

**EBA Consultation Paper on draft Guidelines  
for assessing the suitability of  
members of the management body  
and  
key function holders  
of a credit institution  
(EBA/CP/2013/03)**

**London, 18 April 2012**

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# **I. Responding to this Consultation**

EBA invites comments on all matters in this paper.

Comments are most helpful if they:

- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed;
- describe any alternative regulatory choices EBA should consider; and
- if applicable indicate the specific question to which the comment relates;

Please send your comments to the EBA by email to [CP-2012-03@eba.europa.eu](mailto:CP-2012-03@eba.europa.eu) by 18.07.2012, indicating the reference 'EBA-CP-2012-03'. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

## **Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## **Data protection**

Information on data protection can be found at [www.eba.europa.eu](http://www.eba.europa.eu) under the heading 'Disclaimer'.

## **II. Executive Summary**

*The proposed Guidelines set out the process, criteria and minimum requirements for assessing the suitability of members of the management body and key function holders of a credit institution.*

*Article 11(1) of Directive 2006/48/EC provides that a credit institution shall only be authorised when there are at least two suitable persons who effectively direct the business and asks the EBA to develop guidelines for the assessment of the suitability of the persons who effectively direct the business of a credit institution.*

*Weak governance arrangements, in particular inadequate oversight by and challenge from the supervisory function of the management body, are widely acknowledged to have been underlying causes of the financial crisis. Hence the scope of these Guidelines is not limited to members of the management body acting in its management function, but extends to the members of the supervisory function in order to ensure appropriate oversight. This is consistent with the EU Commissions proposal of 20 July 2011 for a Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV). The ongoing suitability of all members of the management body is crucial for the proper functioning of a credit institution. The Guidelines also specify requirements for the assessment of key function holders, who have a crucial role in the day to day management of the business. Those measures are necessary to ensure robust governance arrangements in credit institutions, as provided in article 22 of Directive 2006/48/EC. As financial and mixed financial holding companies are also required to have suitable persons who direct the business and those holdings have significant influence on credit institutions, the scope of the Guidelines encompasses them as well.*

*Credit institutions should assess the suitability of members of the management body prior to or immediately after their appointment and notify the competent authority of appointments. Some competent authorities may require prior approval. Competent authorities will themselves assess the suitability of proposed or appointed members of the management body. The Guidelines set out several criteria which should be considered in this assessment. In cases where a member of the management body is not suitable, the credit institution and, if necessary, the competent authority should take appropriate action.*

*The EBA has relied in its impact assessment mainly on the assessment done by the European Commission in the context of the proposed Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment*

*firms (proposed CRD IV, published 20/07/2011). This proposal contains the requirement that the suitability of all members of the management body shall be assessed. The Commission analysed the impact of an assessment process for all board members and concluded that although such a requirement would trigger costs, such costs would be insignificant compared to the benefits.<sup>1</sup> Even considering the broader scope of the Guidelines, they do not entail significant costs or have any adverse social or environmental impact.*

*The Guidelines shall be implemented by competent authorities [4 months after publication] and credit institutions by [6 month after publication].*

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<sup>1</sup> The impact assessment of the European Commission can be accessed under the following link:  
[http://ec.europa.eu/internal\\_market/bank/docs/regcapital/CRD4\\_reform/IA\\_directive\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf)

### **III. Background and rationale**

1. According to Article 11 paragraph 1 of Directive 2006/48/EC competent authorities shall grant an authorisation to credit institutions only when there are at least two persons who effectively direct the business of a credit institution. They shall not grant authorisation, if these persons are not of sufficiently good repute or lack sufficient experience to perform such duties. The EBA shall ensure the existence of guidelines for the assessment of the suitability of the persons who effectively direct the business of the credit institution.
2. To remedy weaknesses that were found during the financial crisis regarding the functioning of the management body and the qualifications of its members, and to further harmonise the assessment of the suitability within the EU banking sector, these Guidelines are broader in scope than the mandate provided in Article 11(1) of Directive 2006/48/EC. Article 22 of Directive 2006/48/EC states that Home Member State competent authorities shall require that every credit institution has robust governance arrangements in place. The Guidelines in particular aim to ensure harmonised criteria for the assessment of the quality of the members of the management body as part of such robust governance arrangements.
3. The broadening of the mandate has three dimensions: a) not only the time of authorisation is envisaged in these Guidelines but also the continuing suitability; b) the entities in scope of these Guidelines are not limited to credit institutions, but also include financial holding and mixed financial holding companies, and c) the persons in scope are not limited to persons who effectively direct the business (i.e. not limited to the members of the management body in its management function), but include the management body in its supervisory function and key function holders.
4. The proposed Directive<sup>2</sup> of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions (CRD IV) would require that all members of the management body of any institution shall at all times be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties. In this regard the Guidelines already include the broader requirement of the upcoming directive.
5. The Guidelines should also be applied at the level of the financial holding company. This approach is consistent with article 73 paragraph 3 of Directive 2006/48/EC that states that competent authorities shall require the parent undertakings and subsidiaries subject to Directive 2006/48/EC to meet the obligations laid down in Article 22 on a consolidated or sub-consolidated basis, and with article 135 of Directive 2006/48/EC that states that Member States shall require that persons who effectively direct the business of a financial holding company or a mixed financial holding

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<sup>2</sup>See art 87 (1) of COM (2011) 453 final, 2011/0203 (COD) published on the European Commission's website

company be of sufficiently good reputation and have sufficient experience to perform those duties. Since holding companies often exercise a significant influence on the management of a credit institution, it is important to ensure that members of its own management body are suitable in terms of their reputation and experience.

