Comments

on the
***Joint EBA and ESMA Guidelines on the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU* (EBA/CP/2016/17)**

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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 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 approximately 1,700 banks.

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Comments on the Joint EBA and ESMA Guidelines on the suitability of members of the management body and key function holders

I. General comments

The aim pursued by the joint EBA and ESMA guidelines of harmonising the criteria for assessing the suitability of members of the management body and key function holders is in principle to be welcomed.

However, given their degree of detail, the present guidelines go well beyond the regulatory mandates given to the EBA and ESMA under Articles 91 (12) of CRD IV and Article 9 (1) of MiFID II to draft guidelines for this area. In, for example, the absence of any legal basis, assessing the suitability of key function holders should not, as the primary responsibility of the management bodies, fall within the scope of the guidelines.

Furthermore, the draft guidelines would obligate institutions to establish several sets of internal rules. For example, the requirement to adopt a suitability policy would greatly increase the administrative burden on institutions (also due to its group-wide application). This burden is increased even further by a monitoring requirement. The administrative burden on the supervisory board's nomination committee should also not be amplified by way of increased documentation requirements and various (mandatory) ad hoc obligations to conduct suitability assessments. This will seriously restrict the discretion granted to the committee by the legislator and impair the efficiency of the committee's work. For these reasons, the joint EBA and ESMA guidelines should be confined to harmonisation.

In addition, the guidelines as a whole should be prefaced by reference to proportionality as their governing principle. Small institutions in particular are, as a rule, unlikely to be able to fully comply with the new requirements.

It should also not be overlooked that the exact extent of application to subsidiaries, to which the applicability of the guidelines is to be extended, needs to be clarified for large groups. Particularly with the proportionality principle in mind, eased application of the joint EBA and ESMA guidelines should be possible also for group institutions where the institution's size, internal organisation and the nature, scale, complexity and riskiness of its activities allow this. That goes particularly for those small group institutions which, solely because of their membership of a group, are supervised by the European Central Bank in accordance with Article 6 (4) of Regulation (EU) No 1024/2013.

A distinction should be made in the envisaged requirements for the independence of board members particularly with regard to whether the company concerned is a listed company or a company with no dispersed ownership (e.g. only one shareholder). The EBA's intended implementation of European Commission Recommendation 2005/162/EC by means of its guidelines fails to take account of the fact that this recommendation relates only to listed companies and that the conflicts of interest addressed therein do not exist in the case of companies with no dispersed ownership.

Finally, in view of the comprehensive new (documentation) requirements, a sufficiently long transition/implementation period should be allowed.

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II. Specific comments

Q1: Are there any conflicts between the responsibilities assigned by national company law to a specific function of the management body and the responsibilities assigned by the Guidelines to either the management or supervisory function?

Like the EBA draft guidelines on internal governance, the present draft guidelines are based on the misconception that their addressees can influence the composition of the supervisory body and its committees and thus have a say in who is appointed to both (in terms of adequate knowledge, skills, experience and diversity). The supervisory body of German public credit institutions is, for the most part, elected by the local parliament and/or composed by law (ex officio) of representatives of the institution's public guarantor (e.g. a municipality) and elected employee representatives. In this case, the institution itself has no say whatsoever in the composition of the supervisory body. The public guarantor ('municipal trustee') exerts influence on all requirements calling for pro-active control of the composition of the supervisory body. In other cases, the members of the supervisory body are in principle elected by the shareholders. Institutions have no say here either in the composition of the supervisory body. In Germany, there are also the rules on co-determination in the corporate sector which – irrespective of the number of employees – may lead to part of the supervisory body being made up of elected employee representatives.

Q2: Are the subject matter, scope and definitions sufficiently clear?

Title I, section 10
As the application of the guidelines has been extended to subsidiaries not subject to CRD IV, we assume that it is not the intention to apply these guidelines to other legal entities (e.g. non-operating entities) in the same way as to CRD IV institutions, which could be an excessive burden, depending on the nature, size and complexity of the respective legal entity. While the proportionality principle goes some way to confirming this, it would be useful to make expressly clear within the scope how these guidelines would apply to different types of legal entities.

Paragraph 13

- Definition of "*significant institutions*": According to the draft guidelines, the competent authority should be able to determine other institutions in addition to systemically important institutions (G-SIIs and O-SIIs). The concrete distinction, however, remains unclear. Since the guidelines already take into account criteria such as the size of an institution, the complexity of its business activities, etc., a separate distinction for the purposes of the governance guidelines appears unnecessary. We recommend basing the definition only on systemically important institutions, i.e. global systemically important institutions (G-SIIs) and other systemically important (O-SIIs). "*Significant institutions*" should be replaced by "*systemically important institutions*".

