

Comments

Initial comments on the EBA Consultation Paper on draft Guidelines on the assessment of the suit- ability of members of the management body and key function holders (EBA/CP/2013/03)

Contact:

Arndt Kalkbrenner

Telephone: +49 30 2021- 2315

Telefax: +49 30 2021- 192300

E-Mail: a.kalkbrenner@bvr.de

Berlin, 26 June 2012

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,200 banks.

Coordinator:

National Association of German

Cooperative Banks

Schellingstraße 4 | 10785 Berlin | Germany

Telephone: +49 30 2021-0

Telefax: +49 30 2021-1900

www.die-deutsche-kreditwirtschaft.de

I. General remarks

The German Banking Industry acknowledges that members of the management bodies within credit institutions should be fit and proper, be of good repute and suitable for the position envisaged to ensure a robust governance, proper functioning of the management body and the credit institution as a whole.

However, we have some observations and general remarks on this Consultation Paper:

a) Principle of subsidiarity

In our view it is necessary to strictly apply the principle of subsidiarity, which means that EBA should adhere to mandates with which it is entrusted. The EU Treaty confers powers to EU institutions for law-making within a certain defined remit. These EU lawmaking entities are democratically elected institutions which set out the EU legal framework under said purview. Thus, mandates assigned by these EU law-making entities are confined to the regulatory scope laid down thereunder. Therefore, the regulatory scope should not be extended by authorities who lack the necessary democratic legitimation. From our point of view it is necessary to adhere to the law laid down in the treaties of the EU, thus to the principle of subsidiarity.

- **Legal basis**

We understand that EBA's mandate to issue guidelines is based on Article 11 of the CRD following an amendment by the so-called CRD III.

Nevertheless, we hold the view that the new CRD IV text does not give rise to any specific EBA mandate as a standard setter in the field of corporate governance. The EBA mandate of Article 11(1) CRD is neither present in Article 13(1) nor in Article 87(1) CRD IV. We therefore argue that under the new CRD IV a specific legal basis for a mandate for EBA to draft these Guidelines is absent.

- **Scope**

Our main concern is that EBA extends the scope of the Guidelines to the supervisory board, financial holding companies and key function holders. From our point of view this is covered neither under their mandate of the current CRD nor under the CRD IV¹.

We acknowledge that there is a clear EBA-mandate in Article 11(1) subparagraph 3 CRD addressed to the management board of a credit institution. We agree that ongoing suitability of all the members of a management body is crucial for the proper functioning of a credit institution. However, from our point of view the possibility to enlarge the regulatory scope of the Guidelines to the whole management body and thus the supervisory board seems questionable. The mandate in Article 11(1) subparagraph 3 CRD refers only to those 'who effectively direct the business'. Moreover, Art. 13 CRD IV also makes reference to persons 'who effectively direct the business' who shall meet the requirements of Art. 87(1). In our view this only means that the members of the management board have to meet the criteria of fit and properness, suitability, possession of the requisite skills, knowledge and experience.

¹ EBA CP-2012-03 point 3 on page 6.

b) Principle of proportionality

The application of the proportionality principle to the suitability assessment is welcomed. However, we doubt that it is possible to define the principle of proportionality in a more detailed way and to use “buckets” in order to indicate what is meant/what the dimensions are in terms of size, nature, scale of activities etc..

II. Specific comments on questions

1. Question 1: *While the principle of proportionality is a general principle within European legislation, it may be desirable to spell out this principle in more detail for the application of the Guidelines. Which criteria could be applied by institutions and competent authorities to differentiate the assessment process and the assessment criteria regarding the nature, scale and complexity of the business of the credit institution and how should such a differentiation look like?*

The principle of proportionality is a core principle of banking regulation, especially as far as corporate governance aspects are concerned. Among the European banks there is a wide range of different business models, structures and legal forms. Therefore a “one regulation fits all” approach is not appropriate when it comes to internal structures. Consequently, the proposal of the CRD IV recognises the need to differentiate between the nature, scale and complexity of the activities of different kinds of banks. It is evident that board members of an international banking group or an investment firm need to meet different requirements than board members of a regional bank with a focus on deposits and providing loans to SMEs.

We do not hold the view that the proportionality principle ought to be specified in greater detail in European rules and regulations. Given the current level of financial market integration, we believe it is doubtful that general criteria could be found (for example linked to the value of total assets on corporate balance sheets) which could accommodate the situation in all 27 Member States. In addition to this, any further differentiation in the Guidelines would get caught up in endless details and suffocate the process, banks and regulators.

