management at group level

1	Pursuant to section 25a (1a) KWG, the senior managers of the superordinated enterprise of a group of institutions or financial holding group as well as the senior managers of the superordinated financial conglomerate enterprise of a financial conglomerate are responsible for the establishment of an appropriate and effective risk management at group level. The scope of risk management at group level covers all material risks of the group regardless of whether these are caused by companies subject to consolidation or not (e.g. risks from special purpose vehicles not subject to consolidation). Specific standards for risk management at group level may result from specific statutory regulations, such as, for example, in the case of building and loan associations with respect to the risk control/management concerning the home savings collective (*Kollektivsteuerung*) or in the case of *Pfandbrief* banks.	**Risk management at group level** The concrete risk management structure at group level depends in particular on the nature, scope, complexity and risk content of the business operations performed by the group as well as on the options available under company law. The methods and procedures used (for example IT systems) may not affect the effectiveness of risk management at group level. **Reference to material risks** Risk management at group level covers all material risks. For this reason, subordinated enterprises whose risks are considered to be immaterial by the superordinated enterprise, may, for example, be exempted from the requirements on risk management at group level. This does not apply if the risks of the subordinated enterprise taken together are to be classified as material.
2	The senior managers of the superordinated enterprise have to specify a business strategy as well as a risk strategy consistent with it ("group-wide strategies"). The strategic orientation of the group companies has to be co-ordinated with the group-wide strategies. The senior managers of the superordinated enterprise have to ensure that the group-wide strategies are implemented. The group-wide strategies are to be reviewed at least once a year by the senior managers of the superordinated enterprise and adjusted where required.	
3	On the basis of the group's overall risk profile, the superordinated enterprise has to establish an internal process to ensure the risk-bearing capacity at group level (AT 4.1 section 2). The group's risk-bearing capacity has to be ensured on an ongoing basis.	
4	Appropriate operational arrangements are to be made at group level. This means that processes as well as related tasks, competencies, responsibilities, controls and communication channels have to be clearly defined and coordinated within the group.	
5	The superordinated enterprise has to set up appropriate processes for identifying, assessing, treating, monitoring and communicating risks which include the group companies. Appropriate stress tests have to be	

	carried out at regular intervals with regard to the material risks at group level. The superordinated enterprise has to obtain information at appropriate intervals with regard to the risk situation of the group.	
6	Within the framework of risk management at group level, the group auditing function has to supplement the activities of the internal auditing function of the group companies. The group auditing function may also make use of the audit findings of the internal auditing functions of the group companies	

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AT 5 Organisational guidelines

1	The institution has to ensure that its business activities are conducted on the bases of organisational guidelines (e.g. manuals, work documentation or workflow procedures). The level of complexity of the organisational guidelines depends on the nature, scale, complexity and risk content of the business activities in question.	**Design of organisational guidelines** The main issue with regard to the design of the organisational guidelines is that they should be appropriate and presented in a manner which is comprehensible to the employees of the institution. The specific manner in which the guidelines are designed remains at the discretion of the institution.
2	The organisational guidelines have to be set down in writing and communicated to the staff members concerned in a suitable manner. Care has to be taken to ensure that the latest version of these guidelines is available to these staff members. The guidelines have to be amended to reflect any changes in the institutions' activities and processes as soon as possible.	
3	Most importantly, the organisational guidelines have to contain the following information: a) rules regarding the structural and operational arrangements, as well as the assignment of tasks, the decision-making hierarchy and the various responsibilities, b) rules on the processes for identifying, assessing, treating, monitoring and communicating risks, c) rules regarding the internal auditing function,	

d) rules which ensure compliance with statutory provisions and other requirements (e.g. data protection, compliance) e) rules regarding procedures for material outsourcings and f) principles for remuneration systems.	
4 The organisational guidelines have to enable the internal auditing function to conduct an audit.	

AT 6 Documentation

1	As a general rule, all business, control and monitoring records have to be drawn up systematically and in a manner which is comprehensible to knowledgeable third parties and, subject to statutory regulations, must be retained for two years. Files have to be kept up to date and processes are to be in place to ensure that the contents are complete.	
2	Any material actions and decisions that are relevant for compliance with this Circular have to be documented in a comprehensible manner. This also includes decisions with regard to the use of significant opening clauses, for which grounds may have to be stated, where appropriate.	

AT 7 Resources

AT 7.1 Personnel and incentive systems

1	The staffing of the institution has to be based, in both quantitative and qualitative terms, on the institution's internal operational needs, business activities and risk situation. This also applies to the assignment of temporary staff.	
2	The employees and their deputies have to have the knowledge and experience required by their duties, competencies and responsibilities. Suitable measures have to be taken to ensure that the employees have the appropriate qualifications.	
3	Employee absence, or resignation from the institution, should not result in any long-term impairment of operations.	
4	The structure of the institution's incentive systems, especially its remuneration systems, has to be in keeping with the objectives set out in its strategies. Changes in the strategy must be taken into account. The	**Adverse incentives** Adverse incentives can be created by, among other things, a significant dependency of an employee on variable remuneration. Such a significant dependency may, in practical terms, be an obstacle to reducing the variable

	remuneration systems have to be designed in such a way as to avoid adverse incentives to establish disproportionately high risk positions. The employees of units that do not originate business have to be compensated appropriately in accordance with their responsibility and work. The institution has to review the remuneration systems at least once a year to ensure they are appropriate.	remuneration or even cancelling it altogether because the employee is reliant on it. In addition, adverse incentives may also be caused by significant contractual severance payments the amount of which remains unchanged despite individual negative performance contributions on the part of the employee concerned.
5	Depending on the nature, scope, complexity and risk content of the business activities and the remuneration structure, senior management has to set up a committee to design and further develop the remuneration systems (Remuneration Committee). Besides employees from the human resources department, employees must also be represented on the Remuneration Committee who are in charge of the origination and monitoring of transactions (e.g. employees from the front office and the back office, trading and settlement as well as risk controlling). Within the framework of its duties the internal auditing function must also be involved.	
6	The supervisory body must be provided with information on the remuneration systems. In addition, the chairperson of the supervisory body must be granted a corresponding right to obtain information from senior management and from the Remuneration Committee, if such a committee exists.	
7	In the case of variable remuneration for senior managers and those employees who – due to the decision-making hierarchy – are able to establish high risk positions, account must be taken not only of the individual's performance contribution but also of the performance contribution made by the organisational unit of the corresponding employee as well as the overall performance of the institution. In addition, future negative developments also need to be reflected in the variable remuneration. To this end, the measurement period for the variable remuneration and the performance period for the remuneration have to be adequately long in order to take due account of the duration of the corresponding risks.	**Individual performance contribution** The individual performance contribution must also be measured in terms of non-financial factors, such as qualifications obtained, customer satisfaction and non-compliance with the institution's internal rules. **Measurement of performance** The individual performance contribution as well as the performance contribution of the corresponding organisational unit and of the overall performance of the institution must be measured in terms of such parameters that take into account the goal of long-term performance, considering the risks and cost of capital. **Measurement and performance period** The measurement period for the variable remuneration and the performance period for the remuneration have to take account of the duration of the risks, but do not necessarily have to be identical with it.

AT 7.2 Technical facilities and related processes

1	The scope and quality of the institution's technical facilities and related processes have to be based, in particular, on the institution's operational needs, business activities and risk situation.	
2	The IT systems (hardware and software components) and the related IT processes have to ensure data integrity, availability, authenticity and protection. In order to ensure this, the design of the IT systems and the related IT processes has to be based on established standards as a general principle. In particular, processes have to be set up for an appropriate allocation of IT access authorisations which ensure that each employee has only those rights that he/she needs for his/her work; authorisations may be summarised in a role model. The suitability of the IT systems and related processes has to be reviewed on a regular basis by the employees responsible for the technical and professional aspects of the relevant processes and systems.	**Standards for IT systems** These standards include, among others, the IT-Grundschutz Catalogues (IT Basic Protection Catalogues) of the Federal Office for Information Security (*Bundesamt für Sicherheit in der Informationstechnik* – BSI) and the ISO/ICE 27002 international security standard of the International Standards Organisation. The use of established standards does not mean that standard software or hardware has to be used. As a general rule, the institutions may also use proprietary software.
3	The IT systems have to be tested before they are used for the first time and after any material changes have been made. They then have to be approved by both the staff responsible for the relevant processes and the staff responsible for the systems. As a general rule, the production and testing environments have to be kept separate.	**Changes to IT systems** Any assessments to determine whether or not changes can be classed as material should not be based on the scope of the changes, but on the potential impact of the change on the functionality of the IT system in question. **Acceptance by staff responsible for the relevant systems and processes** When accepting IT systems, the staff responsible for the relevant processes and systems focus on the suitability and appropriateness of the IT systems for the specific situation of the respective institution. Any certificates already issued by third parties may be taken into account during the acceptance process, although they cannot replace it entirely.
4	Developments and changes to technical specifications (e.g. the adjustment of parameters) have to involve both the staff responsible for the relevant processes and the staff responsible for the systems. Technical approval need not be user-specific.	