- Definition of "*key function holders*": We wish to point out that Article 91 of Directive 2013/36/EU (CRD IV) refers only to members of the management body, not to key function holders. There is no legal basis for setting suitability assessment requirements

for key function holders. The guidelines should be confined to harmonising the CRD IV requirements. We believe that the definition is clear ("*persons who have significant influence over the direction of the institution*"). Key function holders are the heads of internal control functions and the CFO, where they are not members of the management body. The additional phrase "*and other key function holders*" therefore should be deleted.

- Definition of "*geographical provenance*": The current definition of "*geographical provenance"* is too broad. Further clarity is needed on how firms would assess individuals against this requirement, especially as regards ensuring that the management body is made up of individuals from diverse "*cultural backgrounds*".

- Definition of "*training*": It should be made clear that the term "*training*" is to be understood broadly and that, for example, structured induction plans can also be used for this purpose.

Q3: Is the scope of assessments of key function holders by CRD-institutions appropriate and sufficiently clear?

Paragraphs 16 and 25
According to the draft guidelines, all credit institutions will be required to assess the suitability of the members of the management body and of the management body as a whole not only as and when required but also on an ongoing basis. Article 88 (2) of CRD IV, in contrast, stipulates such a suitability assessment on an ongoing basis only for significant institutions.

We are against extending such a suitability assessment on an ongoing basis to cover less significant institutions, as this will be accompanied by an increased administrative and time burden. The cases listed in paragraph 20 where a reassessment should be performed are generally sufficient. The rules should therefore be based on reference to the proportionality principle.

Institutions should at least retain some leeway on the question of how and in what form an assessment on an ongoing basis is to be performed, particularly also so that they can limit the administrative (especially the documentation) burden in individual cases.

The requirement to perform a suitability assessment every year or every two years (without specific cause) is excessive, in our view. The requirements set under Article 88 (2) (c) of CRD IV naturally have to be complied with on an ongoing basis.

Paragraph 20
We suggest clarifying the triggers for a reassessment to avoid any unnecessary administrative burden. Paragraphs 20 (b) and (c) appear to be sufficient to cover a reassessment.

Paragraph 21
Institutions generally do not know whether members of the supervisory body exercise other mandates and, if so, what these are. They are therefore unable in practice to check whether the member concerned still has sufficient time to exercise his or her mandate within the

institution. German supervisory law takes this into account in that the obligation to report any further mandates is addressed to the supervisory body member himself/herself (Section 24 (2a) of the German Banking Act). Should this arrangement be retained in the guidelines, it should be made clear that the institution is only required to reassess the time commitment of supervisory body members if it obtains knowledge of a member taking on additional mandates. There is no obligation on the part of the institution to perform such a reassessment.

Paragraph 30

We should like to mention that Article 91 of CRD IV covers only members of the management body but not key function holders. The EBA is therefore going beyond its regulatory mandate here. The scope of the guidelines should be geared to the regulatory mandate, whereby all criteria and requirements for assessing the suitability of key function holders would have to be deleted.

The criteria for an initial and recurring suitability assessment of key function holders cannot (permanently) be the same as those for members of the management body. The administrative burden appears disproportionate if, particularly in all (triggering) cases (paragraph 30), an in-depth suitability assessment at the same level as for management body members always has to be performed for key function holders. What is more, determining such cases calls for monitoring that imposes a disproportionate additional burden.

Should this approach be retained despite our fundamental misgivings, point (d) should at any rate be deleted, as the cases specified in paragraph 30 are an adequate basis for a suitability assessment.

Paragraph 31

Assessing the suitability of key function holders on the basis of the same 'high-level' criteria as those applied for assessing the suitability of the members of the management body is inappropriate, in our view. Differentiated application of the suitability requirements is called for here. Irrespective of this, there is the question of what is the legal basis for the requirements for assessing the suitability of key function holders. Article 91 (12) of CRD IV and Article 9 (1) of MiFID II cover only "*members of the management body*" at any rate (see in this context our above comments on paragraph 30).

Q4: Do you agree with this approach to the proportionality principle and consider that it will help in the practical implementation of the guidelines? Which aspects are not practical and the reasons why? Institutions are asked to provide quantitative and qualitative information about the size, internal organisation and the nature, scale and complexity of the activities of their institution to support their answers.

Q5: Do you consider that a more proportionate application of the guidelines regarding any aspect of the guidelines could be introduced? When providing your answer please specify which aspects and the reasons why. In this respect, institutions are asked to provide quantitative and qualitative information about the size, internal organisation and the nature, scale and complexity of the activities of their institution to support their answers.

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Paragraphs 33-36
The remarks on proportionality should preface the other arrangements as their governing principle. It should also be made clear that the proportionality principle generally applies to all requirements set in the guidelines.