6. The EBA Guidelines on Internal Governance emphasise, in line with other international governance documents, the crucial role of e.g. the (heads) of internal control functions. The Guidelines on Internal Governance (B.1,8.2e) require that the management body should have a policy on selecting, monitoring and planning the succession of key function holders. These Guidelines set out more detailed requirements on institutions' policies for the assessment of key function holders.
7. In some jurisdictions legal persons can be members of the management body. In such cases the Guidelines applied to natural persons should as far as possible be applied to that legal person. Because laws regulating the governance of companies and practices differ considerably in Member States regarding this matter, specific guidelines have not been included in the actual Guidelines.
8. The Guidelines are applied to all credit institutions regardless of their governance system, which is set out in the national laws regulating the governance of companies. Member States usually provide for either a unitary or a dual board structure under their national company law. The management function sets the direction for the credit institution, implements the business strategy and is responsible for the day-to-day running of the institution. The supervisory function oversees the management function and provides appropriate advice and challenge. The oversight role includes developing the business strategy, reviewing the performance of the management function and the achievement of objectives, and ensuring the integrity of financial information as well as effective risk management and internal controls.
9. In a one-tier board structure the assessment of the suitability in terms of fitness and propriety required by these Guidelines will be applied to all board members. In the two-tier board structure, the same holds true for all members of the management body in its management or its supervisory function. As the members of the management body of the different functions have specific roles, the assessment process and criteria can differ.
10. Investment firms are not included in the scope of the Guidelines, as the proposed Markets in Financial Instruments Directive (MiFID)<sup>3</sup> contains similar requirements on the assessment of the suitability of persons who effectively direct the business for investment firms. Respective standards will be developed by the European Securities and Markets Authority in cooperation with EBA.
11. Generally, suitability means the degree to which something or someone has the right qualities for a particular purpose. The suitability of the members of the management body of the credit institution is the degree to which such

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<sup>3</sup>[http://ec.europa.eu/internal\\_market/securities/isd/mifid\\_en.htm](http://ec.europa.eu/internal_market/securities/isd/mifid_en.htm)

persons have good reputation and have sufficient experience to fulfil their duties as member of the management body.

12. While all members of the management body need to be of good reputation independent of the nature, scale and complexity of the credit institution or the position of the member within the credit institution, the experience requirements differ depending on the credit institution's nature, scale and complexity of its activities and the position concerned.
13. The experience of a person consists of educational and professional aspects. The level of the experience of a given person is a synthesis of both aspects. It is important that a person has in fact acquired sufficient skills and knowledge, which cannot merely be expressed in terms of a period of duty in a certain position or a specific educational degree.
14. Credit institutions are responsible for ensuring that members of the management body fulfil the suitability criteria on an ongoing basis. Events with the potential to affect a person's reputation can lead to the need to re-assess the suitability of that person.
15. Institutions need to take into account within their assessment also the overall composition of the management body in its management and its supervisory functions to ensure that robust governance arrangements are in place.
16. Whilst the assessment of the suitability of key function holders is best practice expected from all credit institutions to ensure robust governance arrangements, the practices regarding the supervisory assessment differ. While some competent authorities assess the suitability of key function holders, other authorities leave this completely to the institution. However if, because of unsuitable key function holders, a credit institution fails to ensure robust governance arrangements, competent authorities would have the power to take appropriate measures.
17. It is important to ensure that credit institutions and competent authorities effectively intervene in cases where the person concerned is not considered to be suitable. This applies to members of the management body and also persons who are not yet appointed as members of the management body. The corrective measures will depend on the circumstances taking into account measures already taken. The measures can differ between member states depending on the laws regarding the governance of companies, the banking act and administrative rules. Measures can reach from ordering measures to improve the knowledge of a member or to shift responsibilities, the prohibition to continue performing his or her tasks, temporary ban or dismissal/removal of single members of the management body to ultimately the withdrawal of the credit institution's authorisation.



## **IV. Draft EBA Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution**

### **Status of EBA Guidelines**

1. This document contains draft guidelines which will be issued pursuant to Article 16 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (EBA Regulation). In accordance with Article 16(3) of the EBA Regulation, competent authorities and financial market participants must make every effort to comply with the guidelines.

2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. EBA therefore expects all competent authorities and financial market participants to whom its guidelines apply to comply, unless otherwise stated. Competent authorities to whom guidelines apply should comply by incorporating them into their supervisory practices as appropriate (e.g. by amending their legal framework or their supervisory rules and/or guidance or supervisory processes), including where particular guidelines within the document are directed primarily at financial institutions.

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## ***Title I - Subject matter, definitions, scope and level of application***

### ***Article 1 Subject matter***

These Guidelines set out the criteria and processes that credit institutions and competent authorities should respect when assessing the suitability of proposed and appointed members of the management body of a credit institution in both its management and supervisory functions. The Guidelines set out provisions for the assessment of key function holders. The Guidelines include measures applicable to cases where such persons are not suitable for the position concerned.

### ***Article 2 Definitions***

For the purposes of these Guidelines, the following definitions apply:

- a. 'management body' means the governing body (or bodies) of an credit institution, comprising the supervisory and the management functions<sup>4</sup>, which has the ultimate decision-making authority and is empowered to set the institutions strategy, objectives and overall direction;
- b. 'management body in its supervisory function' means the management body acting in its supervisory function and overseeing and monitoring management decision-making;
- c. 'member' means a proposed or appointed member of the management body;
- d. 'key function holders'<sup>5</sup> are those employees outside of the management body whose positions give them significant influence over the direction of the credit institution.

### ***Article 3 Scope and level of application***

1. These Guidelines apply to competent authorities and credit institutions as defined in art. 4(1) of Directive 2006/48/EC, to financial holding

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<sup>4</sup>As defined in the Guidelines on Internal Governance available on the EBA website.

<sup>5</sup> Key function holders could include; senior managers, heads of internal control functions, or the head of a significant EEA branch or third country subsidiary.

companies as defined in article 4 (19) of Directive 2006/48/EC and mixed financial holding companies<sup>6</sup> as defined in article 2 (15) of Directive 2002/87/EC, all referred to in these Guidelines as "credit institutions".

