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Datum
25.6.2012

EBA-Consultation suitability of members of the management body and key function holders"

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on "EBA consultation on the suitability of members of the management body and key function holders" - Application of the Proportionality Principle" and would like to submit the following position:

1. Key points:

The criteria should be applicable exclusively to the full management board.

The focus of the guidelines must be exclusively on the fulfilment of the requirements at the level of the full management body. Providing proof for the knowledge and skills in the course of a collective review should suffice. Under the aspects of the proportionality principle, there should be no review of the qualifications of individual non-executive members not serving as the chair and underscore the functionality of the full body instead.

We would like to point out that the company itself and the supervisory authority have only limited influence on the appointment of supervisory board members, since these are elected by the shareholders. The regulation that requires the independence from parent companies is already responsible for long-winded selection procedures in practice, particularly since only a restricted number of professionally qualified candidates are available in some areas of banking. Particularly in the highly regulated banking industry, finding an **independent** professionally qualified candidate who has no relations whatsoever to potential co-candidates in spite of his/her professional suitability becomes all the more difficult. Institutions that are embedded in a group of

companies or a sector, in particular, should therefore be permitted to appoint executives from other groups of companies to their supervisory board without infringing on the independence requirement for supervisory board members. Therefore, the requirement for independence would apply primarily in the parent company of a given group.

Excessive involvement of the supervisor in the credit institution's internal staff decisions

The members of the management body in both its supervisory and management function are appointed by the governing bodies of credit institutions. It is clear that the governing bodies only vote people into specific positions who fit in best with their internal organisation. The selection of candidates ultimately also lies in the interest of the credit institution's owner, since this is the only way to ensure best possible performance for a credit institution. Therefore, the supervisor's right to participate in internal staffing decisions does not only curtail the rights of the credit institution's owner but also appears excessive in view of the credit institution's own interest in selecting the most suitable candidate.

Definition of "Management Body"

Unlike the EBA Guidelines on Internal Governance, the proposed guidelines do not state that the definition of "management body" must be seen in the context of national law. Due to the different legal systems in the member states this would have to be clarified.

Key Function Holder

With respect to "key function holders", the credit institution alone should be in charge of verifying suitability. Generally, we oppose the idea of extending the scope of the guidelines to include "key function holders", because we do not deem it indispensable nor would this be covered by EBA's mandate. In any case, complete neutralisation of requirements relating to "key function holders" should be possible on the grounds of the proportionality principle.

Reputation

The proposed guidelines oblige candidates to inform on investigations and administrative as well as criminal proceedings and ask the supervisory authorities to consider these in their assessment (see Article 13 and Annex 1). With regard to the presumption of innocence principle, these provisions raise most serious concerns and we therefore propose cancelling out any reference to pending proceedings or investigations. Submission of a current criminal record should be sufficient. The proposed guidelines should be amended accordingly in Article 13 and Annex 1.

Furthermore, Article 13 (3) would have to clarify that only those administrative sanctions need to be disclosed that affect the candidate's professional reliability. Administrative sanctions, from wrongful parking for example, will not affect a person's suitability to manage the business of a credit institution.

With regard to the experience criteria "education" in Article 14 (5) of the proposed guidelines, it should be clarified that practical work experience and university degrees shall be considered equal.

Annex 1 point 2.g. states that, where available, references of employers of at least three years shall be submitted. Since the provision of references is uncommon (esp. for holding supervisory board mandates), this point should be cancelled. Should - contrary to expectations - a candidate have such references from employers, he or she can voluntarily submit them at any time.

Annex 1 point 8 asks for the submission of a record of the credit institution's suitability assessment results. This would represent an unnecessary additional administrative burden. The company only notifies the supervisory board of the new management board member if the supervisory board appointed the candidate. The candidate is only appointed if the supervisory board is convinced of the candidate's suitability (otherwise the supervisory board should not have appointed the candidate). Regarding the election of supervisory board members, the company plays only a minor role since it is the general meeting that gets to elect the supervisory board members. Therefore, such a report on the results may be interesting but not crucial for the election.

2. Response to the questions for Consultation:

Questions 1:

We consider proportionality to be an important factor in the application of the envisaged standards (particularly for smaller banks, specialised banks and private banks).

The bank's governance code, mission statement, business field and risk profile should be taken into account.