2. Question 2: *Should competent authorities be required by the Guidelines to assess the policies of institutions for assessing the suitability of key function holders aiming to ensure that institutions have appropriate policies in place ensuring that key function holders would fulfil the suitability requirements?*

First of all we would like to mention that we consider that EBA is going beyond the mandate by introducing the concept of key function holders and including it in the scope of the guidelines while there is no specific legal base in Article 11 CRD. In our opinion, it goes too far to suggest that it should be inherent in the notion of ‘robust governance arrangements’ as in Article 22 CRD². Furthermore, the fact that key function holders are mentioned in Solvency II does not give EBA, as the supervisory authority for banks, a ‘carte blanche’ to include them in the guidelines addressed to banks. The scope of the guidelines should be limited to those ‘*who effectively direct the business*’ as stipulated in Article 11(1) subparagraph 3 CRD.

If however, any EBA guidelines would include this concept of key function holders (which should be clearly defined) and require each institution to develop their own suitability testing procedures for this category, we are of the opinion that competent supervisors should only have the power to assess whether

² As mentioned during EBA Public Hearing on these Draft Guidelines of 1 June, London.

credit institutions have a policy in place for key function holders and should not have any powers as regards the content or implementation of such policies. If institutions are required to draw up policies for assessing the suitability of key function holders, they are in the best and closest position to determine the actual personnel needs of the institution. Competent authorities typically will only be in the position to give feedback on general and basic issues that naturally will leave aside the distinctive features of a specific institution.

III. Specific comments on the proposal

- Background: Section III.8, 5th sentence: Two tier structure

The statement that the “oversight role” assigned to the supervisory function “includes developing the business strategy” does not properly reflect the two-tier governance model under German law, for example, which divides the governance function between two bodies – a supervisory board and a management board. There are clear tasks for the management board or – to use the definition in the CRD IV and EBA Guidelines – the “management body acting in its management function”. The EBA would be well advised to avoid interpretive problems and ought to create legal certainty by drawing on the definitions in CRD IV (incorporation by reference) instead of trying to restate them in its Guidelines.

- Article 2 (d), Art. 3 (4), Art. 6 (4): Key function holders

With regard to key function holders, we are of the opinion that the EBA is trying to broaden its own mandate by extending the Guidelines to cover “key function holders”, which seems to be the level below the board and comprises a group to be defined by the individual credit institution (see sections III.2. and III.3.c of the consultation paper). Article 11 (1) of Directive 2006/48/EC (introduced by Directive 2010/76/EC) only says that the Committee of European Banking Supervisors shall ensure the existence of Guidelines for the assessment of the suitability of the persons who effectively direct the business of the credit institution. The draft provides no explanation of why this extension is needed, nor does it specify a legal basis (the wording in section III.2 even seems to doubt the existence of such a legal basis). Our key concern is not only that such Guidelines would inevitably generate additional red tape, but also result in the erosion of a very fundamental principle – namely that public authorities should act within the remit of the mandate assigned to them by legislators. The spurious, let alone non-existent, legal basis of the Guidelines could trigger legal disputes, not only between banks and their supervisors (which rarely occur) but also by a bank’s employees suing their employer (which happens more frequently).

- Article 3: Review process

The need to call the suitability of members of the management body into question because of information the supervisory authority has obtained from the outside or through a so-called “whistle-blowing process” should be rejected. For the same reason that does generally not allow hearsay evidence in court, such information should not be sufficient enough to provoke an assessment. Besides, the use of such sources is unnecessary as the supervisory authorities already are equipped with extensive investigative powers.

- Article 4: Responsibilities

Directive 2006/48/EC and CRD IV, makes the fit-and-proper test the responsibility of regulators and the Guidelines seek to develop harmonised practices for this. Yet, the starting point of the Guidelines is a self-

assessment by the bank and extensive process and documentation requirements. This is a further source of major concern for us. Besides, we do not believe that this reflects reality; in practice a bank would normally approach regulators informally and review the candidate and criteria with them before starting the formal paperwork. The Guidelines should therefore recognise that notwithstanding all the criteria they define, the decision will ultimately be a "judgement call". The Guidelines should take current practices into account and invite banks to liaise with the competent authority (or authorities) at the earliest stage possible.

Furthermore, we would like to point out that an assessment by the credit institution (which is requested under the [current version of the] Guidelines) constitutes an interference with the powers of those functions who are responsible for the appointment of members to the Management Board and the Supervisory Board. Any mandatory obligation on the part of the credit institution to carry out a critical formal assessment if needs be would give rise to considerable issues, to say the least. The only function on which any obligation to make an assessment can possibly be imposed is the function responsible for the appointment and dismissal (whilst not limited to, this especially applies to the suitability assessment). At this juncture, also the German prudential supervision legislation differentiates between the potential target groups for obligations and sanctions, and, for instance, does not impose an obligation upon credit institutions to assess the reliability of key stakeholders (cf. Section 2(c) German Banking Act and the corresponding legal mandate under the regulatory framework at EU level). Hence, the only viable option is and remains the option spelt out under Section 36 German Banking Act: The supervisory authorities are provided with the [necessary] information (either informally prior to the appointment of the management board or officially by virtue of Section 24(1) No. 15 German Banking Act concerning Supervisory Board Members; In the absence of reliability and/or suitability – subject to the instructions issued by the supervisor - it is incumbent upon the functions competent under the German Company Act to remove the respective Member and/or seek other remedies. The respective target groups of the obligations and instructions should hence be chosen on the basis of the effective (remedial) options available.