Section 4 of the draft guidelines describes the nature of the principle of proportionality. However, proportionality is not taken into account sufficiently in the other sections of the draft guidelines. Specific links can only be found in two paragraphs of the draft guidelines (paragraphs 141 (a) and 169). The principle of proportionality should generally be applied to the whole assessment process, with the exception of assessment of reputation. As already mentioned above in our *General comments*, the extent of application to subsidiaries should explicitly be clarified for groups.

The application of the proportionality principle should explicitly include the riskiness of the activities. Paragraph 34 should therefore read as follows: "*Institutions should take into account their size, internal organisation and the nature, scale, **riskiness** and complexity of their activities […]*".

Paragraph 36 (f) should read as follows: "*the underlying business model and strategy (e.g. a buy to hold strategy), the nature, **riskiness** and complexity of the business activities, and the institution's organisational structure*".

Q6: Are the guidelines with respect to the calculation of the number of directorships appropriate and sufficiently clear?

Paragraph 40
The time needed for induction and training can only be planned individually, geared to the person who fills a specific position. Estimating and recording the need for induction and training for positions without reference to the individual are highly flexible and therefore not reliable. The proposed wording should therefore be amended as follows: "*Institutions should record in writing the functions and responsibilities of different positions within the management body and the expected time commitment required for each position*~~, also taking into account the need to devote sufficient time for induction and training~~."

Q7: Are the guidelines within Title II regarding the notions of suitability appropriate and sufficiently clear?

Title II, sections 5 (paragraphs 37-44) and 10 (paragraphs 74-81)
In general, more detailed guidance on how institutions can demonstrate that the members of a board have "*sufficient time*", as well as how they can demonstrate and measure "*independence of mind*" of their board members, would be appreciated.

Annex II lists generic skills. In order to avoid any unnecessary burden, we would appreciate clarification that institutions can use an already existing and carefully detailed framework as opposed to using exactly the same checkboxes.

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Paragraph 37

Especially where members of the supervisory body are concerned, institutions are usually unable in practice to check whether a member can continue to devote sufficient time to exercising his or her mandate, since they have no knowledge of whether that member takes on additional mandates. German supervisory law takes this into account in that the obligation to report any further mandates is addressed to the member himself/herself (Section 24 (2a) of the German Banking Act). Should this arrangement be retained in the guidelines, it should be made clear in paragraph 37 and paragraph 39 that the institution is only required to reassess the time commitment of members if it obtains knowledge of a member taking on additional mandates. There is no obligation on the part of the institution to perform such a reassessment.

Paragraphs 39/53

We fully agree with the exclusion of directorships in entities that "*do not pursue predominantly commercial objectives*" when counting the number of directorships under Article 91 (3) of CRD IV. However, such directorships should also be excluded when assessing an individual's time commitment, as their inclusion would be likely to produce the very consequences that Article 91 (3) seeks to avoid, i.e. directors may have to reduce the number of roles they assume within charitable organisations even if the time commitment required for such roles is low. Furthermore, the requirement to include "*other external professional, political activities and any other functions and relevant activities*" is very broad and will not be administrable in practice.

Paragraph 40

The proposed requirement, calling for institutions to record in writing the functions and responsibilities of positions and the expected time commitment required for each position, meets with reservations on our part. Members of the management body are collectively responsible for managing the company, whereas the supervisory body as a whole is required to oversee the management body. A clear-cut definition and description of the functions and tasks of the individual members of both bodies are therefore only possible where such functions and tasks do not fall within the collective responsibility of the respective body and may be delegated to an individual member. The proposed requirement to record in writing the expected time commitment for each position must not lead to the member also having to meet the time commitment in a blanket manner. This would be at odds with the decision on the individual time commitment that each member has to take himself/herself in line with his or her individual situation, experience and expertise.

A further argument against the proposed requirement in practice is that it will be difficult to accurately indicate the expected time commitment required for the professional performance of a mandate as this may vary (significantly) during the term of the mandate, depending on an institution's risk exposure and economic situation. It is hence likely that the proposed details of the expected time commitment and the accompanying assessment of such time commitment by institutions may impose an additional administrative burden without ensuring the added value intended by the guidelines.

Paragraphs 40-44

The proposal assumes that institutions are primarily responsible for indicating and overseeing the time commitment required by members of the management body. In our view, however,

indicating the time commitment required is primarily the responsibility of the members – not the institution. We are therefore opposed to the requirements for institutions specified in paragraphs 40-44. The obligation to record in writing the time commitment required for all the functions within the management body and the supervisory body imposes an unwarranted additional burden on institutions. What is more, the time commitment required varies from person to person, depending on experience, travel time, training needed, etc. Institutions are thus not in fact able to determine it. Instead, an assessment should only be performed by institutions where knowledge obtained raises doubts about the actual time commitment required.

