*Draft BSG response to EBA/ESMA Guidelines on the assessment and suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU*

The BSG is pleased to respond to the Joint EBA/ESMA Guidelines on the assessment and suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU[[1]](#footnote-1).

*General comments*

We support good corporate governance and believe that the requirements in this regard incorporated firstly in CRD IV and subsequently in MiFID have contributed significantly to its continued improvement. So we welcome the joint guidelines as an important further expression of the authorities’ supervisory expectations. Several members of BSG do not support the previous extension of the guideline requirements to heads of control functions. As the consultation paper recognises CRD IV, Article 91 (12) requires Guidelines to be developed to assess the suitability of members of the board only. It does not require Guidelines to be developed for key function holders. On the contrary, several members of BSG support the extension of the guidelines requirements to heads of control functions.

*Application to dual or unitary board structures*

The opportunity should be taken to re-focusing the Guideline requirements on members of the management body (both in their management and supervisory function). Indeed, the EBA points that this consultation should be read in conjunction with the one on internal governance (EBA/CP/2016/16). In that vein, it has to be noted that, the two consultations state that the EBA has no preference between unitary or dual board structures. However, it seems that they neither adequately fit in dual nor unitary models concerning some issues -as it is argued in our response to question 1. Therefore, the BSG suggests the EBA to rewrite the Guidelines in a way that can be properly implemented in both, unitary and dual boards.

*Assessing key function holders*

Some BSG members are not in favour of extending the guidelines to key function holders, whereas others support this extension. Of course, institutions will continue to make assessments of the suitability of all their staff, including key function holders, based on their own internal policies and procedures In general , we do not think it is unreasonable for competent authorities to oversee such processes in the case of institutions that could impact the stability of the financial system, be they globally or domestically important.. In other cases, institutions should be allowed to take their own approach to assuring fitness and proprietary.

Indeed, several BSG members consider that the Joint EBA/ESMA Guidelines seem to exceed the mandates provided for under CRD IV. This goes for the mandatory assessment of key function holders by CRD-institutions in particular, but for a number of other provisions as well. For instance, in the view of these members there seems to be no legal basis for EBA to require competent authorities’ assessment of a SIFI’s heads of internal control functions and the CFO (paragraph 159). The wording of articles 74 and 88 CRD IV – and article 74 (3) in particular –, as invoked by EBA, appears too general to provide a basis for a Guideline that specific. Moreover, there seems to be no legal basis for paragraph 79 and paragraph 97 of the Guidelines: Whilst paragraph 79 does not really relate to the personal suitability of a member of the management body, but rather requires a specific action (or omission) of the latter under certain circumstances, paragraph 97 runs the risk of effectively extending the Guidelines’ diversity requirements from members of the management board to *ALL* members of staff. Albeit all of these requirements may well be in the interest of prudential regulation, these members consider that the lack of legal basis is problematic.

*Applying the guidelines to insurers*

Furthermore, we recommend that the ESMA and EBA work with EIOPA to ensure the Guidelines are addressed also to insurance companies too, as:

* stability and proper functioning of the financial system requires not only safe banks, but also other important financial institutions, including insurers,
* fit & proper requirements apply equally to insurance companies (see art. 42 of Solvency II directive),
* should the Guidelines be addressed only to Institutions, they would apply only to those insurance companies which are part of financial holdings (or mixed financial holdings), whereas extending them to all insurers would ensure a harmonised approach across sectors and a level playing field.

*Breadth of skills -*

Some members of the BSG stress that there should be no expectation that every member of the management body should have a full set of the skills listed in the draft guidelines, rather the board in its totality should display these skills. Other members of the BSG , on the contrary, expressed the concern that some unqualified enough members could hide under the umbrella of collective skills.

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?

There could emerge some potential conflicts between national company law and the Guidelines. We note that in some jurisdictions governance standards are implemented by voluntary Codes that apply to listed companies, including banks, but not to other companies, including banks that are not listed on a stock exchange. These Codes should not be viewed by the EBA and ESMA as analogous to national company law as to do so would disproportionality widen the scope of Codes aimed at listed companies (including listed banks) to all banks.