- Article 6(3), Art. 15(1): Collective knowledge

In our view, collective knowledge requirements are minimally addressed in the guidelines, and the correlation between individual and collective requirements should be addressed better. The focus of the guidelines must not be predominantly on the review of the qualifications of individual executive and non-executive board members but on the fulfillment of the requirements at the level of the entire body. This is not only legitimate but also desirable, as long as the Board as a whole can fulfill its function. As is regularly highlighted in initiatives at a European level, the principle of diversity in the composition of credit institutions is particularly important. If the requirements for individual board members are set too high, the whole concept of diversity does not make sense.

- Article 7: Policies on suitability

The stipulation that any credit institution should have a recruiting and assessment policy regarding the members of the management body is a formal requirement that will result burdensome especially for smaller institutions whilst not providing any relevant additional information for supervisory authorities [cost-benefit-analysis/principle of proportionality]. We would like to point out that choosing the members of its management body wisely is within any credit institutions' own vested interest. Hence, there is no need for any special rule to this effect.

- Article 11 (3): Interview by competent authorities

In our view interviews held by the competent authorities are not appropriate. After all, one of the widely accepted hallmarks of interviews is that they do not only serve for the purposes of obtaining facts but also serve in order to obtain a personal impression of the interviewed person. The fact that the authority obtains a personal impression does not necessarily ensure better suitability of the candidate or avoid conflicts of interest. Rather, there is a lingering concern that the interviewer's personal impression of the interviewee would overshadow the review of the facts corroborating the suitability of a member of bank's management body. We also feel that the right to interview a person fails to meet the criterion of proportionality because interviews consume resources and fail to live up to a cost-benefit analysis in terms of additional information obtained, i.e the same information could be obtained in a less aggravating manner.

- Article 11(6): Assessment by other EEA supervisor

If the Guidelines harmonise supervisory practices, it should be mandatory to take the result of a suitability assessment by another EEA regulator into account. The verb "may" is too soft and should be replaced with "shall".

- Article 11(8): Assessment by supervisors

It is naturally appropriate that the applicable national processes and criteria should be transparent. But given the harmonisation objective of the Guidelines, we see no scope for national regulators to add anything further. Nevertheless, the verb "may" is too soft and should be replaced by "shall".

- Article 13: Current investigations

The idea of taking current investigations and/or enforcement actions into account may need to be reconsidered. Regulators should duly consider the "presumption of innocence" principle. This should be expressly mentioned.

Furthermore, the proposed assessment criteria list seems far too extensive and would lead to an expanded assessment process. In view of the fact that occupational bans are at stake, certain criteria are definitely disproportionate. In our opinion, the definition of assessment criteria should be left to the national regulators.

- Article 15 (2): Independence requirement in subsidiaries

The proposed independence requirement in Article 15(2) (*"The following situations should be considered in assessing the independence of a member: past and present positions held in the credit institution or other firms; personal, professional or other economic relationships with the members of the management body in their management function, in the same credit institution, in its parent company or subsidiaries; personal, professional or other economic relationships with the controlling shareholders of the same credit institutions, with its parent institution and subsidiaries"*) could create problems when composing the boards of subsidiaries. It reflects an unresolved (though growing) ambiguity surrounding the subsidiary as a legal entity in its own right with a separate licence and the responsibility of the parent company to be a source of strength for the group. We are very concerned to note that, in the context of acquiring or creating a subsidiary, the parent's ability to support it in terms of finance and management is a critical

component of the change-of-control review by the subsidiary regulator (see Article 19a(1)(c) of Directive 2006/48/EC, (introduced by Directive 2007/44/EC) and paragraph 61 of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC issued by CEBS, CEIPOS and CESR (CEBS/2008/214; CEIOPS-3L3-19/08; CESR/08-543b)). But when it comes to the composition of the board of the subsidiary, it becomes important for board members to be independent of the group. The Guidelines even exacerbate this ambiguity as Article 15(2) uses independence as a wide and open concept and does not specify what purpose it should achieve or how it relates to the source of strength requirement mentioned above.

- Annex 1, item 4: Criminal records

These records may not be available to the bank. A qualification to this effect should be added to this item.

- Implementation period

Finally, we have to underline that the proposed implementation period (two months after national implementation) is far too short to be manageable.