

Joint EBA-ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU

Responses to draft in public consultation by

Alberto Balestreri – Studio Balestreri – Milan (Italy) - ab@studiobalestreri.it ¹

Daniela Venanzi – Dpt. of Economics, Roma Tre University, Rome (Italy) – daniela.venanzi@uniroma3.it ²

January 28, 2017

Preliminary considerations

The guidelines in consultation appear to provide many details as far as the procedural aspects are concerned (i.e. phases of the assessment process, the involved subjects, activity scheduling, timing and roles, etc.); on the contrary, the definition of requirements and/or the criteria for their assessment appear to be vague, absent or not enough structured in some cases, making guidelines to remain ambiguous, undefined, and undetermined; in other words, in our opinion, they are not precise enough to steer the target institutions in their implementation, but they leave much discretionary/subjective space in applying them. In our opinion, this approach could favour non-homogeneous practices from supervised institutions, causing high costs, risks, and responsibilities of ex post monitoring/intervention by the competent supervisory authorities.

Therefore, our contribution mainly address to those we consider definition/implementation flaws, by providing (hopefully) useful suggestions, based on our practice, to better precise/detail the requirement definitions and criteria of their measurement/assessment. If these suggestions will be (partially or fully) accepted, the documentation requirements defined in Annex III (see question 18) should be correspondingly updated.

Question 1 – Conflicts with national company law/regulations

In general terms, we suggest that the following items should be clarified:

- the Guidelines **refer to members of management body as well as of any different and specific supervisory/monitoring body;**
- if not specified, **members of the supervisory/monitoring body must be considered, at least, as non-executive members of a management body;**
- the preliminary distinction between these two categories of individuals (executive members of management body, on the one hand, and non-executive members of management body/members of supervisory body, on the other) could make these Guidelines to be clearer; in addition, it **should be taken in account throughout the document, giving different guidelines/criteria/ requirements when appropriate or, alternatively, specifying that the two categories do not differ.** Moreover, it should be avoided to give guidelines for one category, omitting the other (as for example, in section 5 or in § 47 and in many other points of the document);
- full independence between management functions and supervisory functions should be always assured in any type of institution and in any situation.

¹ **Alberto Balestreri** is Chartered Accountant in Milan and serves as consultant/board member of banks and IT consultant firms.

² **Daniela Venanzi** is Full Professor of Corporate Finance at Roma Tre University. She largely published on corporate finance, banking, credit risk assessment, financial performance; she serves as freelance consultant/board member of banks, industrial firms and public institutions.

Question 4 – The proportionality principle

The application of the proportionality principle should be more clearly specified to avoid misunderstanding. Currently, some statements could appear to be mutually contradictory.

Firstly, it should be stated that **the proportionality principle is not applicable to the following requirements in suitability assessment: i) reputation, honesty, and integrity; ii) independence of mind.** In the assessment of these suitability requirements, it should be clearly stated that the same criteria as well as the same procedures should be applied to all institutions, no matter size or business model etc.

Therefore, it should be detailed **how the proportionality principle can be applicable** in assessing the theoretical and practical experience and the time commitment of the board members and key function holders. This application can regard both:

1. the **contents of the requirements:** for example, the extent of knowledge/skills required, the time span of previous experience, the level of time commitment, etc.
2. the **procedures to be implemented** to verify the individual and collective suitability: for example, the documentation to be provided (see Annex III) could be simplified, the frequency of re-assessment (paragraph 145) could be lowered, the competent authorities' assessment procedures (see Title VII) could be simplified, etc.

Lastly, paragraph 36 should: *i)* assign priorities to the listed criteria; *ii)* limit the criteria (as for example i and j) that are difficult to practically measure, also considering that some of them are mutually dependent.

Questions 5-6: Time commitment and number of directorships

- a) in our opinion, the **avored count of directorships** of paragraph 48 (directorships within the same group) and/or paragraph 49 (directorships in affiliated companies) **should be partially limited**, for example defining thresholds (i.e., the maximum number of directorships within the same group for counting as a single directorship; idem for directorships within affiliated companies). In fact, it appears reasonable that over a certain number of directorships, the time synergies can run out, especially when subsidiaries/qualifying held companies operate in various business segments;
- b) in counting time commitment, it should be stated that the **measurement of time commitment of other professional/personal activities should be consistent with law provisions:** for example, the minimum time required by law for full/ partial time academic roles or other regulated positions;
- c) paragraph 51 appears confusing: perhaps an example could help.

Question 7: Adequate knowledge, skills, and experience

a) knowledge and skills

As far as “skills” are concerned, paragraph 57 and the related list in Annex II should be completed with **useful guidelines/suggestions regarding the appropriate ways/channels through which the listed skills can be verified by both the institutions (firstly) and the competent supervisory authorities (after).** In fact, the listed skills need soft information, that cannot be easily provided.