We appreciate the recognition in the draft Guidelines that they aim at being equally applicable to institutions with either a unitary board structure or a dual board structure. However, it seems that they neither adequately fit in dual nor unitary models at some issues arising some possible conflicts, as illustrated below:

* There is a potential conflict between the draft Guidelines and the rules applicable to commercial partnerships under the company laws of certain Member States (e.g. Germany). In such associations, the management and supervision of all business activities may basically be a legal right and duty of the respective shareholders (unlimited partners) themselves. As a consequence, any requirement concerning the suitability of members of the management body operates effectively as an instrument of ownership control. Aside from the fact that ownership control is, at best, a side issue within the framework of CRD IV (see articles 22-27) and therefore largely outside the regulatory perimeter, it might be desirable for the Guidelines to clarify if and in what way the respective provisions shall apply to commercial partnerships (i.e. unlimited partners) as well.
* There are also problems for unitary board systems. For instance, the Spanish Company Law recognises that responsibilities are decided and executed collectively by the whole management body, not only by some members -the members of the management body with a management function. That is, decisions are taken by all members of the board. Going a bit further, under unitary board systems the supervisory and management functions fall under the same body, and the functions will not be performed independently in the way the Guidelines expect. Both functions are performed, yet not independently from one another, rather in a coordinated manner.
  + At European level, the CRD IV allows functions not directly reserved to the management body - such as the day-to-day running of the institution’s business - to be performed by the senior management of the institution, which is accountable to the management body. However, the Guidelines appear to propose to assign the day-to-day running of the institution to the management body in its management function.

In addition, we note that Article 91 (13) of the CRD IV stipulates that article 91 “shall be without prejudice to provisions on the representation of employees in the management body as provided for by national law”. The right of the employees´ council to nominate members of the management body in its supervisory function is part of the labour law of many Member States and should not be constrained by the proposed independence criteria. Hence it might be helpful to clarify if and to what extent paragraphs 123-124 of the draft Guidelines would be applicable to employee representatives appointed as members of the management body in its supervisory function under specific national law, perhaps by the addition of a phrase such as “*representatives of the employees´ council should be considered as independent in any case”.*

Likewise, concerns may arise regarding the members of the management body in credit institutions of the public sector, i.e. institutions run by municipalities, regional authorities or other state organizations. In these entities, members of the management body in its supervisory functions may in many cases be politicians (local mayors, heads of regional governments etc.), which may be required by the respective entity's articles of association or even by (constitutional) law.

The formal independence criteria in the guidelines are problematic in terms of group structures. In the Netherlands for example it is quite common to appoint representatives from the parent company to the supervisory board of subsidiaries. When the parent company is also supervised by our national competent authority, it considers these supervisory board members formally independent. Naturally, these members should be independent ‘in mind’ and ‘in appearance’ at all times. The assessment thereof is included in their suitability assessment.

The Dutch NCA has derived its standing point from the Dutch Corporate Governance Code (DCGC) that details the generally accepted principles of good governance in the Netherlands. This DCGC also considers these supervisory board members as formally independent. Consequently, this practice is considered ‘good governance’ in the Netherlands.

The guidelines do not consider these members as formally independent. This feels uncomfortable, because this would potentially undermine the capacity of the management bodies on group level to supervise all of their operations and also to secure compliance with regulations and supervisory requirements on a group level. It would also give rise to significant practical issues given the number of subsidiaries banks have. Especially if it is not clarified that certain subsidiaries (such as fully owned subsidiaries) are excluded from the scope of the guidelines, as set forth below in relation to Q2. Some BSG members are of the view that this exclusion of subsidiaries should be limited to those domiciled in the same country as the parent company

In many member states, one of the key instruments of group steering is the right of the parent company, in its supervisory function, to nominate members of the management board of its subsidiaries. Most of the proposed independence criteria are formulated in a very restrictive manner that will make impossible the use of this basic principle and right of parent companies towards its subsidiaries within a group structure. Furthermore the Internal Governance Draft GL require that in a group structure the consolidating institution should ensure that governance arrangements, processes and mechanisms are consistent and well integrated group-wide (Section 8, para. 75). How should consolidating institutions ensure that these arrangements, processes and mechanisms are implemented group-wide in the absence of one of their key instruments of group steering?

In this context it should be mentioned with regard to joint stock corporations that the only way in which group steering by the parent company can be exercised in many member states is through its representatives in the management body in its supervisory function of the subsidiaries. For instance, according to the provisions of the Austrian Stock Corporation Act (§ 70 para. 1) the management body in its management function of the subsidiary is not bound by the instructions of the parent company. Furthermore, the Austrian Banking Act lays down certain supervisory requirements which consolidating institutions have to comply with on a consolidated basis and for the fulfilment of which they are responsible (§ 30 para. 6). For this purpose, the subsidiaries are legally required to provide the consolidating institutions with the necessary information and documents (§ 30 para. 8). The application of supervisory requirements on a consolidated basis and the legal obligations related thereto within group structures are also laid down by Art. 11 (1) CRR. All the above mentioned provisions represent legal instruments for the parent companies to exercise their group steering which are being significantly compromised by the proposed EBA Fit & Proper Draft GL.

