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CP-2012-03@eba.europa.eu

CP 2012-03 'EBA Consultation Paper on Draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution'

Dear Sir, Madam,

The European Association of Co-operative Banks (EACB) welcomes the opportunity to provide comments to the 'EBA Consultation Paper on Draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution'.

Please find our general and specific remarks on the following pages.

We remain at your disposal for any further questions or requests for information.

Yours sincerely,

Hervé Guider
General Manager

Volker Heegemann
Head of Legal Department



GENERAL REMARKS

The Members of the EACB acknowledge that the management bodies at large within credit institutions should be fit and proper, be of good repute and suitable for the position envisaged to ensure a robust governance, proper functioning of management body and credit institution as a whole. However, in practice some individual members of management bodies of the cooperative banks have “merely” representative tasks (representing the interests of the member) within the board at large, whilst other members of the board have the requisite expert skills, knowledge and experience. Co-operative banks consider it of utmost importance to always take the collective knowledge of the board into account when assessing the suitability of individual members of the management body.

Furthermore, we have some general observations and general remarks on this Consultation Paper as we consider that there are many issues which will have disproportionate consequences.

a) Legal Certainty

The guidelines should not and cannot be finalized before the CRD IV is finalized for reasons of legal certainty. Given that the discussion of the Trialogue meetings on the CRD IV are still ongoing, it is not reasonable to draft, discuss and finalise guidelines which should serve to clarify supervisory and bank’s practical application of the CRD IV. As the final text of the CRD IV especially as regards corporate governance is still very controversial, we consider that the Guidelines should be finalized only after a final text of the CRD IV is available.

b) Scope and Principle of subsidiarity

We consider that it is necessary to strictly apply the principle of subsidiarity. Our main concerns is that EBA enlarges the scope of the Guidelines to the supervisory board and key function holders for which in our point of view there is no legal basis in the current CRD nor in the forthcoming CRD IV¹

The EU Treaty confers powers to EU institutions for lawmaking within a certain defined remit. These EU lawmaking entities are democratically elected institutions which have the power to issue legislative acts with possible specified mandate therein based on the EU Treaty. Thus, mandates attributed within these legislative acts are confined to the limits commonly agreed by these lawmaking entities based on the EU Treaty. Therefore, they should not be extended by authorities outside the democratic legislative process. From our point of view, it is necessary to adhere to the rules of law laid down in the treaties of the EU, the principle of subsidiarity.

We consider that it would open ‘Pandora’s box’ if EBA would include random issues into the scope of the guidelines while EU legislation does not confer powers to EU institutions for lawmaking in these areas. This would also create legal uncertainty as it is no longer clear what could be included and excluded by EBA in Guidelines. The general legal base for EBA to issue guidelines, Art. 16 EBA Regulation, could then just become an ‘instigation’ provision for EBA to broaden its scope to encompass subjects it wishes in guidelines which is according to us not the objective of the EU Treaty.

¹ EBA CP-2012-03 point 3 on page 6.



Regarding the inclusion of the supervisory board within the scope, we acknowledge that there is a clear EBA-mandate in Article 11(1) subparagraph 3 CRD addressed to the *management board* of a credit institution:

*“The Committee of European Banking Supervisors shall ensure the existence of guidelines for the assessment of the suitability of the persons **who effectively direct the business of the credit institution.**”*

However, the possibility to enlarge the scope of the guidelines to the whole management body and thus to the *supervisory board* seems from our point of view questionable. For this enlargement there is no clear mandate in Article 11(1) subparagraph 3 CRD which refers only to those ‘*who effectively direct the business*’; hence persons with other or plain representative tasks are not covered by the mandate. Moreover, Art. 13 CRD IV also makes reference to persons ‘*who effectively direct the business*’ who shall meet the requirements of Art. 87(1). This means in our view that only the management board should fulfill the conditions of fit and properness, suitability, having skills, knowledge and experience.