AT 7.3 Contingency plan

1 Provisions are to be made for emergencies relating to time-critical activities and processes (contingency plan). The measures set forth in the contingency plan have to aim at reducing the scale of any possible impact. The effectiveness and suitability of the plan have to be reviewed on a regular basis by means of contingency testing. The results of the contingency tests have to be communicated to the responsible members of staff. If time-critical activities and processes are outsourced, the outsourcing institution and the external service provider must have contingency plans that are coordinated with each other.	
2 The contingency plan has to include business continuity and recovery plans. The business continuity plans have to ensure that alternative solutions are available in the event of an emergency as soon as possible. The recovery plans have to ensure the restoration of normal operations within an appropriate period of time. The contingency plans have to provide the communication channels to be used in the event of an emergency and have to be provided to the affected employees.	

AT 8 Activities in new products or on new markets

1 Every institution has to understand the business activities it conducts. A plan has to be drawn up prior to commencing business activities that relate to new products or markets (including new distribution channels). This plan is to be based on the result of the risk content analysis performed for these new business activities. It has to describe the main consequences of the new activities on risk management.	**Content of the plan** The potential consequences of new activities include those relating to the institution’s organisational structure, personnel, necessary adjustments to the IT systems, the methods for the assessment of associated risk, as well as legal consequences (accounting and tax law, etc.) insofar as these are deemed to be material.
2 The decision as to whether or not activities involve a new product or market have to be made in conjunction with a unit independent of front	

	office and trading (BTO 1 item 2).	
3	As far as trading activities are concerned and as a general rule, a test phase has to be introduced before continuous trading in the new product or on the new market commences. During the test phase, trading has to be limited to a manageable scale. Care has to be taken to ensure that continuous trading begins only once the test phase has been completed successfully and appropriate processes for identifying, assessing, treating, monitoring and communicating risks are in place.	**Lending transactions and test phase** For lending transactions, the plan may also be drafted on the basis of a test phase if warranted by the complexity of the new product or business. **One-off transactions** A test phase need not be conducted for one-off transactions.
4	The organisational units which will be involved in the operations of the new business at a later stage have to participate in the drafting of the plan and in the test phase. The internal auditing function also has to be involved within the framework of its duties.	
5	The plan and the commencement of ongoing business activities have to be approved by the senior managers responsible, in cooperation with senior managers responsible for monitoring the activities in question. These approval processes can be delegated, provided that clear guidelines are in place and that senior management is informed of the decisions as soon as possible.	
6	If the organisational units involved in the operation of the new business believe that the activities in a new product or on a new market can be managed appropriately, AT 8 need not be applied.	

AT 9 Outsourcing

1	Outsourcing is the commission of another company to carry out activities or processes related to the conducting of banking business, the provision of financial services or any of an institution's other typical services that would otherwise be performed by the institution itself.	**Other external procurement of services** Other external procurement of services is not to be qualified as outsourcing within the scope of this Circular. Firstly this is the one-time or occasional external procurement of goods and services. It also includes services that are typically procured from an institution and which the institution can normally not perform itself either due to factual circumstances or legal requirements – neither at the time the external service is used nor in the future (for example, the use of central bank functions within the "*Finanzverbünde*", the use of

		clearing houses for payment transactions and securities settlements, the involvement of correspondent banks or the safe-keeping of customer assets pursuant to the Safe Custody Act (*Depotgesetz*)). The application of the relevant regulations pursuant to section 25a (2) KWG is regularly not appropriate in the light of the particular risks of such services. Nevertheless, the institution shall also comply with the general requirements regarding proper business organisation pursuant to section 25a (1) KWG when using other external procurement. **Other typical services of the institution** Reference to the institution's other typical services takes account of Article 13 (5) Sentence 1 of the Markets in Financial Instruments Directive to the extent that it refers to the outsourcing of operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis. Other typical services also include, for example, ancillary services mentioned in Annex I, Section B of the Markets in Financial Instruments Directive.
2	On the basis of a risk analysis the institution shall determine on its own responsibility which outsourcings of activities and processes are material with regard to risks (material outsourcings). The respective operational units are to be involved in the preparation of the risk analysis. The internal auditing function shall also be involved within the framework of its duties. The risk analysis has to be revised when material changes occur in the risk situation.	**Risk analysis** The risk analysis shall take account of all aspects that are relevant for the institution in connection with outsourcing (e.g. the risks of outsourcing, the suitability of the outsourcing firm); the extent of the analysis depends on the type, scope, complexity and risk content of the outsourced activities and processes. Therefore, outsourcings of substantial importance – such as the complete outsourcing of the internal auditing function of a larger institution – need scrutinising whether and how the outsourced activities and processes can be integrated in the institution's risk management. **Intra-group outsourcing** In the case of intra-group outsourcing, effective measures, in particular the implementation of a risk management system at group level and the right to take direct action, will be deemed to be a risk-mitigating factor for the preparation and revision of the risk analysis.
3	Outsourcings which are non-material with regard to risk have to comply with the general requirements on proper organisation pursuant to section 25a (1) KWG.	
4	As a general rule, all activities and processes may be outsourced as long as this does not impair the orderliness of the business organisation pursuant to section 25a (1) KWG. The outsourcing must not lead to the delegation of responsibility on the part of the senior managers to the external service provider. Management functions of the senior managers must not be	**Management functions of senior managers** The management functions of senior managers which cannot be outsourced include corporate planning, coordination, controlling and managerial appointments. It also includes functions that are explicitly assigned to management by legislation or other regulations (e.g. decisions regarding large

	outsourced. Special requirements for outsourcing measures may also arise from specific statutory regulations, for example those for building and loan associations (*Bausparkassen*) with respect to the risk control/management concerning the home savings collective (*Kollektivsteuerung*) or in the case of *Pfandbrief* banks with regard to the keeping of the cover register and the cover calculation.	exposures pursuant to sections 13 to 13b KWG or the specification of strategies). Functions or organisational units which senior management uses when performing its management functions are not considered management functions. These functions may be delegated either internally or externally by outsourcing.
5	If the institution intends to terminate a material outsourcing contract it shall take measures to ensure continuity and quality of the outsourced activities and processes after termination of the respective contracts.	
6	The following terms shall be agreed in the outsourcing contract for material outsourcings: a) specification and if necessary description of service to be performed by the external service provider, b) stipulation of information and audit rights of the internal auditing function and external auditors, c) ensuring BaFin's information and examining rights and control possibility, d) rights to give instructions if necessary, e) regulations that ensure compliance with data protection provisions, f) right to give notice and appropriate periods of notice, g) regulations on the possibility and the modalities of sub-outsourcing which guarantee that the institutions continue to comply with the banking supervisory requirements, h) the commitment of the external service provider to inform the institution of any developments that may impair the proper performance of the outsourced activities and processes.	**The institution's right to give instructions/audits by the internal auditing function** The institution may waive the explicit agreement on the rights to give instructions if the service to be performed by the external service provider is specified with sufficient clarity in the outsourcing contract. In addition, the internal auditing function of the outsourcing institution may choose not to carry out its own audit activities subject to the prerequisites of BT 2.1 item 3. These exemptions may also be used for outsourcings to so-called multi-client service providers.
7	The institution shall manage the risks associated with material outsourcings in an appropriate manner and properly monitor the execution of the outsourced activities and processes. This also includes a regular evaluation of the service of the external service provider on the basis of specific criteria. The institution must assign clear responsibilities for management and monitoring.	
8	If the internal auditing function is to be outsourced completely, senior management shall appoint an audit officer who has to ensure that the internal auditing function is functioning properly. The requirements of AT 4.4 and BT 2 are to be taken into account accordingly.	**Duties of the audit officer** The audit officer shall prepare the audit plan jointly with the commissioned third party. He shall, if appropriate together with the commissioned third party, also draft the overall report pursuant to BT 2.4 item 4 and, pursuant to BT 2.5,

		verify that the deficiencies found have been remedied. The duties of the audit officer may be carried out by an organisational unit, an employee or a senior manager, depending on the type, scope, complexity and risk content of the business activities of the institution. Adequate know-how and the required independence must be ensured.
9	The requirements on the outsourcing of activities and processes must also be complied with when outsourced activities and processes are sub-outsourced.	