Criteria that could be applied include:

- the number of employees, branches and significant other shareholdings
- an institution's systemic relevance
- the covered banking activities (trading book activities: yes/no) and range of products
- the business volume (e.g. EUR 5 bn balance sheet volume)
- an institution's internal organisation, e.g. legal structure, stock exchange quotation, company objects
- the factual limitation of the geographical sphere of action and/or customers (e.g. only retail customers)

- membership in a group of credit institutions or institutional protection scheme/cross guarantee scheme
- Balance Sheet Total / Headcount
The balance sheet total / headcount could serve as differentiation criteria for the assessment process. The higher the balance sheet total / headcount, the more the assessment process should go into detail, as a high balance sheet total / headcount could be an indication for a bigger and more complex business.
- Size of national / European / international network (branches and/or subsidiaries)
The next differentiation criterion could be the size of a bank's network, which determines whether a bank only operates at national level or whether it also operates at European / international level. Market shares and number of branches/subsidiaries in the relevant markets could also be taken into account. The size of a bank's network and its market shares in the relevant markets can be indicators for a more complex business which would require a more detailed assessment process.
- Subsidiary Company
Another differentiation criterion could be the position as subsidiary company. What is important here, is if the subsidiary is a direct or indirect majority participation of the parent company. A direct majority participation could be an indication that the parent company has access to greater subsidiary details and therefore has more control over it, which would require a less detailed assessment process for the subsidiary.

Generally speaking, differentiation should allow for a reduction or neutralization of particular requirements within these guidelines, wherever justified. What needs to be highlighted is that, for smaller institutions, the interpretation of the proportionality principle in regard to specific requirements and their specific implementation poses massive challenges. As a consequence, the applicable criteria must be precise and clear. The structure and design of the "CEBS guidelines on remuneration policies" provide a good example for how better differentiation could be achieved.

The people in charge in smaller institutions engaged in banking activities on a regional scale have a strong regional background and, on account of their strong personal network in the region, they help to control the credit risk of the regional institution. In these small institutions (if they are encompassed by the guidelines at all), representatives should be given the opportunity to learn on the job for a certain period of time after their appointment and before they are assessed.

In terms of the legal consequences of a proportional application for smaller/non complex banks, we propose, inter alia, to exempt these institutions from the standardised assessment process by the supervisor, from subsequent assessments after the first appointment as well as the various documentation requirements ("policies") as they would be particularly burdensome for these institutions.

What needs to be given special attention is the fact that the present Guidelines have to be considered and implemented not only by internationally active institutions but also by smaller institutions that merely do business and recruit in local environments.

As the CRD IV proposal has yet to be finalised, we would further consider it appropriate to insert a review clause in the guidelines as well.

Application of gradation criteria in the individual assessment criteria for suitability:

- Reputation - no differentiation is indicated for the good character requirements.
- Experience - With respect to the theoretical knowledge and practical experience requirements a different suitability requirement would be practicable and expedient using the mentioned gradation criteria. The experience requirement to be met by a given member should be brought into line with the respective bank's business area and the risk profile. The supervisory authorities could implement such an alignment based on the prudential report, the profit and loss account and the balance sheet. Likewise, the qualifications required of the supervisory board members must not be excessive. Management experience, for example, should be excluded if the supervisory board member already has experience in finances.
- Governance - requirements calling for the avoidance of conflicts of interest, a balanced composition and independence of the people: gradations in the suitability requirements should be possible in view of the general composition of the management body. It should be possible, in smaller banks at any rate, for persons to hold two key positions at the same time (e.g. having the same person holding a position in Legal and HR or in Legal and Compliance), as specified in the last sentence on the Compliance function of paragraph 28.3. of the EBA Guideline on Internal Governance (GL 44): "In smaller and less complex institutions this function may be combined with or assisted by the risk control or support functions (e.g. HR, legal, etc)."

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 fulfil the suitability requirements?

- There is no need for the national supervisors to review the assessment policies drawn up by the respective institutions. This would be excessive, interfering too much in the private autonomy of the respective institutions.

The responsibility to manage the company lies with the company's management board - and it should stay there. It is sufficient for the supervisory authorities to assess the suitability of management board members. Assessing the suitability of key function holders should remain the responsibility of the management board members as they are the ones to direct the company under their responsibility.