When it comes to the time commitment required by board members, a documentation and assessment requirement for institutions for other activities of those board members also meets with fundamental reservations on our part. The resulting inclusion of, for example, purely honorary, i.e. non-professional, offices and activities in assessment of the time commitment required constitutes a disproportionate invasion of privacy for board members. When assessing the time commitment required, only professional aspects should therefore be taken into account (see in this context also our comments on paragraphs 39/53).

Even though institutions need to ensure that a board member or key function holder has sufficient time to perform his or her main duties, monitoring performance as an indicator for such a requirement, the actual time commitment attached to different roles varies from one individual to another. An objective assessment including all the details listed in the draft guidelines will be difficult to conduct in practice. In particular, a requirement to keep written records of all individual responsibilities will impose a significant administrative burden. We therefore recommend dropping it or at least restricting it to material external professional and political functions. Again, the applicability to subsidiaries requires clarification.

Paragraph 53
It is unclear what the criterion specified in paragraph 53 (c) ("*companies that are set up …*") means. Clarification would be welcomed.

Paragraph 66
The requirements set for the knowledge and experience of the management body collectively go too far, in our view, for the supervisory body. For example, we do not believe that it is feasible or even necessary in practice for the supervisory body to know each of the material activities of the institution. This criterion should be amended so that merely the "*main*" activities are known.

Paragraph 72 (b)
Gathering, analysing and evaluating information on financial and business performance on a large scale is time-consuming and expensive, and of limited value. However, information on extraordinary financial and business performance may be of value and, in addition, is more easily available, e.g. from press documents. We therefore believe that point (b) should be amended to read as follows: "*extraordinary financial and business performance of entities owned […]*"

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Paragraph 73 (e)
The guidelines require consideration of "*any other evidence that suggests that the person acts in a manner that is not in line with high standards of conduct*". This should read "***material*** evidence" to avoid any confusion that continuous assessment is necessary. A minimum frequency should also be included, as *"ongoing assessment"* should not be read to mean several assessments per year in normal circumstances.

Paragraph 77
The draft guidelines would make it more difficult for persons with political influence to be members of institutions' supervisory bodies, as they are assumed to have a significant conflict of interests (e.g. mayors, local government employees, government officials).
This assumption is incompatible with the public banking sector in Germany and its required democratic legitimation.

At German public-sector institutions such as the savings banks (*Sparkassen*), the size and composition of the supervisory body ('administrative board' [*Verwaltungsrat]*) is usually specified by regional federal state law or the constitution of such institutions. Savings banks generally do not have owners or shareholders but public trustees (*kommunale Träger)*, e.g. a municipality. The members of the administrative board are elected by the representative body (e.g. city council). The chair of the administrative board, as a rule, is the municipality's principal administrative officer (e.g. mayor). To ensure both democratic legitimation and fulfilment of the public mandate, the administrative board is thus made up mainly of representatives of the municipality and qualified citizens. Because this means that, though political influence is exerted, there is no conflict of interests, it is important to include in the guidelines an exemption not only for representatives of shareholders but also for representatives of municipal trustees.

Promotional banks were established to pursue public policy purposes. On account of the public guarantees they usually enjoy, the business of such banks is of great importance for their guarantors. Due to the principle of democracy and the government's budget responsibility, and in order to ensure that promotional banks achieve their statutory purpose, membership of persons holding political office in the supervisory body of such banks is indispensable. Holding political office does not, in itself, lead to any conflicts of interest; the interests of the bank, which are, as a rule, geared to its statutory purpose, and the interests of representatives of its guarantor will in fact usually be identical.

We expressly request deletion of point (f).

An exemption for both representatives of shareholders and representatives of municipal trustees is at any rate urgently required.

We wish to suggest adding the following wording: "*The presence of representatives of shareholders and municipal trustees in the management body in its supervisory function is accepted. This applies particularly to the allocation of supervisory board seats based on special national provisions governing the composition of boards which serve to ensure fulfilment of the founding purpose of the institution or its public mandate."*

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Q8: Are the guidelines within Title II regarding the human and financial resources for training of members of the management body appropriate and sufficiently clear?

Paragraphs 85-91
Paragraph outlines the framework for an induction and training policy. Such a policy should set out, among other things, the responsibilities for the development of a "*detailed training programme*". The requirement to develop a training programme covering the members of the management body and the supervisory body should be proportionate. However, the requirement to develop a detailed training programme appears excessive, especially as both the management body and the supervisory body are always supported by their specialist departments or various (specialist) committees (paragraph 87). Furthermore, the requirement to have an evaluation process in place to review the effectiveness of the training programme will impose an additional administrative burden.

The bureaucratic requirements for induction and training envisaged in the guidelines go much too far. Obligating institutions to adopt detailed policies and procedures in this respect is, in our view, neither necessary nor helpful. These issues should be handled solely individually.