BT 1 Special requirements for the internal control system

1 This module sets out the special requirements for the internal control system. These requirements relate primarily to the structural and operational arrangements in the lending and trading business (BTO). In addition, requirements are also imposed on the structure of the processes for identifying, assessing, treating, monitoring and communicating risks for counterparty risks, market price risks, liquidity risks and operational risks taking due account of risk concentrations (BTR).	

BTO Requirements for the structural and operational arrangements

1 The purpose of this module is to set forth the requirements that apply to the structural and operational arrangements in the lending and trading business. The BTO requirements can be applied in a simplified manner depending on the size of the institution, its business focus and its risk situation.	
2 This Circular distinguishes between the following units: a) the unit which initiates lending transactions and has a vote in the lending decisions ("front office"), b) the unit which has an additional vote on lending decisions ("back office") and c) "trading". Furthermore, a distinction is also made between the following functions: d) those functions which serve to monitor and communicate risks ("risk	**Notes on the use of the terms "unit" and "section"** A "section which is independent of front office and trading" may be incorporated in one of the organisational units in "front office" or "trading", up to senior management level. A "unit separate from front office and trading" only exists if it is separate in structural terms from "front office" and "trading" up to, and including, senior management level.

control function") and e) those functions which serve to settle and control trading transactions ("settlement and control function").	
3 As a general rule, care has to be taken to ensure that the structure of the front office and trading units are kept separate, up to and including senior management level, from those units or functions set forth in item 2 b), d) and e), as well as in BTO 1.1 item 7, BTO 1.2 item 1, BTO 1.2.4 item 1, BTO 1.2.5 item 1 and BTO 1.4 item 2.	**Separation of functions at legally dependent foreign branches** A structural separation up to and including senior management level means a separation of technical and disciplinary responsibilities. In the case of legally dependent foreign branches, however, technical and disciplinary responsibility may be split. This is subject to the condition that at least the separation of the technical responsibilities corresponds to the aforementioned principle of the separation of functions up to and including senior management level. **Notes on the second half sentence** BTO 1.1 item 7: The assessment of certain types of security, – to be determined under risk aspects – and decisions regarding risk provisioning for significant exposures. BTO 1.2 item 1: Responsibility for the development and quality of loan processing, the monitoring of loan processing, intensified loan management, the processing of problem loans and risk provisioning. BTO 1.2.4 item 1: Responsibility for the development and quality as well as the regular review of the criteria which govern the classification of exposures requiring intensified loan management. BTO 1.2.5 item 1: Responsibility for the development and quality as well as the regular review of the criteria which govern whether or not an exposure has to be passed on for restructuring or winding up, as well as lead responsibility for the restructuring or winding-up process and the monitoring thereof. BTO 1.4 item 2: Responsibility for the development, quality and monitoring of the use of risk classification procedures.
4 Market price risk control functions have to be separated, up to and including senior management level, from those units which are responsible for taking positions.	

5	The segregation of functions also has to be observed at deputy level. In principle, the designated deputy can also be a suitable member of staff below senior management level.	
6	The involvement of the senior manager responsible for the risk control functions in a committee entrusted by senior management with risk management duties does not conflict with the principle of the segregation of functions.	
7	The section responsible for accounting (accounting department), in particular for the preparation of the account allocation rules and the development of the system of accounts, has to be independent of the front office and trading units.	**Separation of functions of institutions with significant trading business** Due to the extensive scope for valuation of certain trading transactions (e.g. structured products), institutions which trade intensively have to ensure that their accounting function is independent of the trading units.
8	As a general rule, material legal risks are to be assessed by a section which is independent of the front office and trading units (e.g. the legal department).	
9	In the case of IT-based processing, the separation of functions is to be ensured by means of corresponding procedures and precautions.	

BTO 1 Lending business

1	This module sets out the requirements that apply to the structural and operational arrangements, the procedures for the early detection of risks and the procedures for the classification of risks in the lending business. As far as trading transactions and participating interests are concerned, the implementation of individual requirements set forth in this module may be waived provided that their implementation is not appropriate in view of the specific features of these types of business (e.g. the requirement to monitor the loan purpose set forth in BTO 1.2.2 item 1).	**Analogous implementation for participating interests** The implementation for participating interests includes a participating interest strategy and the establishment of a risk control function for participating interests, irrespective of whether or not the participating interest in question is a credit-equivalent/credit-substituting holding or a strategic holding. If the participating interest in question is a credit-equivalent/credit-substituting holding, the requirements that apply to the structure and the organisation of operations also have to be observed as a general rule. In the case of participating interests under the cooperative umbrella ("*Verbundbeteiligungen*") or compulsory participating interests (e.g. participating interests prescribed by the savings bank laws or by the memorandum and articles of association, or which are participating interests in SWIFT) a separate risk control function is

	not necessarily required. In such cases, other measures may be applied for the necessary supervision (e.g. examining the annual financial statements or annual reports, or by reviewing the participating interest accounts).

BTO 1.1 Separation of functions and voting

1 The basic principle that applies to the structure of processes in lending business is the clear structural separation of the front office and back office up to and including senior management level. In the case of small institutions, exceptions may be made under certain circumstances with regard to the separation of functions.	**Simplified procedures for small institutions** In the event that the required separation of the back office, or other functions which are independent of the front office, and the front office up to and including senior management level is unreasonable due to the small size of the institution in question, it is not required to separate these functions, provided that the direct involvement of senior management in the granting of risk-relevant loans ensures that the lending business is practised properly and in a manner which is appropriate in view of the existing risks. In this respect, senior management has to carry out the processing and decision making with regard to risk-relevant loans. Any absent senior managers have to be informed following any decisions regarding risk-relevant business. This simplified procedure can be applied if the following conditions are met, taking into account all facts and circumstances: - the lending volume does not exceed 100 million euros, - the institution has only two senior managers and - the lending business has a non-complex structure. **Loans to employees** In the case of loans to employees and senior managers, the structural requirements often cannot be implemented one-to-one, particularly because there is no front office involvement. As a general rule, these lending decisions have to involve a suitable section which is not involved in loan processing (e.g. the human resources department). If necessary, the actual processing of the loan can also be performed by the employees responsible for loan processing.

2	Depending on the nature, scale, complexity and risk content of the exposure in question, a lending decision requires two consenting votes by both the front and back office. This is without prejudice to any further-reaching decision-making rules (e.g. KWG, memorandum and articles of association). If these decisions are made by a single committee, the majority structure within that committee has to be defined in such a way that the back office cannot be outvoted.	**Presentation of votes and plausibility checks** The votes may be summarised in the form of a document. In such cases, the second (positive) vote (independent of the front office) is expressed by the signature of the responsible employee on the document, whereas such signature may not be made as a favour. The vote which is independent of the front office has to be subject to at least one plausibility check depending on how the lending processes are allocated to the front office and to the unit which is independent of the front office. The plausibility check does not call for a repeat of the activities already performed in the front office. Rather, the focus is on the comprehensibility and tenability of the lending decision. This includes assessing the informational value of the front office vote and the extent to which the amount and type of loan to be granted is justifiable. The intensity of the plausibility check also depends on the complexity of the lending transactions in question. The employee responsible for the vote which is independent of the front office has to have at least access to all of the relevant lending documents.
3	In the case of trading transactions, counterparty and issuer limits are to be set by means of a back office vote.	
4	In the case of lending decisions which are deemed immaterial from a risk point of view, the institution may decide that only one vote is necessary ("non-risk relevant lending transactions"). The process can also be simplified in the case of lending transactions initiated by third parties. In this respect, the structural separation between front office and back office is only relevant to lending transactions where the risk involved makes two votes necessary. If a second vote is not necessary, care has to be taken to ensure the proper implementation of the requirements set forth in BTO 1.2.	**Distinction between risk-relevant and non risk-relevant lending transactions** Each institution is responsible for making its own distinction between risk-relevant and non risk-relevant lending transactions from a risk point of view. One example of a non risk-relevant lending transaction would be standardised retail business. **Initiation by third parties** The process surrounding the separation of functions may also be simplified in the event of lending transactions initiated by third parties. In promotional lending business, for example, it is not normally necessary to obtain two internal votes, because the lending transactions are often initiated by a "*Hausbank*" (principal bank of a company) or a holding company. Similar situations can occur, for example, in the case of lending transactions by institutions via dealer organisations, by building and loan associations via commercial agents, by guarantee banks via a "*Hausbank*" or, with regard to syndicate members, by the lead manager in syndicated loans. In the case of risk-relevant lending decisions, the additional vote from within the institution

