



## ADVICE TO ESMA

### **SMSG advice on the Joint ESMA EBA guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders**

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#### **I. Introductory remarks**

The SMSG welcomes the new requirements introduced by the CRDIV and MiFID II on the assessment of suitability by financial institutions and competition authorities, the objective of which is to address weaknesses in corporate governance at financial institutions. These requirements need to ensure, in conjunction with other requirements, that decisions that are taken by the Management Bodies of financial institutions are in the long-term interests of the institution, its shareholders and other stakeholders, and the financial sector and the economy as a whole.

The SMSG welcomes the opportunity to respond to the Consultation on the Draft Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders (the Draft Guidelines). Further to the views that are expressed in the statement issued jointly with the Banking Stakeholder Group (attached to this response), the SMSG would like to make two general observations that relate to the workability of the Draft Guidelines, in particular the ability of institutions, also the smaller ones, to safeguard continuity of management.

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#### **1. Ex-ante assessment by competent authorities**

The SMSG is concerned about the practical implications of the mandatory *ex-ante* assessment by competent authorities and the timeframe proposed by the Draft Guidelines (i.e. four months, and six months if the competent authority requires additional information from the institution). Situations may arise in which the immediate replacement of a member of the Management Body (in its management function) is necessary to allow the institution to continue to function adequately. In some Member States (e.g. Denmark), such immediate replacement is also mandated by law. A particularly problematic situation arises if the competent authority issues a negative opinion.

#### *Criteria for assessing individual suitability*

The SMSG is of the view that the Draft Guidelines are overly prescriptive and detailed in regards to the criteria to be used for assessing the individual suitability of members of the Management Body. Especially smaller institutions and subsidiaries might find it difficult to find candidates that fulfill all these criteria. The SMSG would advise ESMA to put more emphasis on collective suitability. Also, ESMA might want to elaborate further on the application of the proportionality

principle, which is in the view of the SMSG too much left open for interpretation. Smaller institutions and subsidiaries might be too discouraged from applying proportionality if they have no guarantee that the competent authority will do so in a similar manner.

Before going into depth on the specific questions outlined in the Consultation Paper, the SMSG also wishes to advise ESMA to take sufficient account of other national, regional and global initiatives that relate to the assessment of suitability of members of the Management Body of financial institutions. For example, the ECB recently (November 2016) launched a consultation on supervisory criteria and procedures for determining suitability of members of significant banks' management bodies.

## **2. Responses to specific questions outlined in the Consultation Paper**

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?

The SMSG's view is that throughout the Draft Guidelines a clear distinction needs to be made between (members of) the Management Body in its management function and (members of) the Management body in its supervisory function. In many Member States (e.g. Austria, Denmark, Germany, the Netherlands and Poland), the dominant governance model is a two tier system that consists of an executive Management Body and a non-executive Supervisory Board. The difference between one-tier and two-tier boards needs to be reflected in the criteria and procedures used for the assessment of individual and collective suitability.

The SMSG also notes that in some aspects the Draft Guidelines are not aligned with requirements posed by national company law or national codes of conduct. Institutions might therefore not be able to comply with all Draft Guidelines without violating these national rules. The SMSG calls upon ESMA to clarify that in such cases national rules prevail and that the extent to which the Draft Guidelines can actually harmonize the assessment of suitability is therefore limited. For example, institutions might be obliged to have employee or shareholder representatives amongst the members of the Management Body in its supervisory function. The SMSG ask ESMA to clarify the extent to which institutions are responsible for ensuring that these members, despite the lack of influence the institutions has on their appointment, fulfil the suitability criteria that are outlined in the Draft Guidelines (and the extent to which they are liable if these members do not fulfil the suitability criteria).

Also, financial institutions might be obliged to comply with provisions that they do not have to comply with according to national company law. For instance with regards to the independence of members of the Management Body. The SMSG is of the opinion that there needs to be a strong legal basis in the Level 1 texts (CRD IV and MiFID II) for legal obligations that surpass national laws or codes of conduct. Such obligations should also have a clear internal market rationale.

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

The Draft Guidelines should at all times respect the scope of the Level 1 texts (CRD IV and MiFID II) and the mandates that were given therein to EBA and ESMA. The SMSG wishes to point out the following examples where it thinks the Guidelines go beyond the scope of the Level 1 texts:

- a. The Draft Guidelines deal extensively with notions of adequate *individual* knowledge, skills and experience of members of the Management Body. However, strictly speaking MiFID II (Article 45 (9)) does not mandate ESMA to issue Guidelines on such notions. It only provides a mandate to issue guidance on notions of adequate *collective* knowledge, skills and experience. As stated in our introductory remarks, the SMSG feels that the emphasis in the assessment of suitability of members of the Management Body should be on collective suitability, particularly if smaller institutions are concerned.
- b. The Draft Guidelines require institutions covered by CRD IV to assess, in addition to the assessment of suitability of members of the Management Body, the suitability of key function holders. SMSG wishes to note that there is no legal basis for this in CRD IV. Moreover, while institutions covered by CRD IV should of course take the necessary measures to assure the fitness and propriety of their staff, SMSG thinks the method for doing so should be decided upon by the institution itself and not be prescribed by the Draft Guidelines. There may however be a legitimate case for the inclusion of key function holders that work at systemically important institutions.
- c. The Draft Guidelines require CRD-institutions to comply with the Draft Guidelines on an individual, sub-consolidated and consolidated basis, including their subsidiaries not subject to Directive 2013/36/EU in accordance with CRD IV, Article 109. The reference to Article 109 is misleading in the context of these Draft Guidelines (as opposed to the Draft Guidelines on Internal Governance). The Draft Guidelines can thus be construed as placing requirements on CRD IV institutions to place upon their subsidiaries (including non-covered subsidiaries) obligations to implement the actual requirements of the Draft Guidelines. This goes indeed beyond the scope of CRD IV, Article 109. To the extent the legislators deemed it appropriate to provide for suitability assessments, training etc. in respect to members of the Management Body and key function holders of non-covered entities, Article 91 of CRD IV would have had to contain a provision similar to Article 92 on remuneration requirements, placing a direct obligation to implement specific requirements on variable remuneration at subsidiary level (note that Article 92 is included in Section III, Chapter 3 (title VI), which Article 109 cross refers to). Also keeping in mind that the consolidation requirement as it is currently phrased would be too burdensome for competent authorities to supervise and manage (e.g. by having to pre-approve appointments in non-covered institutions). The Draft Guidelines need to specify in the scope of application that any consolidation, sub-consolidation etc. of the Draft Guidelines are to be applied by the CRD IV institution on a consolidated and sub-consolidated level as *appropriate*.