Q9: Are the guidelines within Title IV regarding diversity appropriate and sufficiently clear?

Diversity within the management body is undoubtedly an important issue. The requirement to adopt a formal diversity policy is, however, likely to impose too much of a burden in practice, particularly on smaller institutions. With the 'small banking box' initiative at European level in mind, the proportionality principle should be explicitly taken into account in this context as well.

The guidelines specify that "*the diversity policy should include for significant institutions a quantitative target for the representation of the underrepresented gender in the management body"* (paragraph 93), calling for appropriate timeframes and measures in this respect. The undoubtedly desirable increase in the proportion of women in management bodies has already been addressed quantitatively in Germany by the *Act on Equal Participation of Men and Women in Executive Positions*. There thus appears to be no need for any additional action to address this challenge to society as a whole by way of banking regulation that would lead to tighter rules for banks than other business sectors. The quantitative target for significant institutions in paragraph 93 should therefore be deleted.

We should appreciate clarity as to whether institutions are expected to develop a stand-alone diversity policy in case such requirements are already embedded in other existing policies and documents. With regard to such a stand-alone policy, there are again issues concerning the authority to issue such a policy in a two-tier system that imposes an additional administrative burden.

In addition, specific quantitative requirements for subsidiaries might lead to unexpected results and an administrative burden. We thus recommend clarifying the applicability to subsidiaries and the respective details.

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Paragraph 96
Under the two-tier system of corporate governance, the management body in its management function does not comprise any employee representatives. It should therefore be made clear in paragraph 96 that the proposed inclusion of employee representatives in the diversity policy relates to the management body in its supervisory function.

Paragraph 97
Institutions are to be required to implement a diversity policy not only for their management body but also for their staff. This is not called for under CRD IV and should, in our view, only be provided for on a voluntary basis. Paragraph 97 should therefore be deleted.

Q10: Are the guidelines within Title V regarding the suitability policy and governance arrangements appropriate and sufficiently clear?

Paragraph 98
Under German company law, the supervisory board is responsible for appointing the members of the management board and overseeing and advising the management board and its members. The management board is responsible for managing the company. Responsibility for the suitability of the members of the management board therefore lies legally with the supervisory board, while responsibility for key function holders lies with the institution, i.e. the management board. In this context, it is unclear where ultimate responsibility for adopting and maintaining the proposed suitability policy would lie. At a minimum, two separate policies/documents would appear to be needed in this case.

Paragraph 113
Where a nomination committee is not established, the guidelines say that the supervisory body should have the responsibilities of the nomination committee. We are opposed to this blanket requirement for all institutions. It goes beyond the intention of Article 88 of CRD IV, which is geared to significant institutions. Inclusion of a reference to the proportionality principle would be appreciated. We request clarification that, if no committees have been established in smaller and less significant institutions, the supervisory body is not responsible for every task assigned to the nomination committee.

Paragraph 115
We welcome the clarification by way of reference to the last subparagraph of Article 88 (2) of CRD IV. Where the supervisory board is composed solely of representatives of the public municipal trustee, the institution has no say in the appointment of its members. Paragraphs 111-114 are then not applicable at all.

Paragraph 117
In some cases the number of board members is stipulated by law, so that institutions have no influence on it. It should be made clear that in such cases an adequate number of members is always ensured.

The identification and selection of members of the management body in its supervisory function is limited to positions which are not taken up by employee representatives as required

by law and chosen by vote. Although the necessary consistency with legal requirements is mentioned, we recommend additional clarification as follows: "*The management body should****, to the extent possible,*** *identify and select qualified and experienced members and ensure appropriate succession planning for the management body that is consistent with all legal requirements regarding composition, appointment or succession of the management body*."

Paragraph 123

According to the guidelines, individuals with political influence may have a conflict of interests, with the result that the independence of the individuals concerned has to be reviewed. This fails to take account of the required democratic legitimation in the supervisory boards of public credit institutions, particularly savings banks and promotional banks. As in their case the representatives of the public guarantor (municipality) usually have political influence, we expressly request that paragraph 123 be worded more neutrally in this respect.

Paragraph 123 ff.

The requirements for the independence of the members of the supervisory board envisaged in the guidelines are based mainly on the European Commission's Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. This Recommendation is designed to prevent conflicts of interest that may impair directors' powers of judgment. Recital 7 of this Recommendation says that in companies "*with a dispersed ownership, the primary concern is how to make managers accountable to weak shareholders. In companies with controlling shareholders, the focus is more on how to make sure that the company will be run in a way that sufficiently takes into account the interest of shareholders. Ensuring adequate protection for third parties is relevant in both cases*." In both cases, it is a question of ensuring adequate protection of third parties to prevent conflicts of interest. There are, however, no such conflicts of interest in the case of parent undertaking/subsidiary structures with only one shareholder. 'As is' implementation of the European Commission's Recommendation is inappropriate for such cases and, in view of the scope, was also not intended by the Commission, since the Recommendation covers only listed companies. In the case of parent undertaking/subsidiary structures with only one shareholder, what instead matters is that the parent undertaking can exercise its oversight and monitoring function effectively over the supervisory board. We request that the requirements for independence in paragraphs 123 and 124 be differentiated accordingly.