	should, as a general rule, be obtained from a unit which is independent of the sales function, i.e. in the back office, if existing. **Initiation by third parties/workflow standardisation by means of external regulations** Institutions may also refrain from obtaining an additional vote if the decision procedures are already standardised by third parties in a way (e.g. within the framework of statutory provisions such as the German Housing Allowance Act (*Wohnraumfördergesetz*)) that results in a standardisation of the workflows within the institutions and, consequently, in a limitation of the institution's discretionary authority with regard to the granting of loans. ***De minimis* thresholds** To a certain extent, *de minimis* thresholds can be considered an appropriate means of differentiating risk-relevant transactions. It can, for example, make sense to simplify procedures for an additional loan application covering a relatively small amount, even if the total client exposure is classified as risk-relevant.
5 Each senior manager may, within the limits of his individual decision-making power, take lending decisions independently and also maintain customer contact; this does not affect the structural separation between the front office and the back office. In addition, two votes are required where risk aspects render this necessary. In the event that decisions made within the framework of an individual's decision-making power deviate from the votes or if such decisions are made by the senior manager responsible for the back office, they have to be highlighted in the risk report (BTR 1 item 7).	**Individual decision-making power and senior managers** Only a senior manager may exercise his individual decision-making power. A senior manager's right to make independent lending decisions within the framework of individual decision-making authority is not automatically transferred to his deputy where the latter is not a management-level employee. Even in the event that risk-relevant lending decisions are made jointly by the entire senior management or by several senior managers, these decisions have to, as a general rule, be processed appropriately and two votes, one from each unit, have to be obtained.
6 The institution has to define a clear and consistent decision-making hierarchy for decisions in lending business. If the votes are split, clear decision-making rules have to be defined in this hierarchy. In such cases, the loan has to be either rejected or passed on to the next hierarchy level for a decision (escalation procedure).	
7 The review of certain types of security – to be determined under risk aspects – is to be conducted outside the front office. This also applies to	**Preparation of expert opinions**

	decisions regarding risk provisioning for significant exposures. The organisational integration of all other processes or sub-processes listed in BTO 1.2 is at the institutions' discretion (such as loan processing or sub-processes of loan processing), unless this Circular states otherwise.	Expert opinions on the value of certain types of security can also be prepared by front office employees who have the appropriate professional qualification, provided that a plausibility check ensures that the resulting values are subject to an assessment which is performed independent of the front office. **Assessment of the legal status of security** The legal status of security may also be verified by a section that is independent of "front office" and "trading" (e.g. by the legal department).

BTO 1.2 Requirements for lending business processes

1	The institution has to set up procedures for loan processing (the granting and further processing of the loan), the monitoring of loan processing, intensified loan management, the processing of problem loans and risk provisioning. Responsibility for the development and quality of these processes has to lie outside of the front office.	**Responsibility for methods** Development of the aforementioned processes may also lie with the front office, provided that care is taken to ensure that the quality assurance is performed by a unit independent of the front office on the basis of a plausibility check.
2	The institution has to formulate processing guidelines for lending business processes, which are to be broken down (e.g. by loan type) where appropriate. It also has to set up procedures for the monitoring, administration and realisation of pledged security.	**Differentiated processing guidelines** Differentiated processing guidelines also have to be formulated for transactions with hedge funds and private-equity firms, for example with regard to the procurement of financial and other information, the analysis of the purpose and the structure of the transaction to be financed, the manner how security is provided or the analysis of the ability to repay.
3	All aspects material to the counterparty risk of a lending exposure have to be identified and assessed, with the intensity of these activities depending on the risk content of the exposures. Sector and, where appropriate, country risks have to be given the appropriate consideration. Critical issues concerning an exposure are to be highlighted and, where applicable, considered under various scenarios.	
4	The use of external credit ratings does not release the institution from its obligation to form its own judgement of the counterparty risk and to incorporate its own findings and information in the lending decision.	
5	With respect to property/project financing, the loan processing procedure has to ensure that not only the economic aspects, but also those aspects	**Economic assessment and technical feasibility**

	regarding the technical feasibility and development, as well as the legal risks associated with the property/project, are included in the assessment. Recourse may also be made to the expertise of an appropriate organisational unit independent of the borrower. Whenever external sources are consulted for these purposes, their qualification has to be assessed in advance.	By way of example, the economic assessment can contain the following aspects: - project analysis, - financing structure/equity ratio, - security plan or - *ex ante* and *ex post* calculations. Technical feasibility and development can be assessed, for instance, by means of inspections and construction stage monitoring.
6	Depending on the risk content of the loans, the risks related to an exposure are to be evaluated using a risk classification procedure, either as part of the lending decision or on the occasion of regular or ad hoc assessments. The risk classification is to be reviewed annually.	**Scope of assessments** Based on accounting requirements alone, the duty to perform an annual risk assessment also applies to exposures that are not subject to the risk classification procedure due to their low risk content. In such cases, however, the assessments can be performed less intensive and can be limited, for example, to an assessment of the borrower’s repayment regularity.
7	There should be a verifiable link between the classification in the risk classification procedure and the terms and conditions of the loan.	
8	The institution has to establish a procedure for dealing with the exceeding of limits that conforms to the decision-making hierarchy. To the extent acceptable in terms of risk, the requirements set forth in BTO 1.1. and BTO 1.2 may be applied in a simplified fashion to the exceeding of limits and prolongations on the basis of clear rules.	
9	A procedure has to be set up to monitor the timely submission of the necessary lending documents and ensure timely evaluation. A dunning procedure is to be implemented for overdue documents.	
10	The institution has to use standardised lending documents, to the extent that this is possible and appropriate with respect to the type of lending business in question, with the structure of the credit documents	

	depending on the nature, scale, complexity and risk content of the business.	
11	Contractual agreements relating to lending business have to be concluded on the basis of legally validated documentation.	
12	Legally validated standard texts, which have to be updated on an event-driven basis, have to be used for individual loan agreements. Where a deviation from the standard texts is necessary for a given exposure (such as in the case of customised agreements), an examination has to be conducted by a section that is independent of the front office prior to signing the agreement, to the extent that this is deemed necessary from a risk point of view.	**Assessment by an expert front office employee** In the event that the legally validated standard documents are not used, non risk-relevant lending transactions may also be assessed by an expert front office employee.

	BTO 1.2.1 Granting of loans	
1	The process of granting loans encompasses all necessary workflows up to the loan payout. All factors which are material to risk assessment have to be analysed and assessed, taking particular account of the debt-servicing ability of the borrower or the property/project, whereby the intensity of the assessment depends on the risk content of the exposure (e.g. credit assessment, risk classification or an assessment based on a simplified procedure).	
2	As a general rule, the value and legal validity of the security has to be assessed prior to the granting of the loan. Existing security values may be used if there are no indications of changes in value.	
3	If the value of the security is dependent to a substantial degree on the financial situation of a third party (e.g. guarantee), the counterparty risk of the third party has to be reviewed as appropriate.	
4	The institution has to set forth the types of security it is willing to accept and the method of calculating the value of the security.	
	BTO 1.2.2 Further processing of loans	
1	Whether or not the borrower is complying with the terms of the contract has to be monitored in the further processing of loans. In the case of	

	special-purpose loans, the institution has to monitor whether or not the funds made available are being used as agreed (monitoring of the loan purpose).	
2	Counterparty risk is to be assessed annually with the intensity of assessments depending on the risk content of the exposure (e.g. credit assessment, risk classification as part of the risk classification procedure, or assessment based on a simplified procedure).	
3	The value and legal validity of the security has to be assessed at suitable intervals within the framework of further loan processing if a threshold to be set by the institution under risk aspects, depending on the type of security, is exceeded.	
4	Ad hoc reviews of exposures, including security, have to be conducted immediately, but at least whenever the institution obtains knowledge, from either internal or external sources, which would indicate a substantial negative change in the risk assessment of the exposures or the security. Such information has to be forwarded immediately to all of the organisational units involved.	
BTO 1.2.3 Monitoring of loan processing		
1	Process-related controls have to be established for loan processing to ensure compliance with the organisational guidelines. Controls may also be conducted via the standard "dual control" principle.	
2	The monitoring procedure has to focus, in particular, on whether or not the loan approval was in line with the defined decision-making hierarchy and whether or not the prerequisites or requirements of the loan agreement were met prior to the granting of the loan.	
BTO 1.2.4 Intensified loan management		
1	The institution has to set forth criteria to determine when an exposure requires special observation (intensified loan management). Responsibility for the development and quality, as well as the regular review of these criteria has to lie outside of the front office.	**Criteria for intensified loan management** The institution determines at its own discretion whether or not the criteria trigger an automatic procedure, or whether they instead provide indicators which form the basis for an assessment. The objective is to identify problem exposures quickly so that the appropriate measures can be taken at an early