2. Competent authorities should assess the suitability of a member of the management body in the following situations:
  - a. when an application to authorise a credit institution is received;
  - b. when a notification or application regarding the appointment of a new member of the management body is received; and
  - c. whenever appropriate<sup>7</sup>, in relation to appointed members of the management body.
3. Credit institutions should assess the suitability<sup>8</sup> of members of the management body in the following situations:
  - a. when applying to be authorised as credit institution;
  - b. when new members of the management board have to be notified to the competent authorities; and
  - c. whenever appropriate, in relation to appointed members of the management body.
4. Credit institutions should identify key function holders and assess their suitability in line with the policy on the nomination and succession of individuals with key functions.

## ***Title II- Requirements regarding the assessment of the suitability of persons***

### ***Chapter I - Responsibilities & general assessment criteria***

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<sup>6</sup> The role of financial holding companies differs from the role of credit institutions, therefore the process and the criteria for the assessment of the suitability can only be applied in a proportionate way, taking into account the nature, scale and complexity of the financial holding company.

<sup>7</sup> Competent authorities conduct several types of assessments, which are directed to specific aspects of an institution. Within those tasks, a competent authority can also gain information on the suitability of members of the management body. Such information can also stem from other sources like internal whistle blower processes or from external sources. All those information will be followed up by competent authorities and can be used within the assessment of the suitability of a person.

<sup>8</sup> The assessment is required for members of the management body in its management and supervisory function. However, the requirements for different positions may vary with regard to the required experience since tasks and responsibilities differ from each other.

**Article 4**  
**Responsibilities**

1. Assessing the initial and ongoing suitability of members of the management body and key function holders should primarily be the responsibility of the credit institution.
2. If a nomination committee exists, it should actively contribute to fulfilling the credit institution's responsibility and adopting appropriate internal policies on the assessment of the suitability of members of the management body and key function holders.

**Article 5**  
**General assessment criteria**

1. The assessment of the experience of members of the management body and key function holders should take into account the nature, scale and complexity of the business of the credit institution as well as the responsibilities of the position concerned.
2. Members of the management body and key function holders should in any event be of good repute, regardless of the nature, scale and complexity of the business of the credit institution. Where there is a matter which casts doubt on the experience or good repute of a member of the management body and key function holders, an assessment of how this will or might impinge on that person's suitability should be undertaken. All matters relevant to and available for the assessment should be taken into account, regardless of where they occurred.

Question 1 for consultation:

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?

**Chapter II - Assessment by institutions**

**Article 6**  
**Credit institutions' suitability assessment**

1. Credit institutions should assess the suitability of members of the management body on the basis of the criteria set out in Articles 13 to 15 and in accordance with the EBA's Guidelines on Internal Governance<sup>9</sup> at Chapter B.2 and record the assessment and the results. Whenever possible the assessment should be done before the person takes up his or her position. If this is not possible the assessment should be completed in good time after the appointment.
2. Institutions should re-assess the suitability of a member of the management body when events make a re-assessment necessary in order to verify the person's ongoing suitability. This can be limited to examining whether the member remains suitable taking into account the relevant event.
3. When assessing the suitability of members of the management body, credit institutions should assess that the management body is suitable in the round. Weaknesses within the overall composition of the management body or its committees should not necessarily lead to the conclusion that a single member is not suitable.
4. The credit institution should assess the suitability of key function holders before they are appointed and record the assessment and the results.

**Article 7**  
***Credit institutions' policies on suitability***

1. Credit institutions should have a policy for selecting and assessing members of the management body which takes into account the nature, scale and complexity of the business of the credit institution and sets out at least:
  - a. the situations<sup>10</sup> when an re-assessment of the suitability should be performed, and measures to identify such situations,
  - b. the individuals or function responsible for performing the suitability assessment;
  - c. the necessary competencies and skills of a member of the management body needed to assume that the member has sufficient expertise,

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<sup>9</sup> EBA's Guidelines on Internal Governance provide (B.2, 11.1) that the management body shall have policies for selecting, monitoring and planning the succession of its members. The same applies to key function holders (GL 44, B.1, 8, 2e).

<sup>10</sup> To identify such events, credit institutions could, for example, require members of the management body to notify them of any material changes and make an annual declaration of any such changes affecting their compliance with the relevant requirements. Examples of such events include restructurings and the prolongation of the mandate etc.

- d. the applicable internal procedure for the assessment of the suitability of a member;
  - e. the information and evidence that members of the management body should provide to the institution for an assessment; and
  - f. if the person is to be appointed by the shareholders the measures taken to ensure that shareholders are informed about the requirements for the position and the relevant profile of persons before they are appointed.
2. Credit institutions should have a policy in place for assessing the suitability of key function holders, which takes into account the nature scale and complexity of the business of the credit institution and sets out at least:
- a. the positions for which a suitability assessment is required;
  - b. the individuals or function responsible for performing the suitability assessment; and
  - c. the criteria for reputation and experience to be assessed for the specific position.

Question 2 for consultation:

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?

### **Article 8** ***Credit institutions' corrective measures***

1. If a credit institution's assessment concludes that a person is not suitable to be appointed as a member of the management body in its management function, that person should not be appointed.
2. If a credit institution's assessment concludes that a person is not suitable to be appointed as a member of the management body in its supervisory function, the institution should either take appropriate measures to ensure the person's future suitability or not appoint the person. If the credit institution's re-assessment concludes that a member of the management body is no longer suitable or the composition of the management body is unsuitable in the round, the institution should take appropriate measures<sup>11</sup> to rectify the situation and inform the competent authority accordingly.

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<sup>11</sup> Appropriate measures will depend on the particular situation and shortcomings of the person or the composition of the management body in the round; they could include: adjusting responsibilities between members of the management body; replacing certain persons; and training single members or the whole of the

3. If a credit institution's assessment concludes that a key function holder is not suitable, the institution should take appropriate measures.