With regards to key function holders, we consider that EBA is going beyond the mandate to introduce the new concept of ‘key function holders’ and include it in the scope of the guidelines as there is no specific legal base in Article 11 CRD nor in the forthcoming CRD IV. In our opinion, it goes too far to suggest that it should be inherent in the notion of ‘robust governance arrangements’ as in Article 22 CRD². Furthermore, the fact that key function holders are mentioned in Solvency II does not give EBA, as the supervisory authority for banks, a ‘carte blanche’ to include them in the guidelines addressed to banks.

Moreover, for cooperative banks we consider that financial holding companies should not be included in the scope of the guidelines. The forthcoming 115 CRD IV specifically includes a principle of proportionality which refers to the role of the financial holding company. We think this principle should be introduced in this provision and be strictly applied. In many cooperative banks the management board of financial holding companies already consists of members of the executive board of the member banks. Therefore, we consider that directors in these financial holding companies should be excluded from the scope.

In conclusion, EBA cannot enlarge the scope of the Guidelines to the supervisory board and key function holders as there is no specific legal basis. We think the guidelines should be restricted to those ‘*who effectively direct the business of the credit institution*’ based on Art. 11(1) CRD in order to ensure legal certainty.

c) Principle of proportionality

The application of the proportionality principle for the suitability assessment is welcomed.

However, we think that it is very difficult to define the principle of proportionality in such a detailed way at European level that could accommodate the situation in all 27 member states. Moreover, the principle of proportionality is to a great extent applied in practice by national supervisors taking into account the national characteristics:

According to French law (code monétaire et financier), the central body plays a major role in the functioning of cooperative banks. In particular for the assessment of the two persons who direct the business of the

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



regional banks .This role is fully taken into account by the national supervisor in charge of the assessment and agreement of the executives of banks. This is an example of the application of the principle of proportionality by the national supervisor for co-operative banks.

We fear that setting European ranges could lead to total exclusion or too strictly applied limitations which take away the flexibility. A principle of proportionality with specific 'one size fits all' pan European categories within strict limits should be avoided as it could also trigger a passive attitude of supervisors to simply assign and fit banks into 'European buckets' without taking into account the national context. We believe that it is only possible that general notions which determine the principle of proportionality could be further worked out without specific limits (please see EACB answer to Question 1 for further details).



SPECIFIC REMARKS TO QUESTIONS AND ARTICLES

I. Specific remarks to questions

Question 1:

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

The application of the proportionality principle for the suitability assessment is welcomed. However, we think in the first place that it is very difficult to define the principle of proportionality in such a detailed way at European level that could accommodate the situation in all 27 member states.

Each Member State market is different and has its own specificities. Indicating what is meant by or what the specific ranges are of size, nature, scale of activities etc in a sort of buckets³ (e.g. provide for buckets for experience criteria as there are very small banks with very complex products) is already to a great extent applied in practice by supervisors on a national level. They make the determinations on a case by case basis comparing the relevant players in that specific market. In order for the principle to be useful and practicable to every Member State's banking sector, it can be best determined by these national supervisors. Moreover, we fear that setting European ranges could lead to total exclusion or too strictly applied limitations which take away the flexibility.

We believe that it is only possible that general notions which determine the principle of proportionality could be further worked out without specific limits. At European level certain factors could be identified which should and are already used (as a sort of exchange of best practices) by supervisors when determining 'size' e.g. the balance sheet total, absolute and relative market share, etc or the nature of the business whether it is retail, or investment orientated, etc.

Nevertheless, a principle of proportionality with specific 'one size fits all' pan European categories within strict limits should be avoided as it could also trigger a passive attitude of supervisors to simply assign and fit banks into 'European' buckets without taking into account the national context. In addition, further differentiation in the guidelines would lose itself in endless details and suffocate the process banks and regulators.

Secondly, for the adequate application of the principle of proportionality regard should be taken to distinctive features of co-operative networks. Such features are the result of long term historical developments. When providing further details to the components of the principle of proportionality it shall not interfere with or undermine the common understanding of the successful functioning of cooperative networks.