Apart from respecting the scope of MiFID II and CRD IV, EBA and ESMA should ensure the Guidelines are aligned with requirements laid down in other pieces of EU regulation.

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

See point (b) in our answer to Q2.

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 Draft Guidelines require that its provisions should be applied proportionally, meaning that less complex institutions do not need to have processes in place as sophisticated as complex institutions. It is however unclear, in particular in relation to smaller investment firms and subsidiaries, how this proportionality principle should be applied in practice. The SMSG therefore calls upon ESMA to prescribe more clearly the application of proportionality. The SMSG is concerned that if the principle of proportionality is left too much open for interpretation, competent authorities might interpret it more restrictively than institutions themselves. This means members of the Management Body might be found suitable by the institution itself but be rejected later on by the competent authority.

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.

In the cost-benefit analysis, it is stated that ESMA and EBA have chosen for a principle-based approach combined with case-by-case assessment. This policy choice is not sufficiently reflected in the Draft Guidelines. The Draft Guidelines are in the view of the SMSG overly prescriptive and detailed, especially in regards to the criteria to be used for assessing the individual suitability of members of the Management Body. There is doubt among the members of the SMSG on the extent to which all of the criteria that are prescribed are truly necessary and whether the criteria are sufficiently practical (i.e. operationalisable/measurable, and adaptable to individual cases). The Draft Guidelines might lead to overkill, especially for smaller institutions and subsidiaries, and may have the unintended consequence of restricting the pool of suitable candidates, at the expense of diversity within the Management Body. The SMSG therefore feels that more emphasis should be placed on collective suitability, particularly if smaller institutions or subsidiaries are concerned.

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

The Draft Guidelines explicitly state that the assessment of good repute of members of the Management Body is without prejudice to the 'presumption of innocence' principle. At the same time, the Draft Guidelines mention 'ongoing prosecutions' as a factor to be taken into consideration when assessing the good repute of a member of the Management Body.

The SMSG is of the view that a delicate balance should be found between the rights of the candidate member of the Management Body (innocent until proven guilty) and the right of the institution to protect itself from damages it would suffer in case the candidate is exposed to a possible future conviction while having joined as a member of the Management Body. In the view of the SMSG, the Draft Guidelines do not reflect the delicacy of this issue.<sup>1</sup>

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<sup>1</sup> The SMSG suggests to lay down some basic principles and guidance on the process to be followed in such cases, in order to ensure a fair treatment for both the institution and the individual: (i) exercise judgment on a case-by-case basis with due regard to facts and circumstances; (ii) ensure that concerned parties have timely access to relevant information so that the subject of the prosecution understands and can respond adequately to the advice and reasoning underlying a management body decision; (iii) ensure that any external communication on the subject is discussed and agreed by the subject and the management body prior to release; and (iv) ensure that the management body, in

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

The SMSG feel that the essential role of the Chairman of the Management Body has not been fully recognised in the Draft Guidelines. The Chairman plays a pivotal role in ensuring the collective and individual suitability of members of the Management Body. Moreover, the role of the Chairman might require qualifications different from other members of the Management Body. A separate subsection on what is expected from the Chairman might therefore be warranted.

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

The timeframes that are foreseen for the ex-ante assessment of suitability by the competent authority, in particular for members of the Management Body in its management function are considered too long. In certain situations (e.g. mergers and acquisitions, sudden resignations), an immediate or timely replacement is necessary and also required by law. If an institution has to wait for the assessment by the competent authority, which can take up to four (or even six) months, this time frame might threaten the continuity of management. Institutions might be tempted to appoint a person whose suitability has already been approved (instead of the most qualified candidate).

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?

The SMSG wishes to advice ESMA to emphasize the means that competent authorities have at their disposal if faced with an institution that, over an extended period of time, fails to present candidates that pass the assessment of suitability as performed by the competent authority (especially when it concerns members of the Management Body in its management function).

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

The Draft Guidelines state that the use of the matrix, to assess collective competence of members of the Management Body, provided in Annex 1, is not mandatory. Still, it is stated that the competent authority might request the outcomes of this matrix or any other matrix that is used by the institution in the process of assessing suitability. The SMSG urges ESMA to clarify that competent authorities are not allowed to mandate the use of the matrix in Annex I or a similar matrix. According to the SMSG, the matrix is too detailed and burdensome (especially for smaller institutions). It also might reduce the assessment of collective suitability to a box-ticking exercise.

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exercising its discretion, retains not only the right but the obligation to monitor the situation closely on an ongoing basis and potentially escalate or deescalate its action.

This advice will be published on the Securities and Markets Stakeholder Group section of ESMA's website.

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[Signed]

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