In this context, it should not be overlooked that the European legislator refrained from implementing the aforementioned Commission Recommendation on independence in this form within the framework of CRD IV. Instead, it chose at the time to directly address problematic cases with significant potential for conflicts of interest: thus, under Article 88 (1) (e) of CRD IV the chairman of the management body of an institution in its supervisory function is not allowed to exercise simultaneously the functions of a chief executive officer within the same institution, unless this is justified by the institution and approved by the competent authorities. In addition, the management body is required under Article 88 (1), third sub-paragraph of CRD IV to monitor and periodically assess the effectiveness of the institution's governance arrangements and take appropriate steps to address any deficiencies. We regard this approach as appropriate.

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Personnel ties between parent undertaking and subsidiaries should at any rate remain possible in the future at group level to ensure group-wide management and oversight. The parent undertaking, which has an interest in protecting assets and, if a German stock corporation, is responsible under Section 91 (2) of the German Stock Corporation Act for ensuring that suitable measures are taken within the group so that developments threatening the continued operation of the subsidiary and, in the event of contagion effects, that of the parent undertaking as well are detected at an early stage, must be able to effectively control the supervisory board. This assumes that a majority of the risk committee, which deals closely with all issues adversely affecting the institution's risk position, can continue to be composed in future of members of the management body such as the Chief Financial Officer of the parent undertaking and of employees of the parent undertaking. Furthermore, where an institution is embedded in a group, it must continue to be ensured in future that the chairs of the supervisory board committees may be members of the management board and employees of the parent undertaking. This would no longer be possible, however, with a definition of "*independence*" that goes too far, since persons "*employed by any entity* <u>*within the scope of consolidation*</u>" are to be considered non-independent.

Directors employed by the parent undertaking, such as the parent undertaking's Chief Financial Officer or representatives of the parent undertaking's senior management, who represent the interests of the parent undertaking and whose job is to effectively oversee and monitor the subsidiary, would consequently have to be considered non-independent. In conjunction with paragraphs 42 and 44 of the consultation paper on *Draft Guidelines on internal governance*, this would mean that these persons would no longer be able to make up the majority of the risk committee or occupy the chair of any supervisory board committees. This is inappropriate, in our view, as effective oversight and monitoring of the subsidiary would then be virtually impossible. In the case of parent companies operated as a stock corporation, such a restriction would, moreover, impair the ability of the management board to perform its duty in accordance with Section 91 (2) of the German Stock Corporation Act to take suitable measures so that developments threatening the continued operation of the subsidiary and, as a result of the subsidiary's difficulties, the parent undertaking as well are detected at an early stage.

Furthermore, assessing the risk profile and the risk exposure of captive financial companies calls for special knowledge of the business model and internal operations that persons outside the group do not usually possess.

We request clarification that the members of the management body and employees of the parent undertaking are not considered to be non-independent. The wording "*are not employed by any entity within the scope consolidation*" could be amended to, for example, read "*are not employed by the entity or any subsidiary of the entity*". This restriction should at any rate apply to subsidiaries in a group whose shares are not traded on the stock exchange.

In addition, when assessing independence, more attention should be paid to the specificities of the two-tier system of corporate governance. According to a decision by the German legislator, the required independence of supervisory board members already follows from the institutional separation of the supervisory body from the management body (<u>cf. government explanatory memorandum on the Audit Reform Act, Bundestag printed matter 18/7219, p. 56</u>). Irrespective of this, personnel ties between parent undertaking and subsidiaries should remain possible at

group level to ensure an effective group-wide strategy. Clarification to this effect would be helpful.

The guidelines are to include an assessment that individuals who have served as a member of the management body in its supervisory function for or longer should automatically be considered non-independent. This may lead to such members no longer serving on the management body in future, depriving the institution of valuable corporate knowledge and experience. Bearing this in mind, the arrangements in the guidelines should be reconsidered.

When assessing independence, more attention should be paid to the specificities of the two-tier system of corporate governance. According to a decision by the German legislator, the required independence of supervisory board members already follows from the institutional separation of the supervisory body from the management body (cf. government explanatory memorandum on the Audit Reform Act, Bundestag printed matter 18/7219, p. 56). Irrespective of this, personnel ties between parent undertaking and subsidiaries should remain possible at group level to ensure an effective group-wide strategy. Clarification to this effect would be helpful.