### ***Chapter III - Assessment by supervisors***

#### ***Article 9 Notification***

1. Competent authorities should establish a notification procedure<sup>12</sup> applicable to appointments and re-appointments of a member of the management body. Competent authorities should impose rules as to when such notifications need to be made.
2. Credit institutions should provide, at the request of the competent authority, all written information necessary to assess the suitability of the members of the management body, including the information contained in Annex I. For any re-appointment this information can be limited to relevant changes and additional information.
3. Both the credit institution and the member of the management body concerned should verify that the information provided is accurate.
4. Credit institutions should notify the competent authority when the appointment of a member of the management body is terminated, explaining the reasons.

#### ***Article 10 Assessment process***

1. Competent authorities should ensure that the process<sup>13</sup> applicable to the assessment of the suitability of members of the management body is publicly available.
2. Competent Authorities may distinguish between the process applicable to members of the management body in its management function and in its supervisory function, as well as between the initial authorisation of a credit institution and subsequent assessments according to national

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management body to ensure that the collective qualification and experience of the management body is sufficient.

<sup>12</sup> Some competent authorities require a formal prior application. Other competent authorities require pre or post notification from the credit institution of the intention to appoint or nominate members for appointment. The term 'notification' is intended to encompass these practices or variations of them.

<sup>13</sup> The range of practice varies between member states, some competent authorities grant an explicit approval of members of the management body whereas others raise objections or otherwise give their silent consent.



specificities, the size and structure of the banking sector and national laws concerning the governance of companies.

### **Article 11** **Assessment technique**

1. Competent authorities should evaluate the information provided by the credit institution, require further evidence of reputation or experience as appropriate and assess the suitability of members of the management body on the basis of the criteria in Article 13 to 15 of these Guidelines.
2. When assessing the suitability of members of the management body after a credit institution's authorisation in the circumstances described in Article 3(2b) and 3(2c) above, competent authorities may use a selection of these criteria and accord them different weight, taking into consideration relevant national law as well as the result of the review of the specific policies and procedures established by the institution for the assessment of these persons' suitability. In the case of Article 3(2c) the re-assessment of the suitability should in particular be related to the circumstances that led to the reasons for re-assessment.
3. In accordance with national law, competent authorities may, on a risk based approach, interview<sup>14</sup> persons when assessing the suitability of members of the management body. As appropriate, the interview process may also serve to re-assess the suitability of a member of the management body when facts or circumstances raise doubts about the suitability of this member.
4. The assessment under Article 3 (2a) and (2b) by the competent authority should be completed within good time.
5. Where a competent authority has previously assessed a member's suitability, the relevant record should be updated as appropriate.
6. A competent authority may take into account suitability assessments from other EEA authorities. It shall, however, still itself consider any recent developments which may be relevant for its own assessment.
7. The competent authority should inform the credit institution of the results of the assessment.
8. Competent authorities may assess the suitability of key function holders and make publicly available the applicable processes and criteria.

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<sup>14</sup> The interview process may be used to assess a proposed candidate's knowledge, experience and application of skills in previous occupations, as well as how the qualities of the proposed candidate relate to the skills and experience of the existing members of the management body. For example, the assessment of an individual's skill set can be based on analysis of a candidate's previous professional conduct and on how a candidate responds and behaves during the interview itself.

**Article 12**  
**Supervisory corrective measures**

1. Where a member or credit institution fails to provide sufficient information regarding the suitability of a member to the competent authority, the competent authority should consider that person to be unsuitable.
2. If a member of the management body is not considered to be suitable, the competent authority should request the credit institution to either not appoint the member, to dismiss him or her or to take other appropriate actions to ensure that this member meets the suitability requirements. When unsuitability is due to any lack of good repute, the member should be replaced.
3. In cases where a credit institution's response is inadequate, competent authorities should themselves adopt appropriate corrective measures.

**Chapter IV - Assessment criteria**

**Article 13**  
**Reputation criteria**

1. A member of the management body should be considered to be of good repute if there is no evidence to suggest otherwise and no reason to have reasonable doubt about his or her good repute. All relevant information available for the assessment should be taken into account, without prejudice to any limitations imposed by national law and regardless of the state where any relevant events occurred.
2. A member of the management body should not be considered to be of good repute if his or her personal or business conduct gives rise to any material doubt about his or her ability to ensure the sound and prudent management of the credit institution.
3. Competent authorities should take into account any administrative or criminal records, considering the type of conviction or indictment, the level of appeal, the punishment received, the phase of the judicial process reached and the effect of any rehabilitation measures.
4. Competent authorities should consider the surrounding, including mitigating, circumstances and the seriousness of any relevant offence or administrative or supervisory action, the time period and the member's conduct since the offence and the relevance of the offence or administrative or supervisory action to the proposed role.

5. Competent authorities should consider the cumulative effects of more minor incidents, which individually do not impinge on a member's reputation but may in sum have a material impact.
6. Account should be taken of the following factors, which may cast doubt on a member's good repute:
  - a. conviction or indictment of a relevant criminal offence<sup>15</sup>, in particular:
    - i. any offence under the laws governing banking, financial, securities, insurance activity, or concerning securities markets or securities or payment instruments, including laws on money laundering, market manipulation, or insider dealing and usury;
    - ii. any offences of dishonesty, fraud, or financial crime;
    - iii. any tax offences;
    - iv. any other offences under legislation relating to companies, bankruptcy, insolvency, or consumer protection;
  - b. relevant current or past investigations and/or enforcement actions relating to the member, or the imposition of administrative sanctions for non-compliance with provisions governing banking, financial, securities, or insurance activities or those concerning securities markets, securities or payment instruments, or any financial services legislation;
  - c. relevant current or past investigations and/or enforcement actions by any other regulatory or professional bodies for non-compliance with any relevant provisions.
7. Attention should be paid to the following factors regarding the propriety of the member in past business dealings:
  - a. any evidence that the member has not been transparent, open, and cooperative in its dealings with supervisory or regulatory authorities;
  - b. refusal of any registration, authorisation, membership, or license to carry out a trade, business, or profession; or revocation, withdrawal, or termination of such registration, authorisation, membership, or license; or expulsion by a regulatory or government body;
  - c. dismissal from employment or any position of trust, fiduciary relationship, or similar situation, or having been asked to resign from employment in such a position; and

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<sup>15</sup> Article 3, paragraph 5 of the Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing contains a definition of 'serious crimes' which includes, among others, 'all offences which are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as regards those States which have a minimum threshold in their legal systems, for a minimum of more than six months'.