In a co-operative network numerous individual cooperatives are joined together in a network without losing their independence and sovereignty (this is also the clear

³ As mentioned during EBA Public Hearing on these Draft Guidelines of 1 June, London



distinction with respect to corporate groups). This aspect is of crucial importance since it allows the individual co-operatives to maintain the regional focus of distribution of services to the local citizens who are at the same time the members owning the cooperative. The representatives of the co-operative are usually recruited among the members of the co-operatives. Due to the regional focus, the representatives (and members of the cooperative) have a strong regional background, enabling them to take decisions which suit the demands of the cooperative and the members at the same time. Representatives are coping with the everyday challenges of the banking business by means of continuous learning and special training arming them with knowledge and skills necessary for their very concrete tasks.

Moreover, the regional aspect of the activity of the co-operative safeguards the fulfillment of the promotion members' interest. This distinctive purpose for the co-operative is fulfilled e.g. by the provision of credit to the members of the cooperative. Moreover, the fact that the employees of co-operative banks often have a regional background, guarantee that they know their customer. This mechanism, i.e. the personal network within the co-operative networks, is therefore a strong and reliable vehicle for controlling the credit risk which is the greatest risk in a traditional regional credit institution. This credit risk controlling device would be undermined if the requirements for the suitability of representatives were drafted in a way excluding the adequate acknowledged and approved practice in co-operative networks, where members of the board improve their knowledge and skills on the job. Obviously these methods take some time, but this is no problem, if the collective knowledge of the board is being taken into account.

Any definition of the notion of proportionality should safeguard the described features of cooperative networks.

Question 2:

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

First of all we would like to mention that we consider that EBA is going beyond the mandate by introducing the concept of key function holders and including it in the scope of the guidelines while there is no specific legal base in Article 11 CRD. In our opinion, it goes too far to suggest that it should be inherent in the notion of 'robust governance arrangements' as in Article 22 CRD⁴. Furthermore, the fact that key function holders are mentioned in Solvency II does not give EBA, as the supervisory authority for banks, a 'carte blanche' to include them in the guidelines addressed to banks. The scope of the guidelines should be limited to those 'who effectively direct the business' as stipulated in Article 11(1) subparagraph 3 CRD.

Given that that 'key function holders' is a completely new concept and there is no legal base in the CRD nor forthcoming CRD IV to include in the scope, we consider that the Guidelines could not include any provisions for 'key function holders' and thus competent authorities could not be required to assess the policies of banks in this respect.

⁴ As mentioned during EBA Public Hearing on these Draft Guidelines of 1 June, London



If however, any EBA guidelines would include this concept of key function holders (which should be clearly defined) and require each institution to develop their own suitability testing procedures for this category, we are of the opinion that competent supervisors should only have the power to assess whether credit institutions have a policy in place for key function holders and should not have any powers as regards the content or implementation of such policies.

If institutions are required to draw up policies for assessing the suitability of key function holders, they are in the best and have closest position to determine the actual personnel needs of the institution. Competent authorities typically will only be in the position to give feedback on general and basic issues that naturally will leave aside the distinctive features of a specific institution.



II. Specific comments to Articles

- **Background and Rationale, Paragraph 8, 5th sentence: two tier structure**

The statement that the "oversight role" assigned to the supervisory function "includes developing the business strategy" does not properly reflect the two-tier governance model which divides the governance function between two bodies – a supervisory board and a management board. In some jurisdictions the supervisory board has to approve the determination of the general business policy. However, this does not make the supervisory board to a management body. There are clear tasks for the management board or – to use the definition in the CRD IV and EBA guidelines – the "management body acting in its management function". The EBA would be well advised to avoid interpretive problems and create legal certainty by just drawing on the definitions in CRD IV instead of trying to restate them in these guidelines.

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

We are seriously concerned that the EBA is trying to broaden its own mandate by extending the guidelines to cover "key function holders" (see also EACB general remarks and EACB answer to question 2 above).

Article 11(1) of Directive 2006/48/EC (introduced by Directive 2010/76/EC) only says that the Committee of European Banking Supervisors shall ensure the existence of guidelines for the assessment of the suitability of the persons who effectively direct the business of the credit institution. The draft provides no explanation of why this extension is needed, nor does it specify a legal basis (the wording in Background and Rationale paragraph 2 even seems to put the existence of such a legal basis into doubt). It goes too far to suggest that it should be inherent in the notion of 'robust governance arrangements' in Art. 22 CRD. Furthermore, the fact that key function holders are mentioned in Solvency II does not give EBA, as the supervisory authority for banks, a 'carte blanche' to include them in the guidelines addressed to banks.