The presumption in the guidelines that individuals who have served as a member of the management body in its supervisory function for 12 years or longer should automatically be considered non-independent may lead to such members no longer serving on the management body in future, depriving the institution of valuable corporate knowledge and experience. With this in mind, the arrangements in the guidelines should be reconsidered.

Paragraph 124
In the cases listed in paragraph 124, the required independence is generally considered to be missing. This assessment should at least be made open to disproval to allow decisions on a case-by-case basis.

- In point (a), the words "*is an officer of*" in conjunction with "*a substantial shareholder of the CRD institution*" should be deleted. As explained in our comments on paragraph 123, employees of the parent undertaking should not be considered non-independent. In addition, it should be made clear that members of the management body and employees of the parent undertaking are not automatically considered to be "*otherwise associated with a substantial shareholder of the CRD institution*" because of their membership of the management body or contract of service with the parent undertaking.

- With regard to point (b), we request deletion of the words "*another group entity*". As explained in our comments on paragraph 123, members of the management body and employees of the parent undertaking should not automatically be considered non-independent. It should also be made clear that the cooling-off period of three years applies only to future management board members.

- Point (f) should be deleted. Not every 12-year membership of a management body automatically rules out the required independence. On the contrary, membership over a period of many years may deliver a significant and indispensable benefit in terms of experience.

- Furthermore, when revising this provision, the following should not be overlooked: Under the German corporate system, where the members of the supervisory board are either elected by employees or elected by shareholders, the broad definition of "*independence*" would likely lead to uncertainty about who is actually independent and therefore complicate the establishment of necessary board committees (nomination committee, risk committee).

Paragraph 125

According to paragraph 125, the nomination committee, where established, is responsible for ensuring that the individual and collective suitability assessments of the members of the management body are carried out. The supervisory board is then responsible for determining the final suitability assessments. This arrangement poses problems particularly when it comes to assessing the suitability of the members of the supervisory board who are appointed by decision of the general shareholders' meeting. Banks are required under paragraph 127 to inform their shareholders of the result of the collective and individual suitability assessments before the general shareholders' meeting takes any decision on the appointment of members. Where the general shareholders' meeting appoints a member that was not proposed or vetted by the institution, banks are required to assess that member's suitability no later than three weeks after the general shareholder's meeting and, if this assessment is negative, to inform the competent authority and the shareholders thereof without delay. In accordance with the law currently in force in Germany, the nomination committee supports the supervisory board in preparing its proposals for the selection of supervisory board members; in so doing, the nomination committee has to take into account the balance and diversity of the knowledge, skills and experience of all members of the board in question (Section 25d (11) no. 1 of the German Banking Act). The provision of the German Banking Act is thus geared solely to the collective suitability of the board in the event that a new member is appointed. The individual suitability assessment of potential new supervisory board members by the supervisory board itself or its nomination committee, called for in paragraph 127, would affect the owners' right to appoint board members enshrined in the company's constitution or elsewhere. Particularly supervisory board members whose membership of the supervisory board is based on such right of appointment by the owners enshrined in the company's constitution or elsewhere could face considerable conflicts of interest through their inclusion in the assessment of individual suitability. Conflicts of interest also cannot be ruled out for bank staff involved in preparing the decision in this respect. For these reasons, assessing individual suitability rightly falls within the responsibility of the competent authority. Paragraph 127 should be thoroughly revised so that institutions in particular are not required to perform an individual suitability assessment of supervisory board members.

Paragraph 127

The 'suitability assessment <u>before</u> appointment' rule is to be introduced. Only in justified cases are exceptions to this rule to be allowed. The period granted to institutions to assess the suitability of board members is shortened to three weeks at most after the appointment of members. We are in favour of retaining the current practice (flexibility as to whether the assessment is ex-post or ex-ante) and the current six-week period (see in this context also our comments on paragraphs 161 and 195).

Comments on the Joint EBA and ESMA Guidelines on the suitability of members of the management body and key function holders

Paragraph 132
The procedure proposed by the EBA and ESMA, stating that the outcome of the suitability assessment is to be transmitted to the competent authority as well, imposes a needless additional burden. Where an institution appoints a new member, this act in itself implies that the member is considered suitable. Such additional notification over and above notice of the appointment is therefore unnecessary, in our view.

The outcome of the suitability assessment is to be notified to the competent authority in highly detailed form (as per Annex III). The list of documents to be submitted is lengthy. To avoid any unnecessary burden, we believe that only the outcome of the assessment but not any details thereof should be communicated where suitability is confirmed.

Paragraph 140
It would be useful to recognise the different roles of the supervisory function within single and two-tier companies, specifically to provide guidance on how collective suitability is applied to each. The matrix in Annex 1 implies that they should be assessed as if the function had the same responsibilities.