- d. disqualification by competent authority from acting as a person who directs the business.
8. Competent authorities should take into consideration the following situations regarding past and present business performance and financial soundness of a member<sup>16</sup>:
- a. inclusion on the list of unreliable debtors or any negative records on this kind of list conducted by recognised credit bureau;
  - b. financial and business performance of the entities owned or directed by the member or in which the member had or has significant share with special consideration to any rehabilitation, bankruptcy and winding-up proceedings;
  - c. declaration of personal bankruptcy; and
  - d. civil lawsuits, administrative or criminal proceedings, large investments or exposures and loans taken out, in so far they can have a significant impact on the financial soundness.

#### ***Article 14*** ***Experience criteria***

1. The competent authority should assess a member's experience considering both, the theoretical experience attained through education and training and the managerial experience gained in previous occupations, taking into account the skills and knowledge acquired and demonstrated by the professional conduct of the member. The supervisory assessment should not be limited to the educational degree or proof of a certain period of service in a credit institution or firm which is active in comparable lines of business. A more thorough analysis of the members's experience should be conducted as the knowledge gained from previous occupations depends on the nature, scale and complexity of the business as well as the function performed within the firm.<sup>17</sup>

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<sup>16</sup> The competent authority should assess the financial soundness of the person because the person's behavior in financial affairs can have an impact on the person's reputation. However, the fact that a person has limited financial means shall not negate his or her suitability.

<sup>17</sup> The level and the nature of the experience required from a member of the management body in its management function will be different from that required from a member of the management body in its supervisory function. For example, a member of the management body in its supervisory function may not require the same level of technical knowledge as it is required for a member of the management body in its management function. However, such members must still be able to demonstrate that they have, or will be able to acquire, the technical knowledge necessary to enable them to understand the business of the credit institution and the risks that it faces sufficiently well to allow them to provide constructive challenge to and effective oversight of the management function.

2. A person to be appointed as a member of the management body in its management function of a credit institution should have gained sufficient experience from a managerial position<sup>18</sup> in a credit institution or in other relevant firm offering comparable services. Competent authorities should in particular take into consideration the practical and professional work experience gained from previous positions with special consideration given to:
  - a. length of service;
  - b. nature and complexity of the institution where the position was held, including its organisational structure;
  - c. scope of competencies, decision making powers, and responsibilities;
  - d. number of subordinates.
3. To be appointed as a member of the management body of a credit institution in its supervisory function a member should have sufficient experience to enable him or her to engage with and provide constructive challenge to the decisions of the management function. This experience may be gained from managerial, academic, administrative or other activities related to the nature, size and complexity of the business of the credit institution. Such experience can also be gained in the management, supervision or control of firms other than financial institutions.
4. The competent authority should consider the nature size and complexity of the business of the credit institution and the position which the member is to fill within the management body when making its assessment of whether the member has the required experience.
5. With regard to assessment of a member's education<sup>19</sup>, the competent authority should take into particular consideration the level and profile of the education and whether it relates to banking and financial services or other relevant areas.
6. With regard to assessment of the overall experience of the member the competent authority should take into particular consideration knowledge and experience with regard to:
  - a. financial markets;

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<sup>18</sup> To gain sufficient experience for serving as a member of the management body in its management function, a member should have served for a long enough period in a management position, which has allowed the person to gain sufficient professional experience. Several short-term appointments, a honorary position or functions held in order to temporarily replace a manager will not usually count towards the required experience.

<sup>19</sup> Education e.g. in the areas of banking and finance, economics, law, administration, regulation and quantitative methods can in general be considered to be related to banking and financial services.

- b. regulatory framework and requirements;
  - c. managing a credit institution, in particular:
    - i. strategic planning, and understanding of a credit institution's business strategy or plan and its accomplishment;
    - ii. risk management (identifying, assessing, monitoring, controlling and mitigating the main types of risk of a credit institution and the role the individual plays in managing them);
    - iii. managing the teams of employees;
    - iv. assessing the effectiveness of a credit institution's arrangements, creating effective governance, oversight and controls; and
    - v. interpreting a credit institution's financial information, identifying key issues based on this information and appropriate controls and measures.
7. Competent authorities may assess whether a member has sufficient skills<sup>20</sup>.

### **Article 15** **Governance criteria**

1. When assessing the suitability of a member the competent authority should also assess other criteria relevant for the functioning of the management body, including potential conflicts of interest, the ability to commit sufficient time, the overall composition of the management body, the collective knowledge and expertise required and members' ability to perform their duties independently<sup>21</sup> without undue influence from other persons.

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<sup>20</sup> Some competent authorities conduct interviews within the assessment process aiming to assess whether the member has sufficient skills to perform his or her duties. Skills considered include decisiveness, strategic vision and judgment on risks, leadership, independence of mind, persuasive power, strategic vision, and the ability and willingness to engage in continuous learning and development.

<sup>21</sup> The criteria are laid down in these Guidelines and in the Guidelines on Internal Governance, Chapter B2 and C. The Guidelines are available on the EBA's website. Independent directors play an important role in overseeing and challenging management decisions. According to the EBA Guidelines on Internal Governance (par. B.2, 14, 7), specialised committees set up within the management body (e.g. risk; remuneration; nomination etc.) should have a sufficient number of independent members. The independence requirement is additional to, and should not prejudice, the reputation and experience criteria. The criteria to assess the independence vary according to national laws, ownership structures and other specific circumstances.