Our fundamental concern is not only that the guidelines would inevitably generate additional red tape, but also that a fundamental principle is being undermined – namely that public authorities should act within the remit of the mandate assigned to them by legislators.

In addition, the concept of "key function holders" within the meaning of Article 2 and the requirement to identify these persons according to Art. 3(4) is too uncertain to be practicable. In practice, it is not clear who we should select as key function holders. Furthermore, we think that especially for co-operative banks with the local banks this is a disadvantage, having key function holders at each entity. For example, for the 'risk takers' co-operative banks had to select for the remuneration policy (in the context of the CEBS Guidelines on remuneration Practices and Policies of December 2010), they did not have to look at each separate entity but only a number of entities and specific functions. Moreover, it cannot be decided with certainty whether their "significant influence over the direction" or the position of "senior manager" within the meaning of Article 2 plays. Therefore, if this concept is to stay within any forthcoming guidelines it should be further specified to avoid difference in interpretation.



- **Article 4: Responsibilities and Art.8: institutions' corrective measures**

One of our concerns is the question with which function in the banks the end responsibility lies for the assessment of suitability of board members. We think Article 4 is incompatible with Article 8 which should be deleted or clarified.

The primary responsibility of the initial and ongoing assessment lies with the bank as is clearly indicated in Art. 4(1) (with extensive process and documentation requirements as in Art. 5). However, Article 8 constitutes an interference with the powers of those functions which are responsible for the appointment of members to the Management Board and the Supervisory Board and more specifically questions with whom this responsibility lays for the assessment. The management board could not assess itself in the light of Article 8 and the dismissal would in principle be the task of a nomination committee.

Any mandatory obligation on the part of the credit institution to carry out a critical formal assessment if needs be would give rise to tensions. The only function on which any obligation to make an assessment can possibly be imposed is the function responsible for the appointment and dismissal (whilst not limited to, this especially applies to the suitability assessment). We think Article 8 would create unnecessary complicated situations and enhance legal uncertainty with regards who should to determine that a board member is unsuitable.

Furthermore, we do not believe that the process indicated in the guidelines: the banks assesses candidate and only after a complete internal assessment notify or contact the competent authorities, reflects reality. In practice a bank would normally approach regulators informally and review the candidate and criteria with them before starting the paperwork. The guidelines should therefore recognise that notwithstanding all the criteria they define, the decision by the supervisors will ultimately be a "judgment call". The guidelines should take current practices into account and invite banks to liaise with the competent authority (or authorities) at the earliest stage possible.

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

We consider that collective knowledge requirements are minimally addressed in the guidelines. Article 6(3) mentions that it is necessary to assess whether the management body is suitable 'in the round'. We consider that this term is vague, not a legal term and not very well chosen. We consider it necessary to replace the word 'in the round' by 'collectively' (which would be in line with Art. 86(2)(3) CRD IV and Art. 87(1)(b) CRD IV which is however not finalized yet).

Moreover, the correlation between individual and collective requirements should be addressed better. If the requirements for individual board members are set too high, there would be a risk that the often stressed diversity in organs could not be guaranteed. Therefore, the focus of the guidelines must be predominantly on the fulfillment of the requirements at the level of the entire body. It should suffice to demonstrate knowledge and skills in the context of a collective board.

The appointment of management board or supervisory board members is made by the banks. It is obvious that the banks will choose only the most suitable people from internal organization for certain positions. The supervisory board internal decision not only curtail the rights of the members of the bank but will appear in the context of self-interest a financial institution to select the most suitable candidates or firing them.



Under proportionality principle, it should not be considered primarily from a view of the qualifications of individual executive and non-executive board members but also emphasize the collective knowledge and skills of the entire body. There are also elected persons who are not banking experts since they are “merely” representing the interests of the members of the cooperative. This is not only legitimate but also desirable, as long as the Board as a whole can fulfill its function.