Some BSG members consider appropriate that the Guidelines include enough safeguards and guarantees that independent members are totally independent, allowing them to be critical (see Recital 60 of CRD IV).

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

The subject matter and definitions are clear. We fully agree that members of management bodies should be suitable for their role, tasks and responsibilities.

Also, the guidelines seem to apply to all subsidiaries of banks including those that are not subject to CRDIV. We feel that this is not consistent with the proportionality principle. It could also potentially lead to conflicts with (foreign) legislation relating to these specific subsidiaries. The larger banks have many legal entities for various reasons. Some of them regard entities with banking activities and others are of a different nature. We feel that a proportionate approach would be to limit the scope of the guidelines to financial institutions in the EU included in the prudential consolidation. This remark also relates to section 15. *Suitability in a group context* (paragraph 106-110).

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

We agree that CRD-institutions, or more correctly the management body of such institutions should be responsible for the assessment of all their staff’s fitness and propriety. However, in the view of some BSG members, the relevant directives do not formally extend this requirement outside of the management body. So, they consider that this section 3 should be addressed only to systemically important financial institutions (either globally or domestically). In other cases, institutions should be allowed to take their own approach to assuring fitness and proprietary.

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.

The BSG is a strong supporter of proportionality in regulation and supervision and agrees that the approach to proportionality proposed in the Guidelines should take into account the size, internal organisation and the nature, scale, and complexity of the activities of financial institutions when developing and implementing policies and processes –as stated in pages 26 and 27 of the Guidelines.

However, we encourage EBA to elaborate further on the limits of the proportionality principle, in the sense that it should not result on a lowering of suitability standards. A good example of a precise definition of these limits would be the ECB *Draft guide to fit and proper assessments*:

“*The application of the proportionality principle to the suitability criteria cannot lead to a lowering of the suitability standards, but can result in a differentiated approach to the assessment procedure or the application of suitability criteria*.”

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.

No, we think the Guidelines do appropriately enable proportionate application but note that an institution is expected to assess the suitability of members of the management body on an ongoing basis, which is a reasonable expectation. However, the requirement to re-assess existing members whose role is not changing (as suggested by 16 b ii) when a new member of the management body is being appointed could appear disproportionate. The ‘checklist’ in paragraph 17 need not be repeated on every such occasion.

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

Yes, they guidelines are clear. However, some flexibility should be allowed to distinguish among different directorships that involve different degree of responsibility and commitment, such as between large and small companies.

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

Yes, and we note that the factors that institutions should take into account are presented as ‘for consideration’ allowing them weigh different factors differently, depending on the circumstances, an approach we support. In the view of some BSG members, the condition “at least” mentioned in Annex II – Skills should apply only to the collective suitability and not to individual members of the Board or key function holders.

Regarding “Reputation, honesty and integrity”, it is important that the information on on-going investigations should be at no prejudice at all to fundamental rights, including the presumption of innocence until the final sentence. This is even more important in jurisdictions where the legal action (investigation) is mandatory after any accusation.

The time allowed for validation of individual information (three weeks) is too short, particularly if this assessment can be carried out only ex-post, like in jurisdictions where board members are elected in the general assembly (such as in Italy) among competing lists. A more balanced division of the time for assessment between institutions (draft GLs: 3 weeks) and authorities (draft GLs: three months) is advisable.

Institutions may find it difficult or even impossible to monitor *on an ongoing basis* that the members of the management body commit sufficient time to perform their functions (paragraph 43 of the draft Guidelines). It should therefore principally be an individual responsibility of each member of the management body himself/herself to make sure that he/she commits sufficient time to perform his/her functions. Institutions should only be required to check on the sufficiency of the respective time committed if there are actual concerns regarding this issue.

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

We support the expectation that institutions will keep their policies and procedures and training plans up to date. But the expectation that the training requirements for a new member of the management body should be identified before on boarding and then be fully inducted within a month is overly ambitious. We suggest that a longer period of time that would allow the induction’ journey’ to be completed within say three months should be contemplated.

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

Yes, and we fully support the diversity policy objectives they promote.

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

We note that paragraph 124 potentially introduces a ‘general principle’ by which the independence of members of the management body should be assessed as independent or not. Where national jurisdictions have more granular indicators of independence articulated in national law or industry Codes, the Guideline ‘general principle’ should not override these. Please also refer to our previous remark on formal independence in relation to Q1.