- Generally, we oppose the idea of extending the scope of the guidelines to include "key function holders", because we do not deem it indispensable nor would this be covered by EBA's mandate. In any case, complete neutralisation of requirements

relating to “key function holders” should be possible on the grounds of the proportionality principle.

Apart from that, there does not appear to be any need for competent authorities having to assess the policies of institutions. Indispensable criteria are already sufficiently outlined in the draft guidelines. Therefore, we see no additional value in any pre-approval of the policies but rather a bureaucratic burden for both institutions and supervisors. The administrative costs appear to be higher than the added benefits to be expected. Supervisors have the option of checking these policies in their ongoing supervision anyway (which could also be after enforcement of the policies).

Specific Comments

Article 2: Definitions

The definition of “management body” needs to be streamlined with the definition in Art 4 (2) (d) CRD IV and should reflect the definition under national law as currently reflected in the respective definition.

“Key function holders” should, if at all, be appropriately defined by the credit institutions, the definition should be left to their responsibility. This should be reflected in the wording. As “third country subsidiary heads” are mentioned in footnote 5, the question arises at which level these guidelines should be applied in groups of credit institutions: consolidated and/or solo? Should third country subsidiaries be addressed by a consolidated perspective (as is the case with the remuneration guidelines)? What is the competency/responsibility of the parent institution in respect to the this guideline's requirements? These questions need to be clarified.

Article 3: Scope and level of application

We generally oppose the idea of broadening the scope of the guidelines to include “key function holders” because we do not deem any such broadening indispensable nor would it be covered by EBA's mandate. In any case, complete neutralisation of requirements relating to “key function holders” and “financial holding companies” should be possible on the grounds of the proportionality principle.

Moreover, the assessment criteria set out under Chapter IV may be suitable for members of the institution's management but are unsuitable for financial holding companies and/or key function holders (e.g. “managing a credit institution”). As regards members of the supervisory board, we believe that the experience criteria, as spelled out in the guidelines, will hamper the institutions' ability to develop and maintain diversified boards because the guidelines largely focus on “banking experience”. We consider this to be inconsistent with CRD IV's aim to broaden the collective knowledge, skills and experience within the management of institutions.

Similar concerns exist with regard to the application of the guidelines to “financial holding companies”, as the criteria in their present form are unsuitable for the different role and tasks of the management of financial holdings.

With respect to the supervisory board, the guidelines do not differentiate between certain classes of members. As a consequence, it is assumed that the guidelines apply to

both shareholder representatives and employee representatives. For the sake of clarity, this should be stated explicitly under Article 3.

Furthermore, (2) (c) states that competent authorities should assess the suitability of a member of the management body “whenever appropriate”. Footnote 7 provides examples of such cases, while simultaneously illustrating that the information leading to an assessment might be obtained from various channels. It should be noted that the simple presence of information provided by external sources cannot be considered sufficient for an assessment by a competent authority. As the term “external sources” would cover a very extensive diversity of sources, it should be explicitly stated that this specific information needs to be reliable, comprehensive and certified. Otherwise, a potential backdoor would be possibly invite to misuse (such as defamation). This should be reflected in the footnote.

Article 4: Responsibilities

Article 4 should reflect the realities of national (company) laws. Generally speaking, setting up new responsibilities for credit institutions should reflect the current legal responsibilities concerning the appointment of members to the management body. Members of the management body in its supervisory function are appointed by the general meeting in Austria, meaning by the shareholders. There is also a special group of members of the management body in its supervisory function, namely those nominated by the worker’s council. The question arises who exactly is responsible when it comes to ensuring that the respective requirements are fulfilled, especially when the management of the credit institution itself has no power over the appointment process. Therefore, we propose clearly distinguishing between nomination processes where the management of the credit institution has an influence and where not. In the latter case the management cannot be made responsible, it would have to be up to the appointing/nominating bodies and supervisory authority to control the process but not to the management of the credit institution. This should clearly be reflected in the wording.

Article 6 Credit institutions' suitability assessment

It is unclear what "the management body being suitable in the round" actually means. The need to explicitly state such a measure indicates that the suitability of each single management body member could eventually be insufficient. Therefore, some standards to govern the relations between the members seem to be indicated. They would require further detailing.