2. The following situations should be considered in assessing the independence of a member: past and present positions held in the credit institution or other firms; personal, professional or other economic relationships with the members of the management body in their management function, in the same credit institution, in its parent company or subsidiaries; personal, professional or other economic relationships with the controlling shareholders of the same credit institutions, with its parent institution and subsidiaries.

### ***Title III- Final Provisions***

#### ***Article 16 Implementation***

EU competent authorities should implement the Guidelines by incorporating them within their supervisory procedures by **[four month after the publication of the Guidelines]** and credit institutions by **[6 month after publication]**. After that date, competent authorities should ensure that credit institutions comply with it effectively.

## ***Annex 1 – Documentation requirements for initial appointments***

Information to be included in the notification of the appointment of members of the management body:

1. Name of the person to be appointed
2. Complete signed curriculum vitae, including:
  - a. full name, name of birth
  - b. place and date of birth
  - c. address
  - d. nationality
  - e. detailed description of education and professional training
  - f. professional experience, including the names of all organisations for which the person has worked and nature and duration of the functions performed, in particular for any activities within the scope of the position sought. When describing these activities, the person must specify his or her delegated powers, internal decision making powers and the areas of operations under his or her control, including the number of employees. If the CV includes honorary activities, including board representation, this should be stated.
  - g. where available, references of employers of at least the last three years
3. Statement as to whether criminal proceedings are pending or the person or any organisation managed by him or her has been involved as a debtor in insolvency proceedings or a comparable proceeding.
4. Relevant criminal records, or criminal investigations or proceedings, relevant civil and administrative cases, and disciplinary actions (including disqualification as a company director or bankruptcy, insolvency or similar procedures);
5. Information, if relevant, on:
  - a. investigations, enforcement proceedings, or sanctions by a supervisory authority which the person has been the subject of;
  - b. refusal of registration, authorisation, membership or license to carry out a trade, business or profession; or the withdrawal, revocation or termination of registration, authorisation, membership or license; or expulsion by a regulatory or government body;
  - c. dismissal from employment or a position of trust, fiduciary relationship, or similar situation, or having been asked to resign from employment in such a position;
  - d. whether an assessment of reputation as a person who directs the business of a credit institution has already been conducted by



- another competent authority (including the identity of that authority and evidence of the outcome of this assessment);
- e. whether any previous assessment by an authority from another, non-financial, sector has already been conducted (including the identity of that authority and evidence of the outcome of this assessment)
6. Description of any financial<sup>22</sup> and non-financial<sup>23</sup> interests or relationships of the person and his/her close relatives to members of the management body and key function holders in the same credit institution, the parent institution and subsidiaries and controlling shareholders.
7. The position for which the person is/will be appointed.
8. Record of any credit institutions' suitability assessment results

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<sup>22</sup> Financial interests include for example credit operations, shareholdings

<sup>23</sup> Non financial interests include for example close relations like a spouse, registered partner, cohabite, child, parent or other relation with whom the director shares living accommodations.

# V. Accompanying documents

## a. Draft Cost- Benefit Analysis / Impact Assessment

### **Impact Assessment on the Guidelines for assessing the suitability of the members of the management body and key function holders of credit institutions**

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## **Scope and nature of the problem**

1. A stable financial system is crucial for the economy. The persons effectively directing the business are responsible for the sound conduct of business of an institution<sup>24</sup>. The day to day management of an institution is regularly done by key function holders. It is key that members of the management body and other key function holders understand the business and its risks. The assessment of the suitability of members of the management body by competent authorities is necessary to safeguard that the banking system can provide their functions within the economy. The financial crisis has proven that a lack of understanding of the business and its risks can create major losses for institutions, customers and the economy.

2. Article 11 of Directive 2006/48/EC requires that 'the competent authorities shall grant an authorisation to the credit institution only when there are at least two persons who effectively direct the business of the credit institution. According to Article 22 of Directive 2006/48/EC credit institutions shall have robust governance arrangements. The persons effectively directing the business have the ultimate responsibility for establishing robust governance arrangements and for the wellbeing of the institution. This responsibility lies collectively with the management body in its management function under the oversight of the management body in its supervisory function. Suitable members of the management body are required to ensure that the internal governance of a credit institution is sound, including its business strategy, risk culture, risk management and internal control framework. Therefore it is essential that the members of the management body are of good repute and have individually and collectively in each of both functions sufficient experience.

3. In late 2009, CEBS undertook a survey on the implementation by supervisory authorities and institutions of its Internal Governance Guidelines published in January 2006. Regarding the management body competent authorities identified inadequate oversight by the management body in its supervisory function of the senior management as the most important and the most frequently observed weakness. Many other problems were related to this, e.g. concerns about the quality of the management body, both executive and non-executive members, as well as concerns about the independence of the latter. As a result board challenge to management's business proposals and practices was weak in some cases. Contributory factors might have been time constraints, particularly for non-executive directors to fulfill their duties, and a failure to check the institution's control environment. The management body, in particular in its supervisory function, might not have understood the complexity of the

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<sup>24</sup> regarding the responsibilities of the management body, see also EBA guidelines on internal governance

business and the risk including operational risk involved and might consequently have failed to identify and constrain excessive risk-taking. Another related issue was the difficulty of keeping managements' expertise up-to-date especially in fast moving markets with complex and innovative financial products.

### **Impact assessment of the EU Commission**

4. While the EU Commission has published an impact assessment on their CRD III (Directive 2010/76/EU) proposal amending Directive 2006/48/EC, this does not cover the requirement to develop guidelines on the suitability of directors. This requirement was added later on in the process of negotiating CRD III.