	stage. The same applies to those criteria which are decisive with respect to the procedure whereby an exposure is passed on for intensified loan management (BTO 1.2.5 item 1). **Exemptions from intensified loan management and the processing of problem loans** As with the application of the procedure for the early detection of risks, the institution is permitted to exempt certain types of lending business to be defined under risk aspects or lending transactions below certain thresholds from intensified loan management and the processing of problem loans. A transaction can, for example, be exempted from intensified loan management or the processing of problem loans if the institution has limited access to the required data due to objective circumstances and has already refrained from setting up a procedure for the early detection of risks (transactions initiated by third parties). In doing so, the institution has to ensure that it is informed of all significant circumstances that affect the borrower.
2 Exposures under intensified loan management are to be reviewed at regularly scheduled intervals, in order to determine what sort of further handling they require (further intensified loan management, return to normal management, transfer to winding up or restructuring).	
BTO 1.2.5 Treatment of problem loans	
1 The institution has to set forth criteria governing the transfer of an exposure to the staff or units specialising in restructuring and winding up, and/or their involvement. Responsibility for the development and quality, as well as the regular review of these criteria has to lie outside of the front office. The lead responsibility for the restructuring or winding-up process and the monitoring thereof need not be exercised by the front office.	**Criteria for transfer to problem loan processing** The notes to the criteria that apply to intensified loan management (see BTO 1.2.4 item 1) apply accordingly to the criteria for transfer to problem loan processing. **Assessment of non-standard agreements in restructuring cases** The assessment of non-standard agreements by an independent section need not be performed in restructuring cases if the restructuring process involves experts who are in a position, due to their expertise and experience, to draw up such agreements independently and without the need for further independent assessment. **Voting in the case of restructuring loans and exposures in reduction**

	portfolios As far as decisions on restructuring loans are concerned, one vote from the unit independent of the front office is sufficient. This also applies to exposures in what are known as reduction portfolios ("*Abbauportfolien*"), whereby the various exposures, as well as the intended action to be taken by the institution, have to be set forth in a comprehensible manner (e.g. in a reduction plan – "*Abbaukonzept*").
2 If an institution is considering supporting a restructuring, it has to require submission of a restructuring plan in order to assess the borrower's capacity for restructuring and has to make its decision on this basis.	
3 The implementation of the restructuring plan and the effects of the measures are to be monitored by the institution.	
4 In the case of significant exposures, the responsible senior managers have to be informed of the status of the restructuring process on a regular basis. If necessary, recourse can be taken to outside specialists with relevant expertise for the restructuring process.	
5 In the event that an exposure is to be wound up, a winding-up plan needs to be developed. Employees (or external specialists where appropriate) with relevant expertise are to be involved in the process of realising security.	
BTO 1.2.6 Risk provisioning	
1 The institution has to set forth criteria which are to form the basis for valuation allowances, write-downs and loan loss provisions (including country risk provisioning), taking due account of the accounting standards in use (e.g. an internal valuation procedure for loans).	
2 The calculations of necessary risk provisioning are to be kept up to date. In the event that substantial risk provisioning is required, senior management has to be notified immediately.	

BTO 1.3 Procedure for the early detection of risks

1 The procedure for the early detection of risks is intended primarily to identify, in a timely manner, borrowers whose loans are beginning to show signs of increased risk. With such a system in hand, the institution shall be able to initiate countermeasures at the earliest possible stage (e.g. intensified loan management).	
2 To this end, the institution has to develop indicators for the early identification of risks based on quantitative and qualitative risk features.	
3 The institution is permitted to exempt certain types of lending business to be defined under risk aspects or lending transactions below certain thresholds from the application of the procedure for the early detection of risks. The function of early detection of risks may also be performed by a risk classification procedure, provided that this procedure adequately allows early detection of risks.	**Exception for loans via a "*Hausbank*"** An institution may refrain from setting up a procedure for the early detection of risks if it has only limited access to the required data due to objective circumstances. This can occur if the lending transactions are initiated by another institution and are also managed by the latter (e.g. "*Hausbank*" in promotional lending business or in lending business of guarantee banks). The institution granting the loan has to ensure that it is informed of circumstances that affect the borrower. **Risk classification procedure and early detection of risks** Taking into account business management aspects, a risk classification procedure has to contain, in particular, the following components, so that it can also serve as an early risk detection procedure: - the indicators on which the procedure is based (e.g. account transactions, check returns) should allow impending risks to be recognised at an early stage ("indicator-related component"), - the indicators should enable the ongoing identification of impending risks ("time-related component") and - signals produced by the early risk detection procedure should also result in

	the appropriate measures being taken at the institution as soon as possible (e.g. intensified client contact, addition of security, suspension of repayments), so that the risks do not result in losses ("process-related component").

BTO 1.4 Risk classification procedure

1	Meaningful risk classification procedures are to be set up at every institution for the initial, regular or ad hoc assessment of counterparty risk and, as appropriate, property/project risk. Criteria have to be defined to ensure that risks are assigned to a risk class in a comprehensible manner for the purpose of their assessment.	
2	Responsibility for the development, quality and monitoring of the use of risk classification procedures must not lie with the front office.	
3	Key indicators for determining counterparty risk in the risk classification procedure have to include not only quantitative criteria but, wherever possible, also qualitative criteria. In particular, account has to be taken of the borrower's ability to generate income in the future in order to repay the loan.	
4	The classification procedures are to be adequately incorporated into the lending business processes and, where appropriate, into the decision-making hierarchy.	

BTO 2 Trading business

1 The main purpose of this module is to set forth the requirements that apply to the structural and operational arrangements in the trading business.	

BTO 2.1 Separation of functions

1 The basic principle that applies to processes in the trading business is the clear structural separation between the trading unit and the "risk control function" and "settlement and control function" up to and including senior management level.	**Customer service representatives** Customer service representatives who pass client orders onto the trading department within a certain limit for pricing purposes are deemed to act in accordance with this Circular. They should neither quote prices independently nor build up own positions.
2 An institution may refrain from the separation of functions including senior management level if the whole of trading activities focus on trading transactions deemed immaterial from a risk point of view ("non-risk-relevant trading activities").	**Non-risk relevant trading activities** These simplifications can be applied if the following conditions are met, taking into account all facts and circumstances: - the institution is a non-trading book institution, - the focus of the trading activities is on fixed assets and/or the liquidity reserve, - the volume of trading activities is very low as compared with overall business volume and - the structure of the trading activities is non-complex, and the complexity, volatility and risk content of the positions is low. The above prerequisites need not be fulfilled cumulatively. It is rather the case that a holistic assessment should be made taking into account the above points and weighting them appropriately in each individual case. If an institution makes use of this simplified procedure, then an organisational segregation of duties and functions, for example by allocating activities to different units, is also not necessary with regard to non-trade functions. Mutually incompatible activities are, however, to be carried out by different employees (AT 4.3.1 item 1). Thus employees engaged in trading activities must as a general rule

	not be in charge for non-trade functions. **Simplified processes for small institutions or in cases of a very low volume of trading activity** If a separation of functions is impossible with regard to trading activities owing to the size of the institution, the proper settlement of transactions has to be ensured by the direct involvement of senior management. If an institution's level of trading activity is so low that one single employee would not be working to full capacity, separation of functions can be ensured by temporarily allocating other employees who are normally not entrusted with trading transactions