As is regularly highlighted in initiatives at European level, the principle of diversity in the composition of credit institutions is particularly important. The requirements for individual board members are set too high, there is a risk that the often stressed diversity in organs cannot be guaranteed. Similarly, excessive demands would mean that only people from the closed circle of the banking industry occupying specific organ functions would be suitable. This is not desirable on the one hand and on the other hand, such a scenario would reach its limits, because the number of pure banking experts is limited. This could also mean that many mandates are exercised by a small group of suitable candidates.

- **Article 11(3): Interview by competent authorities**

We consider that providing competent authorities with the possibility to hold interviews should be in principle rejected as it would not necessarily ensure a better suitability of the candidate or avoid conflicts of interest.

A special feature of an interview is to obtain not only the objective facts, as mentioned in footnote 14 of the candidate’s knowledge, experience and application of skills, but also to get a personal impression of the candidate. In our opinion, the competent authorities have sufficient objective information available to make an objective judgment. An interview, that could also give them a subjective impression, would not necessarily result in a better suitability assessment of the candidate or avoid conflicts of interest. It is questioned whether the interview as means meets the objective to choose a suitable candidate.

Nevertheless, where it is applied it should be strictly confined to where it is already possible under national law (and avoid opening possibilities in member states where this is not the case). Furthermore, it is necessary to specifically mention and have a broad application of the principle of proportionality for this Art. 11(3) beyond only risk based approach. Certain co-operative banks at local level should not be subject to such requirement as, especially in consolidated co-operative banking groups this is the task of the central body of the network.

- **Art. 12(1): supervisory corrective measures**

We consider that a candidate cannot be unsuitable merely on the basis that the information provided is insufficient. We therefore think this provision should be deleted

- **Article 13: current investigations and/or enforcement actions**

The idea of taking current investigations and/or enforcement actions into account may need to be reconsidered. Regulators should pay due regard to the presumption of innocence. This should be expressly mentioned. Art 13 (3) taking into account any



administrative or criminal record is too broad. This should be limited to records that give rise to material doubts about his or her ability to ensure the sound and prudent management of the credit institution.

- **Article 14(3), 2nd sentence: Experience Criteria**

In general, some Member States have no specific experience criteria laid down and the requirements in these guidelines may be very intrusive.

- **Article 15(2): Independence requirement in subsidiaries**

This could create problems when composing the boards of subsidiaries. It reflects an unresolved (though growing) ambiguity surrounding the subsidiary as a legal entity in its own right with a separate licence and the responsibility of the parent company to be a source of strength for the group. We are very concerned to note that, in the context of acquiring or creating a subsidiary, the parent's ability to support it in terms of finance and management is a critical component of the change-of-control review by the subsidiary regulator (see Article 19a(1)(c) of Directive 2006/48/EC, (introduced by Directive 2007/44/EC) and paragraph 61 of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC issued by CEBS, CEIPOS and CESR (CEBS/2008/214; CEIOPS-3L3-19/08; CESR/08-543b)). But when it comes to the composition of the board of the subsidiary, it becomes important for board members to be independent of the group. The guidelines even exacerbate this ambiguity as Article 15(2) uses independence as a wide and open concept and does not specify what purpose it should achieve or how it relates to the source of strength requirement mentioned above.

It should be noted that in cooperatives there are historically strong ties between the cooperatives, its members and the functionaries who are typically recruited among the members. Due to the promotion tasks inherent to cooperatives there are also economic ties between the cooperatives and the functionaries. This traditional concept should be taken into account while defining the requirements of general independence. To safeguard an adequate level of independence there are effective mechanisms in place requiring the supervisory board's approval prior to the conclusion of legal transaction between the cooperative and members of the management/supervisory board.

- **Annex 1, item 4: Criminal records**

These records may not be available to the bank. Moreover, there is a need for mutual recognition of assessments across Member States subject to Art. 11 of the Guidelines

- **Annex 1, item 6: Conflict of interest**

The presentation of the financial and non-financial interests and family ties to other board members, other executives and subsidiaries should be deleted from the list of criteria.