5. With its proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervisions of credit institutions and investment firms (CRD IV), the commission proposed to require the development of Binding Technical Standards regarding the assessment of the suitability of directors and extending the scope of this provision also to non-executive directors.<sup>25</sup>

6. The EU Commissions objectives for a reform of corporate governance are to prevent failures of credit institutions and to reduce systemic risks, in particular excessive risk taking by credit institutions shall be prevented by remedying weaknesses in risk governance systems. Beside others this should be achieved by improving the effective challenging of the board, which would be achieved by improving the time commitment, expertise of board members, counterbalancing the management dominance and improving diversity of board composition.<sup>26</sup> The EU Commission conducted an impact assessment regarding its proposal and arrived at the subsequent conclusions. Regarding the expertise of board members the Commission retained beside others the sub option that board members shall be subject to an enhanced 'fit and proper' test and considers this to be an effective and enforceable measure which has a positive effect regarding the level playing field. However this measure will limit the flexibility of credit institutions regarding the recruitment of board members.<sup>27</sup>

7. The suitability of directors would be a part of the supervisory review of governance arrangements; regarding the latter the Commission has estimated costs for the supervisory authority between 40.000 Euro and 12

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<sup>25</sup> The Commission's impact assessment can be accessed under the following link: [http://ec.europa.eu/internal\\_market/bank/docs/regcapital/CRD4\\_reform/IA\\_directive\\_en.pdf](http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf)

<sup>26</sup> EU COM impact assessment page 113

<sup>27</sup> EU COM impact assessment page 118

Mio Euro for those assessments. The costs are mainly driven by the size of the member states banking system.<sup>28</sup>

8. The Commission recognised that the number of suitable candidates for Management Body memberships will decrease with a strengthened 'fit and proper' test. However, this would only be a problem if there is a lack of suitable candidates. The Commission sees evidence that there is a sufficient pool of candidates.<sup>29</sup>

9. The EU Commission's impact assessment concludes that all potential costs of the measures to strengthen board oversight 'seem to be insignificant compared to the annual operational expenses for credit institutions' in the EU which reached €454 billion for the whole European banking sector in 2009.<sup>30</sup>

10. The Commission does not expect that the 'new principles on corporate governance are going to have any direct impact on the natural environment or on third countries.'<sup>31</sup>

### **EBA's impact assessment**

11. Directive 2006/48/EC requires that the EBA develops guidelines for the assessment of the suitability of the persons who effectively direct the business of credit institutions. The scope for developing different regulatory options is quite narrow. In addition institutions are required to ensure robust governance arrangements. The EBA has already published Guidelines on Internal Governance.

12. The Commission analysed the impact of a 'fit and proper' assessment for all board members and concludes that such a requirement would trigger costs, but that those costs are insignificant. Therefore it can be assumed that these Guidelines do not cause significant costs or an adverse social or environmental impact.

13. The EBA agrees with the Commissions assessment of the costs and benefits; hence EBA conducted only an additional impact assessment concerning aspects of the Guidelines which were not yet analysed in the impact assessment for the proposed Directive.

### **Baseline scenario**

14. The baseline scenario for the following additional assessment would be one in which no action is taken. The EU would continue to rely on the existing national regimes for the assessment of the suitability of members

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<sup>28</sup> EU COM impact assessment page 124

<sup>29</sup> EU COM impact assessment page 126

<sup>30</sup> EU COM impact assessment page 127

<sup>31</sup> EU COM impact assessment page 130

of the management body which covers at least the assessment of two persons who effectively direct the business in the moment of the authorisation of a credit institution.

### **Options on the scope and content of the Guidelines**

15. The assessment of the suitability contains two key elements, firstly the process how the assessment is done, secondly the aspects which should be scrutinised and criteria applied for this purpose. Art. 11 of Directive 2006/48/EC deals with the authorisation of credit institution. The mandate provided to the EBA is not precise on the situations when an assessment shall be done. In addition it may be sensible to broaden the scope of the assessment to the members of the supervisory function of the management body as foreseen in the proposed directive and to other key function holders.

16. Financial holding and mixed financial holding companies have significant influence on the management of a credit institution. Article 135 of Directive 2006/48/EC states that Member States shall require that persons who effectively direct the business of a financial holding company or a mixed financial holding company be of sufficiently good repute and have sufficient experience to perform those duties. Therefore the Guidelines scope could also cover the assessment of the suitability of members of the management body of such holdings.

### **Scope of the Guidelines**

17. Regarding the situations where the suitability of a person needs to be assessed, the Guidelines can either be limited to the assessment in the context of the authorisation of the credit institution or otherwise encompass also the assessment of newly appointed members of the management body and an ongoing review.

18. As explained in the section on the scope and nature of the problem, it is essential that the members of the management body are of good repute and have individually and collectively in each of both functions sufficient experience to ensure the sound management of a credit institution. Obviously this needs to be ensured on an ongoing basis. To ensure that the Guidelines are effective in ensuring a sufficient suitability of members of the management board, an assessment of newly appointed members and an ongoing review is needed. The measure is necessary to ensure the wellbeing of institutions and the financial sector, as the management body has the ultimate responsibility for the management of the credit institution. Following the assessment of the costs by the European Commission, the costs for this measure are insignificant.

19. An assessment of the suitability of members of the management body only in the moment of the authorisation of the credit institution would not

establish a prudential control on the suitability of such persons; hence the measure would not be effective.

20. To ensure the ongoing suitability of members of the management body, it is preferred that the guidelines include rules on the assessment of newly appointed members and the ongoing review of the suitability.

21. The day to day management and the implementation of the strategy and internal governance framework is often done by other key function holders and not directly by the management body. Therefore institutions need also to ensure that all key function holders are suitable for their respective position to ensure that they have robust governance arrangements.

22. The Guidelines clarify the institutions responsibilities regarding the assessment of key function holders. The assessment by institutions itself and the respective policies is already required by the EBA Guidelines on Internal Governance. A mere clarification of the responsibilities and content of policies is not considered to have a significant impact on institutions. The same applies to the clarification of the content of policies for the institutions assessment of members of the management body.