BTO 2.2 Requirements for trading business processes

BTO 2.2.1 Trading

1 When a trade is concluded, the terms and conditions, including any ancillary agreements, have to be agreed in full. Internal trades may only be concluded on the basis of clear rules.	**Standardised wording of contracts** The institution has to use a standardised wording of contracts to the extent that this is possible and expedient with respect to the corresponding types of business. **Internal trades** Internal trades within the meaning of this Circular are transactions conducted within a legal entity that serve to transfer risks between individual organisational units or sub-portfolios (e.g. trades between own branches, organisational units, portfolios, etc.). Analogous compliance with the requirements on external trading activities is to be ensured for internal trades.
2 As a general rule, trades which are not in line with market conditions are not permitted. Exceptions may be made in individual cases if a) they are made at the client's request, can be justified and the deviation from market conditions is clearly visible from the documentation, b) they are made on the basis of internal rules governing the	

	types of trades, the client group, the scale and the structure of these trades, c) the deviation from market conditions is disclosed to the client in the trade confirmation and d) management has been informed in the case of material transactions.	
3	The conclusion of trades outside the business premises is only admissible within the scope of internal rules. These rules have to specify, in particular, the authorised individuals, scope and recording. The counterparty has to make an immediate telex confirmation for such trades. These trades are to be reported immediately by the trader to his own institution in a suitable form, they are to be marked and brought to the notice of the responsible senior manager or an organisational unit authorised by that member.	
4	Audio recordings have to be made of traders' conversations relating to transactions, and these recordings are to be retained for at least three months.	
5	Immediately after their conclusion, trades must be recorded together with all of the relevant transaction data, taken into account when determining the respective position (roll-over of positions) and passed on to the settlement function together with all documentation. The transaction data may also be transferred automatically by a settlement system.	**Transaction data** The relevant transaction data includes inter alia the type of transaction, volume, terms, maturity, counterparty, date, time, name of the trader, serial number, and ancillary agreements.
6	Where data is recorded directly in an IT system, care has to be taken to ensure that a trader can enter transactions solely under his own trader ID. The recording date and time as well as the transaction's serial number are to be entered automatically by the system and must be impossible for the trader to alter.	
7	Trades concluded after the cut-off time for settlement (late trades) are to be marked as such and included in that day's positions (including subsequent settlement) if they result in substantial changes. The transaction data and documentation relating to late trades have to be passed on immediately to a unit which is independent of trading.	**Requirement to mark late trades** Late trades need not be marked as such if the cut-off time is fixed and, as a result, the character of the late trade is evident due to the time or the time zone in which the transaction is concluded.

8 Prior to the conclusion of agreements in connection with trading activities, especially in the case of master agreements, netting agreements and security agreements, assessments are to be performed by a section which is independent of trading, to determine whether and, if so, to what extent they are legally enforceable.	
9 Employees belonging to the trading unit in organisational terms may only have joint signature authority for payment transaction accounts with employees from a unit which is independent of trading.	
BTO 2.2.2 Settlement and control	
1 Settlement involves the issuing of trade confirmations or contract notes on the basis of the transaction data received from trading and the performance of subsequent settlement tasks.	**Settlement systems** Depending on their nature, scope, complexity and risk content, trades are generally to be settled electronically; existing settlement systems are to be used as far as possible.
2 As a matter of principle, every trade is to be confirmed immediately in writing or in equivalent form. The confirmation has to contain the required transaction data. If the trade is transacted via a broker, the broker is to be named. Assessments are to be performed to ensure that the corresponding counter-confirmations are received immediately, whereby care has to be taken to ensure that the incoming counter-confirmations are passed directly to the settlement function in the first instance and are not addressed to trading. Missing or incomplete counter-confirmations have to be reported to the counterparty immediately, unless all parts of the trade in question have been executed correctly.	**Counter-confirmations for foreign trades** If counter-confirmations cannot be obtained, the institution has to verify the existence and contents of the transactions in other suitable ways. **Confirmation procedure for complex products** If the master agreements specify that, in the case of complex products, only one of the two parties is responsible for drafting the agreement, a mutual ad hoc confirmation (abridged form) and the unilateral draft agreement (full-length form) after clarification of all details suffice. The ad hoc confirmation has to contain the key information on the agreed trade. **Cancellations and corrections** In the confirmation and reconciliation procedure, special attention must be paid to frequent cancellations and corrections effected by individual employees or occurring in relation to certain transactions.
3 The institution may refrain from effecting its confirmation procedure in the case of trades cleared via a settlement system that ensures the automatic reconciliation of the relevant transaction data ("matching") and executes trades only where the data matches. In the event that there is no automatic matching of the relevant transaction data, the institution may	

	refrain from effecting its confirmation procedure if the settlement system allows both counterparties to access the transaction data at all times and these are kept monitored.	
4	Transactions are to be subject to ongoing monitoring. In particular, assessments have to be made to ascertain whether a) the transaction documents are complete and have been submitted as soon as possible, b) the data supplied by traders is correct and complete and – where available – matches the data in the brokers' confirmations, print-outs from trading systems or other relevant sources, c) the transactions fall within the defined limits with regard to their type and scope, d) the terms agreed are in line with market conditions, and e) any deviations from predefined standards (e.g. master data, settlement data, methods of payment) have been agreed. Changes and cancellations related to transaction data or bookings have to be assessed independent of the trading section.	**Automatic transfer to the settlement function** The institution may refrain from performing the assessments set out under a) and b), if the transaction data entered by the traders is automatically transferred to the settlement function in a manner which ensures that the traders can no longer alter the data.
5	Appropriate procedures, broken down by trade type as appropriate, must be set up to allow assessments to ensure compliance with market conditions. The senior manager responsible for the assessments has to be informed without delay if, in deviation from BTO 2.2.1 item 2, the terms and conditions of executed trades do not comply with market conditions.	**Notes on the assessments to ensure compliance with market conditions** In the case of liquid spot and forward transactions, the assessments may be performed on a random basis, if this is deemed appropriate from a risk point of view. Institutions may refrain from performing the assessment to ensure compliance with market conditions for trades which are settled, either directly or via third parties (e.g. via a correspondent bank) - on a German stock exchange or - on another regulated market, irrespective of its home country. Reference may be made to the following lists in order to identify regulated

	markets within the meaning of this requirement: - 'Annotated presentation of regulated markets and national provisions implementing relevant requirements of ISD (93/22/EEC)' of the EU Commission dated 22 February 2007 (2007/C 38/07) for regulated markets in the member states of the EU and in the other signatory states to the Agreement on the European Economic Area. - 'List of stock exchanges with an official market and of the other organised markets' pursuant to section 47 (1) nos 2 and 4 of the Investment Act (*Investmentgesetz* – InvG) for regulated markets in countries outside the member states of the EU and outside the other signatory states to the Agreement on the European Economic Area. A simplified procedure may be used with regard to assessment of compliance with market conditions for first-time acquisitions from an issue, depending on the nature and structure of these trades. For instance, the assessment of an issue via public auction/tender can be reduced to a check to ensure that the issue price has cleared correctly. The assessment to ensure compliance with market conditions also has to include internal trades. Exceptions are possible by means of analogy with the requirements set out in BTO 2.2.1 item 2.
6 Any discrepancies identified during settlement and control have to be remedied immediately by a unit independent of trading.	
7 The positions established in the trading unit are to be co-ordinated with the positions in the downstream processes and functions (e.g. settlement, accounting) on a regular basis.	
BTO 2.2.3 Positions to be covered by the risk control function	
1 Trades, including ancillary agreements which result in positions, have to be covered by the risk control function immediately.	**Positions to be covered by the risk control function** This preserves the possibility of accessing accounting data for risk control purposes.

BTR Requirements for processes for identifying, assessing, treating, monitoring and communicating risks

1 This module contains special requirements for the structure of processes for identifying, assessing, treating, monitoring and communicating risks (AT 4.3.2) taking due account of risk concentrations with regard to a) counterparty risks (BTR 1), b) market price risks (BTR 2), c) liquidity risks (BTR 3) and d) operational risks (BTR 4).	

BTR 1 Counterparty risks

1 The institution has to introduce appropriate measures to ensure that counterparty risks and associated risk concentrations can be limited, taking into account its risk-bearing capacity.	**Risk concentrations in the case of counterparty risks** This concerns counterparty and sector concentrations, regional concentrations and other concentrations in the lending business which may lead to substantial losses relative to the risk-taking potential (e.g. borrower concentrations, product concentrations or concentrations of the underlyings of structured products, of sectors, allocation of exposures to size and risk classes, securities, possibly countries and other highly correlated risks).
2 No lending transaction may be entered into without a borrower-related limit (borrower limits, borrower unit limits), i.e. without a lending decision.	
3 As a general rule, trades may only be executed with contractual partners for whom counterparty limits apply. All transactions concluded with a particular counterparty are to be counted towards that counterparty's individual limit. Replacement risks and settlement risks have to be taken into account when determining the extent to which the counterparty limits have been utilised. The individuals responsible for the positions in question have to be informed of the limits that apply to them and their current utilisation level as soon as possible.	**Counterparty limits** These do not apply to stock exchange transactions and spot transactions, where an amount equivalent to the transaction value has been acquired or is to be acquired on a delivery-versus-payment basis, or for which appropriate cover is available.