In the view of some members, the general concept behind independence/conflicts of interests and the distinction between these two concepts in the EBA Fit & Proper Draft GL and the ECB Fit & Proper Draft Guide but also in the Internal Governance Draft GL is not sufficiently clear. According to this view, the proposed independence criteria for members of the management body in its supervisory function in Section 18 of the Fit & Proper Draft GL are unsuitable and do not take into account national legal provisions. These members think that th applicability of the proposed independence criteria will impede in the future the election of suitable and high qualified members and will consequently significantly restraint the proper selection of members of the management body in its supervisory function.

Conflicts may arise with respect to paragraphs 106-110 (Suitability Policy in a group context). According to the separate entity principle, i.e. the legal principle separating the rights and duties of each legally independent entity, CRD-institutions may find it difficult to comply with the respective Guidelines under the corporate laws of their domestic jurisdiction. For instance, Member States’ respective laws may impose strict obligations of confidentiality on board members, thereby preventing subsidiaries from interacting or exchanging information with a parent institution under paragraph 108 of the draft Guidelines. National law may also prohibit subsidiaries from being subject to binding directions issued by the parent company, as is the case with certain stock corporations in Germany. The Guidelines might hence, where appropriate, set out to clarify that the respective provisions shall – or shall not – apply without prejudice to conflicting principles of Member States’ company laws (as is already the case in paragraph 109 in particular).

As indicated previously in relation to Q2, the guidelines seem to apply to all subsidiaries of banks including those that are not subject to CRDIV. We feel that this is not consistent with the proportionality principle. Please refer to our previous remark relating to section 15 *Suitability in a group context*.

Moreover, it appears questionable whether there is a sufficient legal basis for paragraph 113 of the draft Guidelines. Where a nomination committee is not established, i.e. in CRD-institutions which do not qualify as “significant” under article 88 (2) CRD IV, the wording of the Directive does not explicitly impose on said institution – or its management body – the responsibilities set out in the first subparagraph of point a) and points b) to d) of article 88 (2) CRD IV. Hence, the Guidelines may run the risk of undermining the specific decision taken under CRD IV, i.e. the decision that its article 88 (2) shall only be relevant for significant institutions which need to establish a nomination committee.

Q 11: Are the guidelines within Title VI regarding the assessment of suitability by institutions appropriate and sufficiently clear?

Yes, we think the draft Guidelines reflect the processes already regularly applied to the periodic assessment of board effectiveness by many institutions and represent good practice, albeit that they should be applied in a proportionate way.

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

A neutral approach would be preferable. In some jurisdictions, the election of board members via a vote among competing lists make the ex-post valuation the only possibility. A clear and well defined list of suitability criteria and suitability skills, as spelled out in these GLs, would ensure an adequate ex ante self-selection.

We support the Guidelines’ suggestion that competent authorities should establish a service standard setting a time limit for the completion of their assessment. We believe a period of no longer than three months is appropriate.

Q13: Which other costs or impediments and benefits would be caused by an ex-ante assessment by the competent authority?

An ex-ante assessment provides more certainty to the board member and the institution and these benefits outweigh the extension of the elongation of the appointment period, which can be mitigated by a reasonable service standard for the completion of the competent authority’s assessment process.

Q14: Which other costs or impediments and benefits would be caused by an ex-post assessment by the competent authority?

Despite our preference for ex ante assessment it should be recognised that an ex post assessment should be possible in exceptional circumstances, for instance in the case of sudden illness or other incapacity of a member of the management body.

An ex post assessment should also be possible if the institution in question qualifies as a commercial partnership under national law (see above). In such cases, the respective member of the management board may at the same time be an unlimited partner of the partnership, i.e. acquired his or her position *automatically* (*ex lege*) without having been formally appointed, e.g. by having inherited the partnership shares of a deceased family member. Competent authorities would be unable to perform an ex ante assessment under these circumstances.

Similar concerns may arise with respect to the management body of a credit institution in the public sector, where certain members (e.g. politicians) may be appointed automatically under the entity’s articles of association and/or *ex lege* under applicable public law.

Q15: Are the guidelines within Title VII regarding the suitability assessment by competent authorities appropriate and sufficiently clear?

Yes.

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

Yes.

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

Yes, although some members of the BSG are of the opinion that there should be no expectation that every member of the management body should have a full set of these skills, rather the board in its totality should display these skills.

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

Yes.

1. https://www.eba.europa.eu/documents/10180/1639842/Consultation+Paper+on+Joint+ESMA+EBA+Guidelines+on+suitability+of+management+body+%28EBA-CP-2016-17%29.pdf [↑](#footnote-ref-1)