With regards to “knowledge” we suggest a more accurate specification and a better coordination with what actually included in paragraphs 60 and 66.

b) theoretical and practical experience

The **distinction between theoretical experience (which is different from knowledge) and practical experience should be better defined.** On detail, as far as non-executive members of management bodies and members of supervisory/monitoring bodies are concerned, it appears appropriate that the *theoretical experience* could

regard (among others) academic teaching & research activities (for example, academic roles) on fields which are directly/indirectly related to banking, as it is stated in paragraph 62. Assuming this distinction, **some criteria to measure both types of experience should be provided in a consistent way with the above distinction**; in fact, in the current version, paragraph 61 details these criteria for the *practical experience* (mainly of executive members), but paragraph 62 omits to do the same for theoretical experience (mainly of non-executive and supervisory members). For instance, the followings: academic rank (the theoretical experience of a full professor can be higher than that of an assistant professor), the tenure-track in the position, the direct involvement as teacher in induction activities, etc.

In addition, **the measurement/evaluation of both types of experience should take in account not only “hard” factors** (as those detailed in paragraph 61 for practical experience), **but also “soft” ones**. The latter could be collected by the competent supervisory authorities through direct channels (as, for example, one-to-one interviews, board minutes of previous memberships, etc.) and they should concern the actual quality and relevance of the experience gained in the field. For instance, as far as the *theoretical experience* is concerned, it would be important to measure the active role/commitment/continuity in research activities of the professor and their respective relevance to the fields of interest; on the other hand, as far as the *practical experience* is concerned, it should be considered the active role/commitment of the member in his/her functions, the quality/commitment/continuity of his/her participation to the board meetings, the quality of his/her contribution to the decision making or to the supervisory process, etc.. In other words, to be simply board members do not guarantee to gain valuable experience if the role is not exercised in a fully useful (for the institution) and demonstrable way.

c) reputation, honesty, and integrity

In our opinion, to avoid misunderstanding, **the lists of items to be considered for assessing reputation, honesty, and integrity** (provided in various manners and with different styles, more or less prescriptive, in paragraphs from 69 to 73) **should be integrated and presented in a more systematic and complete framework**.

In particular, it seems not clear the rationale of paragraph 70. It details convictions and ongoing prosecutions with regard to their relevance to banking & financial areas. However, we suggest that **the assessment of reputation, honesty, and integrity should be rather referred to the following features of convictions/ongoing prosecutions/ongoing investigations, no matter in which fields** [paragraph 69 lists some of them, but in our opinion a unique comprehensive list could be clearer]:

- the typology and gravity of offences or charges: for example, corruption, collusive tendering, abuse of public office, and so on, in whichever areas, financial or not;
- the relevance of the charge/conviction to the actual role of the individual under assessment;
- the entity of the administrative sanctions;
- the iteration of the prosecutable behaviours, for example in several occasions along a certain time span, during the same role in management or supervisory/monitoring bodies;
- the member roles in the board: the higher the position and the power, the more severe the reputational risk;
- the phase of the ongoing prosecutions/civil lawsuits (for example, if sanctions or charges are confirmed on appeal);
- the media clamour of the proceedings/lawsuits (in any case, the board should also consider malpractices of the media industry);
- the outcome of prosecutions, whether acquit or prescription;
- the processual strategy adopted;
- the mitigation instrument disposable;

- the level of internal transparency on these items adopted by the member during the assessment.

In our opinion, **it should be kept separate the judgement of fault from the evaluation of the reputational risk**. If these two judgements are explicitly separated (for example, at the beginning of Section 9), the statement at the end of page 34 [*The differences in national criminal and administrative laws as for example, the type of offences, penalty received, the seriousness of any relevant offence, periods of limitation, are different from a Member State to another and therefore limits the achievement of the harmonization of practices when assessing this particular aspect of suitability*] could be overcome and therefore omitted. We mean that **assuming the existence of a reputational risk does not adversely affect the presumption of innocence**, since it pertains to the sphere of public ethics, which means that the relevant question is: is it appropriate/opportune/prudent that a board member involved in convictions/prosecutions/investigations/lawsuits/sanctions (although not judicially proven in a definitive manner) holds a certain position/role? It is a widespread wisdom (mainly after the recent crisis) that banking area requires more severe ethic requirements than other (private) business areas, since involves public interests and takes advantage from the State guarantee.

d) independence of mind

We appreciate very much the definition of paragraph 75, which is very effective and clear, particularly in comparison with other vague and contradictory definitions, present in some national legal systems or soft laws (self-conduct codes). In addition, it suggests how to verify the requirement, in a general manner. However, in our opinion, **the guidelines for assessing the independence requirement could be better specified:**