Article 7 Credit institutions' policies on suitability

The institutions' obligation to have a policy in place for the selection and assessment of management body members should per se be subject to the principle of proportionality (leading to complete neutralisation where justified).

Article 8 Credit institutions' corrective measures

(2) Idem Article 6

With reference to the concerns outlined under the comments to Article 4, the responsibilities and competencies of the various bodies should also be taken into account when instructing "institutions" to take "appropriate measures".

Article 9 Notification

An adequate notification procedure is already in place in Austria. With respect to (1), it is the legislator's authority in Austria to define when notifications need to be made not that of the supervisor. This should be reflected in the wording.

For financial holdings it should be clearly defined who exactly is responsible for the notification: Is it the - unregulated holding - or the - regulated - credit institution?

Article 10 Assessment process

Regarding (1) "should" should be replaced by "shall": The competent authority shall be obliged to make the information publicly available. And it should be specified that the information should be available on the authority's website.

Regarding the distinction applicable to the assessment process for members of the management body in its management function and in its supervisory function, the wording of (2) should be amended to "Competent Authorities *shall* distinguish (...)" from "Competent Authorities *may* distinguish (...)". A clear distinction seems to be appropriate even in one-tier systems.

Article 12 Supervisory corrective measures

With respect to (1), a clarification would be needed specifying that any failure to provide sufficient information regarding the suitability of a member to the competent authority must have occurred in a culpable way.

The existing options available whenever a member of the management body in (2) is considered unsuitable shall be left to the discretion of the credit institution in any instance (lack of experience, lack of good repute). The competent authority should set a clear timeframe to resolve the situation in whatever way. The target is clear anyway. It should also be reflected in the wording that national legislators have specific flexibility on how to react. In Austria, for instance, the legal situation concerning the head of the management body in its supervisory function is currently such that the supervisor has the power to reject the appointment by calling the courts which then have to decide on the matter. This mode of action should not be impeded by the guidelines.

Article 13 Reputation Criteria

There are repeated references to administrative measures and sanctions throughout the criteria. It should be noted that administrative criminal law is not harmonised at European level.

While we fully agree that any convictions due to relevant criminal offences should be taken into account when assessing the suitability of members of management bodies, we oppose considering indictments, investigations and/or enforcement actions as well as the imposition of administrative sanctions as relevant criteria.

The wording "investigations and/or enforcement actions" could refer to procedures which were closed once charges are dismissed. This definitely goes beyond the scope of these guidelines, which are supposed to set a general framework for national authorities. In terms of criminal procedure law, only convictions provide the proof that a person has violated the law. Consequently, we believe that only convictions should be taken into account when assessing the suitability of the members of management bodies. "Investigations" and "indictments", as such, imply that a definitive decision - on the basis of which the authority can assess a person's good repute - has not yet been taken. At this stage, this is for the respective authority to decide. In Austria, the criteria "indictment" was removed some ten years ago because of these implications.

The regime of "administrative sanctions" is different and shows certain particularities in each of the member states. The Austrian legal system, for example, allows the imposition of administrative sanctions on the statutory representatives (basically members of the management bodies) of the company for offences that are attributable to the company. This means that the statutory representatives are responsible for offences which they themselves did not directly commit. The offence is attributed to them only by reason of their legal responsibility for the company. Under these circumstances we recommend removing the consideration of administrative sanctions when assessing the suitability of members of management bodies. The member states should be able to decide for themselves whether to consider administrative sanctions or not, depending on the configuration of their own legal systems.

Furthermore, the provisions in point 7 clearly overshoot the mark and include factors which cannot be quantified nor are they within the members' sphere of control.

In conclusion, we believe that an approach involving a general framework for assessing the reputation of management board members would better suit the scope of the present guidelines. Specifying very precise criteria leaves no room for discretion when

assessing the suitability of management board members while giving due consideration to the particularities of their own legal systems. In other words, harmonisation should involve basic assessment requirements rather than very detailed criteria.

Article 15 Governance Criteria

In our point of view, the relation to Art 86 ff CRD IV is unclear.
With respect to (2), it is particularly unclear why independence is required in the relationship between members of the management body in its supervisory function and the shareholders. In other words: Should it be required that members be economically independent from shareholders?

Yours sincerely,

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