4 Furthermore, issuer limits generally also have to be set up for trades. If limits do not exist for particular issuers in trading, issuer limits for trading purposes may be defined at short notice based on clear rules, without the need to perform the full loan processing procedure defined in the relevant organisational guidelines according to risk aspects. The relevant loan processing procedure has to be initiated within three months. The relevant rules have to take due account of the risk aspects. They have to be in accord with the objectives set out in the strategies.	**Allowances for an issuer's special share price risks** An institution may refrain from setting up a separate counterparty risk limit for an issuer, provided that appropriate consideration is given to the issuer's special share price risks within the framework of market price limitations and on the basis of suitable procedures. Risk concentrations have to be included as appropriate. **Liquid lending products (e.g. "loan trading")** Counterparty or issuer limits must be set up in accordance with this Circular before trading is taken up with regard to liquid lending products which are traded on the secondary markets like securities. The simplifications set forth in item 4 may be applied to the determination of issuer limits.
5 Transactions are to be counted towards the borrower-related limits immediately. Compliance with the limits has to be monitored. Records are to be kept of any instances in which limits are exceeded, as well as of any measures taken as a result. If counterparty and issuer limits exceed a threshold determined from a risk point of view, this has to be reported to the responsible senior managers on a daily basis.	
6 Risk concentrations have to be identified with dependencies being taken into account. The evaluation of the risk concentrations has to be based on qualitative and, to the extent possible, quantitative procedures. Risk concentrations have to be managed and monitored with the help of suitable procedures (e.g. limits, traffic lights systems or on the basis of other precautionary measures).	**Dependencies** Existing dependencies may take the form of economic and legal interdependencies between companies and similar entities.
7 A risk report, which has to include the key structural characteristics of the lending business, has to be drawn up at regular intervals, but at least on a quarterly basis, and provided to senior management. The risk report has to contain the following information: a) the performance of the lending portfolio, e.g. by sector, country, risk class and size or security category, taking special account of risk concentrations, b) the extent of limits granted and external lines; moreover, large exposures and other noteworthy exposures (e.g. material problem loans) have to be listed and commented on,	**Exercise of individual decision-making power by the senior managers responsible for the back office in the case of restructuring loans** Given that information has to be provided on noteworthy exposures (e.g. material problem loans) in accordance with item 7b), there is no need for an additional reporting requirement for decisions relating to restructuring loans taken by a senior manager responsible for the back office as part of individual decision-making power.

c) where appropriate, a separate analysis of country risks, d) any instances where limits were exceeded to a substantial degree (including reasons), e) the scale and development of new business, f) the development of the institution's risk provisioning, g) any major lending decisions made which deviate from the strategies and h) lending decisions in the risk-relevant lending business taken by senior managers acting within their individual decision-making power which differ from the votes or were taken by a senior manager responsible for the back office.	

BTR 2 Market price risks

BTR 2.1 General requirements

1 A threshold system has to be set up on the basis of the institution's risk-bearing capacity in order to limit market price risks.	**Structure of BTR 2** In BTR 2.1, this Circular sets forth general requirements which are applicable to all market price risks (including interest rate risks in the banking book). BTR 2.2 supplements BTR 2.1 by providing rules that relate to market price risks in the trading book. BTR 2.3 provides simplified rules for the market price risks in the banking book. **Market price risks** Market price risks include: - share price risks, - interest rate risks, - currency risks and - market price risks from commodities transactions (including electricity derivatives and CO_2 emission certificates). They do not, however, include market price risks from traditional commodities transactions executed by semi-public credit cooperatives.

	In the processes for identifying, assessing, treating, monitoring and communicating risks, appropriate consideration has to be given to market-related risks that result from the change in a party's creditworthiness (e.g. special share price risks relating to securities or price risks in the case of credit derivatives).

2 No transaction that entails market price risks may be entered into in the absence of a market price risk limit.	
3 The procedures used to assess market price risks have to be reviewed on a regular basis. The procedures must be reviewed in order to verify that they also lead to useful results during periods of severe market disruptions. Alternative valuation methods must be determined for material positions in the event of longer periods during which market prices are unavailable, outdated or distorted.	
4 The results calculated by the accounting department and the risk control function have to be subjected to regular plausibility checks.	
5 A risk report on the market price risks incurred by the institution has to be drawn up at regular intervals, but at least on a quarterly basis, and provided to senior management. Taking account of internal trades, the report has to contain the following information: a) an overview of the risk development and performance of positions that entail market price risks, b) any instances in which the limits have been substantially exceeded, c) changes to key assumptions or parameters which form the basis of the market price risk assessment procedures. d) irregularities occurring during the reconciliation of trading positions (e.g. with regard to trading volumes, repercussions on the P&L, cancellation rates).	**Performance** The risk report can be based either on accounting P&L according to the Commercial Code (including unrealised profit and losses) or economic P&L changes in the economic value.

BTR 2.2 Market price risks in the trading book

1 The institution has to ensure that trading book transactions which entail market price risks are counted immediately towards the corresponding limits and that the individual responsible for a position is informed as soon as possible of the limits relevant to him and of their current level of	

	utilisation. Suitable measures have to be introduced in the event that these limits are exceeded. An escalation procedure has to be initiated as appropriate.	
2	The trading book positions that entail market price risks have to be valuated on a daily basis.	
3	Trading book results have to be calculated on a daily basis. The existing risk positions have to be consolidated into overall risk positions at least once a day at the close of trading. In principle, the overall risk positions, results and limit utilisation levels have to be reported to the senior manager responsible for the risk control function as soon as possible on the next business day. This report has to be agreed with the trading units.	**Daily reporting** Non-trading book institutions with trading book positions which are marginal from the risk point of view may be dispensed from daily reporting in favour of a longer reporting interval.
4	Risk figures derived from risk simulation models have to be continuously compared with actual trends.	

BTR 2.3 Market price risks in the banking book (including interest rate risks)

1	The banking book positions that entail market price risks have to be valued on a quarterly basis at the very least.	
2	Furthermore, the banking book results have to be calculated on at least a quarterly basis.	
3	Suitable measures have to be taken to ensure that situations in which limits are exceeded due to interim changes in risk positions can be avoided.	
4	Depending on the nature, scale, complexity and risk content of the positions in the banking book, valuation, calculation and communication of risks may also be necessary on a daily, weekly or monthly basis.	
5	The procedure used to assess interest rate risks in the banking book have to cover the key characteristics of interest rate risk.	**Treatment of interest rate risks in the banking book** As a general rule, the institution is free to decide how it wishes to take interest rate risks into account. These can either be treated separately in the trading

	and banking book, or can be considered together at institution level (provided that the institution adheres to the required daily valuation of the risk positions in the trading book and its daily performance evaluation). **Scope of the positions to be included** The procedure has to include both the balance-sheet and off-balance sheet positions in the banking book which are subject to interest rate risks.
6 The determination of interest rate risks can be based either on the effects of interest rate changes on accounting P&L of the institution or on the market or present value of the positions in question. In determining the impact on accounting P&L, possible developments after the balance sheet date have to be taken into account as appropriate.	**Consideration of the P&L according to the Commercial Code** Even in the event that a present-value method is applied, the institution has to monitor the development of accounting P&L according to the Commercial Code.
7 Appropriate assumptions have to be established with regard to the consideration of positions with indeterminate capital tie-up or interest rate fixation.	**Positions with indeterminate capital tie-up or interest rate fixation** E.g. positions with indeterminate capital tie-up or interest rate fixation can be: - positions where the actual interest rate fixation deviates from the legal interest rate fixation (primarily demand and savings deposits), - non-interest bearing assets and liabilities (e.g. participating interests) or - option elements (e.g. client termination rights, early repayment options, repayment options). Equity components that are available to the institution for an indeterminate period may not be included in the calculation of the present value of interest rate risk positions.
8 Institutions which incur material interest rate risks in various currencies have to assess the interest rate risks in each currency.	