23. The assessment of the suitability of key function holders by competent authorities improves the robustness of governance arrangements and increases the level of prudential control on the governance arrangements.

24. In the case that the assessment of the suitability by competent authorities would be extended, this would establish an additional control on the quality of governance arrangements. The measure would be effective to ensure the suitability of key function holders. However, one may also rely on the members of the management body, which need to ensure the robustness of the internal governance.

25. The cost for an assessment by the competent authority depends mainly on the number of assessments to be done, which is driven by the size and number of credit institutions. A requirement to perform such an assessment can have a significant cost impact for the competent authority. For institutions, who would need to assess the quality of the key function holders anyway the impact would be limited to some additional administrative burden.

26. As the number of institutions differs significantly and for some competent authorities a requirement to assess the suitability of key function holders would create significant costs, which have to be reimbursed by taxpayers or credit institutions, it is preferred to leave the assessment of the suitability of key function holders by competent authorities to national discretion.

27. While Art 11 of Directive 2006/48/EC refers explicitly only to credit institutions, article 135 of Directive 2006/48/EC sets out requirements on the suitability of members of the management body of financial holding companies. As they have a significant influence on credit institutions, it is obvious that the stability of the financial system benefits from an assessment of the suitability of their members of the management body, even if an authorisation is not required.

28. While the holdings would need to do an assessment of the suitability of their members of the management body to comply with the above requirement, the assessment by competent authorities is at the moment often not performed. The costs of the assessment is driven by the number of such companies, which is by far lower than the number of institutions, therefore the additional ongoing costs are neglect able. The implementation of respective requirements will lead in some cases to changes in the national laws, which will also trigger additional one off costs, if the Guidelines is complied with in this respect.

### **Harmonisation of the process or national discretion**

29. The Directive 2006/48/EC requires assessing the suitability of persons who are effectively directing the business. While competent authorities have assessment processes in place, the processes differ. Some authorities require a prior approval of a person by the competent authority, before the person takes the position as a member of the management body in its management function. Other competent authorities allow the appointment on a non objection basis. This may also depend on the national law regulating the governance of companies.

30. A harmonised process may be beneficial, if a process is chosen, which ensures the best possible assessment of the suitability. This may include assessments by institutions, off-site evaluations by competent authorities and interviews with persons who effectively direct the business of institutions.

31. It is important to apply those processes in a proportionate way, as the structure of the banking system and the number of institutions differs between member states banking systems.

32. A more intense assessment process, including interviews of the persons, requires additional resources within competent authorities. In particular in member states with a high number of institutions the full roll out of an interview process, including a periodical reassessment of the suitability of directors, would be costly as it would require addition staff within the competent authority. This would also be burdensome and time consuming for the assessed person and would therefore add opportunity costs for the institutions.



33. EBA guidelines need to be implemented by competent authorities before they are applied. However, guidelines are not legally binding. Even if the Guideline would aim to achieve a harmonised process, it is not certain that this can be achieved. Competent authorities would have to apply the processes in a proportionate way. Considering the structural differences of financial markets and national company laws, this would already lead to differences within the application of such processes.

34. It is important that the objective is achieved, rather than a harmonised process is used. National discretion regarding the process reduces the cost of implementation of the guidelines, as competent authorities would have the option to stick to the established processes.

35. On the other hand to ensure a harmonised procedure and a level playing field regarding the assessment of the suitability of members of the management body, a harmonisation of the main tasks and documentation requirements within the assessment process would be desirable. This would also facilitate the reliance of assessments done by other competent authorities and the discussion of any arising issues regarding the suitability of directors without triggering significant costs.

#### **Harmonisation of criteria**

36. Given the requirements within Art. 11 of Directive 2006/48/EC, a sufficient reputation and experience of persons effectively directing the business is indispensable. The harmonisation of aspects for the assessment ensures that the outcomes of the assessment are of sufficient homogeneity between member states.

37. Harmonised criteria would ensure that members of the management body fulfill the same suitability standards. Given the European passport for credit institutions this is crucial as it ensures a minimum quality of members of the management body competencies, which would improve the trust of stakeholders in the supervisory suitability assessment.

38. While the number of aspects and criteria which need to be assessed has some impact on the costs of the assessment for both, institutions and competent authorities, the harmonisation of criteria itself would, if at all only create minor one off costs. The criteria should be defined in a way that allows the application of the proportionality principle.

#### **Data used for the Impact Assessment**

39. The Impact Assessment is based on input from competent authorities of the EU, which provided information about the existing processes used for the assessment. It takes into account the Commissions impact assessment on CRD IV.

### **Preferred Options**

40. To harmonise the scope of the assessment for members of the management body, the aspects and criteria used for the assessment and the main outline of the process would be preferred.

41. The content of policies for the institutions assessment of the suitability of members of the management body and key function holders should be clarified.

42. The assessment of the suitability of key function holders should be subject to national discretion, as a harmonised process regarding this matter would be too costly.

43. Mixed financial holding companies and financial holding companies have a significant influence on credit institutions. The role of financial holding companies differs from the role of credit institutions, therefore the process and the criteria for the assessment of the suitability can only be applied in a proportionate way.

44. Considering the European passport for institutions, the harmonisation of prudential criteria used for the assessment of the suitability of persons effectively directing the business is important to ensure that the assessments are of consistent quality throughout the EU. These measures would be sufficient to ensure an effective assessment of the suitability of members of the management body, while the implementation costs would be limited.

### **Additional impact assessment actions**

45. As the mandate provided by CRD III is quite narrow and considering the results of the Commissions impact assessment, additional impact assessment measures are not necessary.

## **b. Overview of questions for Consultation**

In addition to comments on the proposed Guidelines, respondents are asked to provide answers to the following 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?

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?