- **the relations between “independence of mind” and “independence” should be explicated** (section 10 and section 18), by integrating the common items/requirements, if any, and highlighting the conceptual differences in a more organic and comprehensive framework;
- it should be clarified that **the independence of mind particularly refers to both non-executive members of management body and members of supervisory & monitoring bodies;**
- criteria for assessing “independence” should take in account, in addition to those currently specified, also **the weight of total remuneration received from the institution/group**, whose management/supervisory body the individual under assessment serves as member, **on:** *i) his/her total annual remuneration*, including all sources of compensations, fees and economic benefits (we refer to rules of the Dodd-Frank Act): the higher the weight, probably the lesser the independence (some thresholds should be identified but could be surpassed if the roles played are particularly time absorbing); *ii) his/her personal or family wealth*, net of any debts;
- criteria for assessing “independence of mind” should take in account, in addition to those currently specified, also the following:
 - **paragraph 76 should be operationalized;** for example, **reading/analysing the past board minutes** to “fundamentally” assess: *i) board member’s actual activism/effectiveness in monitoring/assessing the proposed decisions* of leading members of the management body; *ii) the strength/consistency/continuity/qualification of his/her argumentations against the group-think;* *iii) the active and critical contribution to the decision making or monitoring process*. In summary, we think that the assessment of the independence of mind (just as defined in paragraph 75) cannot only refer to hard criteria, but needs a **more in-depth analysis of the “actual behaviours”**; the independence of a member who showed mainly passive/acquiescent behaviours should be further analysed (for example, by means of direct channels like interviews or one-to-one exams);
 - the possible **influence from other members of management body, deriving from past positions of the member under assessment in the group/institution;** for example, when the member under

assessment was previously nominated in a certain position from a current member of the management body;

- the possible **influence deriving from customers of the member under assessment** (or of his/her professional partners), **who are served by the institution**;
 - in listing situations of conflicts of interests (in paragraphs 77 and 124), when assessing the **materiality of a board member's relationship with the institution**, the issue **should be considered** not merely from the standpoint of the member, but **also from that of persons/organizations with which the member has an affiliation**. Material relationships can include commercial, industrial, banking, consulting, legal, accounting, charitable and familial (i.e. social ties) relationships, among others;
 - it should be stated that **the absence of conflicts of interests doesn't make the independence requirements' check unnecessary**;
 - point e) of paragraph 77 should be extended to more key-roles than owner of the company borrower of the institution/group (for example, CEO or CFO or other top managers);
- the guidelines should state that the requirement of independence (before the suitability assessment by the competent authorities) must be both: *i) firstly self-certificated by the member under assessment; ii) collectively verified by the whole management or supervisory board*, by analysing all the appropriate/necessary documentation; **this check cannot be a formal acknowledgement of the member's statement, but an effective and in-depth examination of all the relevant aspects/criteria**. The board should be considered collectively responsible for this check on independence requirements as well as for their permanence over time.

Question 15 - Suitability assessment by competent authorities

Title VII regards a crucial point in the assessment process by the competent authorities, i.e. which are the appropriate and reliable ways/channels to obtain correct/unbiased information for the assessment of the individual and collective suitability of the members of the management and supervisory bodies. The section shows awareness of the following aspects:

- analyses/assessments from the supervised institutions could be biased, softened, or omitted in some cases;
- soft information is crucial for assessing some suitability requirements, but it is difficult to be provided;
- it is important to identify additional ways/channels that allow the competent authorities to assess individual and collective suitability directly and effectively, in a substantial and non-formal manner.

In addition to direct channels as interviews or meeting attending/conducting (discussed in §§ 169-171), we suggest: *i) frequent direct contacts between supervisory authorities and members* of the management board **with supervisory functions and/or supervisory/monitoring body**; *ii) the regular invitations of board members* to participate, also via web, **to strategic discussion** with supervisory authorities; *iii) the accurate reading/analysis of some board minutes* (and respective annexes/documents), of the management/supervisory bodies under assessment and their internal committees as well as of boards/committees whose individuals under assessment were former members (in institutions of interest).

As said above, in our opinion, these analyses could provide **unbiased data about both actual behaviours of members and quality of their judgements/contributions to the decision making or to the supervisory/monitoring process**. Moreover, this channel of information provision could trigger (when it is recognized as a “modus operandi” of the competent authorities) the best practices from members of management/supervisory boards.

Obviously, the above channels can be useful for assessing collective suitability of boards, too.

We conclude observing that in some paragraphs throughout the document, track records of former assessments by other competent authorities are cited and used as suitability proofs or broadened information. It should be clarified that these former assessments can be considered valuable/reliable only when implemented in a framework of suitability assessment which is consistent with the current guidelines (in fact, previous frameworks may be less rigorous or looser).