BTR 3 Liquidity risks

1 The institution has to ensure that it can meet its payment obligations at all times. At the same time, it has to guarantee a sufficient level of diversification, primarily with regard to its asset and capital structure. To	**Cooperative solutions** The requirement set out in sentence 2 can also be fulfilled by means of existing

	the extent necessary, the institution also has to ensure it has sufficient liquidity during the course of the day.	cooperative or group structures. **Liquidity positions in different currencies** To the extent that an institution has large liquidity positions in different currencies, it has to implement appropriate procedures for the management of foreign exchange liquidity in the main currencies in order to ensure it can meet its payment obligations.
2	The institution has to establish its risk tolerance for liquidity risks and take suitable measures to ensure compliance with it.	
3	The institution has to ensure that an emerging liquidity squeeze is identified at an early stage. To this end the institution has to set up procedures and review their appropriateness at regular intervals. These procedures should take due account of the effects of other risks on the institution's liquidity (e.g. reputational risks).	
4	The institution has to prepare a liquidity overview covering an appropriate period of time, which has to compare the institution's expected inflows with its expected outflows of funds. It has to specify the assumptions on which the expected in- and outflows are based.	**Assumptions regarding expected inflows and outflows of funds** The assumptions also have to take due account of any utilisations of liquidity lines that the institution has made available to third parties.
5	Assessments have to be performed on an ongoing basis, including in an adverse market environment, in order to determine the extent to which the institution is in a position to cover any liquidity requirement which may arise. These assessments also have to focus in particular on the liquidity of the institution's assets. Uninterrupted access to the funding sources that are relevant for the institution has to be reviewed at regular intervals.	**Deterioration of the liquidity situation occurring at short notice** The institution has to maintain adequately large and sustainable liquidity reserves (e.g. in the form of highly liquid unencumbered assets) for the event that the liquidity situation deteriorates at short notice.
6	Depending on the nature, scope, complexity and risk content of the business activities in question, relevant liquidity costs and risks as well as any contributions for the funding of individual business activities must be identified and taken into account in the management of business activities.	
7	Appropriate stress tests are to be carried out at regular intervals for liquidity risks. The stress tests should take account both of causes of liquidity risks arising within the institution and of market-wide causes of liquidity risks.	**Stress tests** The institution has to define the stress tests on an individual basis. The stress tests are to be based on time horizons of different lengths. On the one hand, capital-market oriented institutions have to consider stress tests that are based on causes of liquidity risks within the institution (e.g. deterioration of the institution's rating). On the other hand, separately from the stress tests it has to consider stress scenarios that are attributable to market-wide causes of liquidity

	risks (e.g. the technical default of central counterparties, price decreases on the secondary markets for securities). In addition, stress tests have to consider a combination of both aspects.
8 The institution has to specify which measures are to be taken in the event of a liquidity squeeze (contingency plan for liquidity squeezes). This also involves specifying the sources of liquidity available in these cases, taking into account any liquidation shortfalls. The institution also has to determine the communication channels to be used in the event of a liquidity squeeze. The planned measures are to be reviewed at regular intervals with regard to their feasibility and have to be adjusted if necessary, taking into account the results of the stress tests.	
9 The institution has to monitor to what extent company law, regulatory and operational restrictions prevent the transfer of liquidity and unindebted assets within the group.	
10 A report on the institution's liquidity situation, the results of the stress tests and important modifications to the contingency plan for liquidity squeezes has to be submitted to senior management on a regular basis. The report has to deal separately with special liquidity risks resulting from off-balance sheet company structures.	

BTR 4 Operational risks

1 The institution has to introduce appropriate measures to account for operational risks.	
2 Care has to be taken to ensure that material operational risks are identified and assessed at least once a year.	
3 Major losses are to be analysed immediately with regard to their causes.	
4 A report on major losses and material operational risks has to be provided to senior management at least once a year. This report has to include the type of loss or risk, the causes, the scope of the loss or risk and, where appropriate, any countermeasures which have been introduced.	
5 The report is to be used as the basis for decisions as to whether measures have to be taken to remedy the causes, and, if so, which measures, or	

which risk management measures (e.g. insurance policies, alternative procedures, reorientation of business activities, catastrophe protection measures). The implementation of these measures has to be monitored.	

BT 2 Special requirements for the internal auditing function

BT 2.1 Duties of the internal auditing function

1 As a general rule, the audit activities of the internal auditing function have to cover all of an institution's activities and processes based on a risk-oriented approach.	
2 The internal auditing function has to be involved in key projects, although it has to preserve its independence and avoid conflicts of interest.	
3 In the case of material outsourcings to another company, the internal auditing function of the institution may not carry out own audit activities provided that the auditing work carried out within the external service provider meets the requirements of AT 4.4 and BT 2. The internal auditing function of the outsourcing institution shall satisfy itself at regular intervals that these prerequisites are fulfilled. The audit findings concerning the institution are to be passed on to the internal auditing function of the outsourcing institution.	**Execution of auditing work by the external service provider** The auditing work may be taken over by: - the internal auditing function of the external service provider, - the internal auditing function of one or several of the outsourcing institutions on behalf of the outsourcing institution, - a third party assigned by the external service provider or - a third party assigned by the outsourcing institutions.

BT 2.2 General principles for the internal auditing function

1 The internal auditing function has to perform its duties in an autonomous and independent fashion. In particular, it has to ensure that it is not subject to any instructions with regard to its reporting and evaluation activities. The senior management's right to order additional audits does not conflict with the autonomy and independence of the internal auditing function.	
2 As a general rule, members of staff employed in the internal auditing function must not be entrusted with tasks which are not related to auditing. In particular, they must not perform tasks which are incompatible with auditing activities. Provided that the internal auditing function maintains its independence, it may provide advisory support to senior management or other organisational units of the institution within the framework of its	

duties.	
3 As a general rule, members of staff employed in other organisational units of the institution may not be entrusted with internal auditing function tasks. This does not, however, rule out justified situations in which other employees can, due to their particular expertise, conduct activities for the internal auditing function on a temporary basis.	

BT 2.3 Planning and conduct of the audit

1 The activities of the internal auditing function have to be based on a comprehensive audit plan which has to be updated on a yearly basis. Audit planning has to be risk-oriented. The activities and processes of the institution, even if these are outsourced, have to be audited at appropriate intervals, as a general rule within three years. Auditing has to be performed annually if particular risks exist. Activities and processes which are deemed to be immaterial from a risk point of view may be exempted from the three-year audit cycle.	
2 Audit planning, audit methods and quality are to be reviewed and further developed on a regular and event-driven basis.	
3 It has to be ensured that any special audits required at short notice, e.g. due to deficiencies which have arisen or certain informational requirements, can be performed at any time.	
4 Audit planning, as well as any major adjustments to it, have to be approved by senior management.	

BT 2.4 Reporting obligation

1 The internal auditing function has to prepare a written report on each audit as soon as possible and, as a general rule, submit this report to the responsible senior managers. In particular, the report has to include a description of the subject of the audit and the findings, including any	**Grading of audit findings** The Circular differentiates in BT 2 between 'major,' 'severe' and 'particularly severe' findings. This creates a graded rating with regard to the (potential) significance of findings that are relevant from the risk point of view. The precise

	planned measures where appropriate. Any major findings have to be highlighted. The results of the audit also have to be assessed. In the event of severe findings, the report has to be submitted to senior management immediately.	definition of the individual rating grades is left to the discretion of the corresponding institution. The institution may define further rating grades at its own discretion for findings that are less relevant from the risk point of view.
2	The audits are to be documented by working documents. These must show the work carried out, the findings, the conclusions and must be drawn in a manner that is transparent for competent third parties.	
3	If no consensus can be reached between the audited organisational unit and the internal auditing function with regard to the implementation of measures necessary for the remedy of findings, the audited organisational unit has to make an official statement.	
4	The internal auditing function has to prepare an overall report of all of the audits performed in the course of the financial year as soon as possible and present this report to senior management as soon as possible. The overall report has to provide information on major findings and the remedy measures taken. It has to state whether or not and to what extent the audit plan has been adhered to.	**Presentation of findings** A concise presentation of the facts may be made. Individual findings which are similar in nature, as well as the status of the measures resolved, can be summarised in the report.
5	Senior management has to be informed immediately in the event that the audit identifies severe findings against senior managers. Senior management then immediately has to inform the chairperson of the supervisory body and the supervisory authorities (BaFin, Deutsche Bundesbank). If senior management fails to meet its reporting obligation or if it fails to implement appropriate measures, the internal auditing function has to inform the chairperson of the supervisory body.	
6	Senior management has to provide the supervisory body with a concise report on severe findings and on the major findings which have not yet been remedied at least once a year. Severe findings, the measures resolved to remedy them and the implementation of these measures have to be highlighted in this report. Senior management has to inform the supervisory body of particularly severe findings immediately.	
7	Audit reports and working documents are to be kept for six years.	

BT 2.5 Reaction to findings

1	The internal auditing function has to perform appropriate assessments to ensure that any findings identified in the course of the audit are remedied within the required period. Where appropriate, it has to perform a follow-up audit.	
2	If the major findings are not remedied within an appropriate period, the head of the internal auditing function at first has to inform the responsible member of senior management in writing. If the findings remain unresolved, senior management has to be informed of these findings in writing in the next overall report at the latest.	