Paragraph 151
It should be made clear that no reassessment is required for key function holders.

Q11: Are the guidelines within Title VI regarding the assessment of suitability by institutions appropriate and sufficiently clear

Q12: Are the guidelines with regard to the timing (ex-ante) of the competent authority's assessment process appropriate and sufficiently clear?

It should be clarified what is meant by "*management body in its supervisory function"* for single-tier board structures, as clearly this will not be segregated from the management function except in certain board committees.

Q13: Which other costs or impediments and benefits would be caused by an ex-ante assessment by the competent authority?
Q14: Which other costs or impediments and benefits would be caused by an ex-post assessment by the competent authority?
Q15: Are the guidelines within Title VII regarding the suitability assessment by competent authorities appropriate and sufficiently clear?

General comments
The 'suitability assessment before appointment' rule is to be introduced. Only in justified cases are exceptions to this rule to be allowed. We regard this approach as impractical, as the assessment by the competent authority under the draft guidelines is to take 3-4 months and would lengthen the appointment process considerably. Irrespective of this, an ex-ante procedure taking around four months would seriously obstruct any switch by board members to other institutions.

Paragraph 159
The envisaged assessment procedure by the competent authority before the appointment of a member is incompatible with the principles governing the public banking sector in Germany, particularly where it affects ex officio members of the supervisory board. By virtue of their principal office, these are members of the supervisory board by law, so that an ex-ante assessment by the competent authority is not possible. To take due account of such cases as well and avoid having to explain every time why an ex-ante assessment could not be performed, an open procedure should be adopted. An assessment taking several weeks/months prior to appointment must also be rejected because the long waiting period makes the position in question less attractive for potential applicants. We request clarification to the effect that an ex-post assessment is sufficient.

Paragraph 161
Paragraph 161 requires competent authorities to assess the suitability of individuals who are to be newly appointed or reappointed as board members ahead of their appointment (ex-ante assessment). Exceptions are only to be possible in justified cases. The period set for the competent authorities' assessment procedure is to be not less than three months and not more than four months (paragraph 166). In the question following the paragraph (Q13), it is already conceded that the currently conducted ex-post assessment (suitability assessment after appointment) shortens the period between the start of the appointment process and actual appointment, whereas an ex-ante assessment has a risk-mitigating effect. It should be noted in this context that an ex-ante assessment would undermine existing powers and responsibilities when it comes to appointing board members and generally call into question processes for appointing board members. The experience made in banking practice shows that there is the danger that appointment processes would in this way easily take twelve months or more. This period would seriously hamper the selection of candidates committed elsewhere by reducing planning security and might generally diminish the attractiveness of board membership at banks. Any regular lengthening of the appointment processes would also risk endangering confidentiality, which might be harmful to the reputation of both institutions and candidates alike. The general ex-ante assessment approach should therefore be dropped.

Paragraph 165
Competent authorities are also to be empowered to assess the suitability of key function holders of non-significant institutions. No criteria for when they can make use of this power are indicated, however. As mentioned earlier, key function holders should not be included in the scope of the guidelines as neither CRD IV nor MiFID II contain a regulatory mandate in this respect. The selection and assessment of this group of individuals is the responsibility solely of the management boards within institutions. For this reason, paragraph 165 should be deleted.

Paragraph 168
As already explained in our comments on paragraphs 16 and 25, we do not believe that a reassessment of suitability on an ongoing basis is necessary particularly for less significant institutions. The proportionality principle should be applied.

Comments on the Joint EBA and ESMA Guidelines on the suitability of members of the management body and key function holders

Paragraphs 169-171
Competent authorities are to be allowed to attend board meetings at institutions. Where significant institutions are concerned, additional interviews are possible. As there is no basis for this, we request deletion of these paragraphs.

Paragraph 174
Competent authorities are to inform institutions only of negative results of suitability assessments. Positive results, on the other hand, will be deemed to be tacitly communicated "*where the maximum period for the assessment is reached and the competent authority has not taken a negative decision*"*.* We recommend that institutions also be informed without delay of positive results so that they obtain legal certainty as soon as possible.

Q16: Is the template for a matrix to assess the collective competence of members of the management body appropriate and sufficiently clear?

Q17: Are the descriptions of skills appropriate and sufficiently clear?

The skills listed leave open how they are to be checked in practice – take, for example, the required communication skills. Guidance on this for institutions should be included in the guidelines.

Q18: Are the documentation requirements for initial appointments appropriate and sufficiently clear?

Q19: What level of resource (financial and other) would be required to implement and comply with the Guidelines (IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? If possible please specify the respective costs/resources separately for the assessment of suitability and related policies and procedures, the implementation of a diversity policy and the guidelines regarding induction and training. When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.