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Confédération Européenne des Associations d'Administrateurs

European Confederation of Directors' Associations

<p><b>Draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution (EBA consultation)</b></p>
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*Guidance on director assessment within a comply or explain framework*

The EBA wants to offer guidance on the assessment<sup>1</sup> that persons who effectively direct a financial institution are of sufficient good repute, have sufficient knowledge, skills and experience, while also committing sufficient time to perform their duties. On top of that, ecoDa wants to stress the need for directors of a financial institution to have sufficient insight into what constitutes good governance practice while being committed to apply a good governance attitude. Convinced of the necessity to have a professional assessment of directors, **ecoDa considers this a positive step towards good governance**. Moreover, by harmonising the criteria for such assessment the EBA **facilitates the creation of a level playing field among Member States**.

The EBA expects all competent authorities and financial market participants to whom the guidelines apply to comply, unless otherwise stated. **ecoDa welcomes that the EBA confirms that for governance matters a comply or explain approach is the most feasible route to offer sufficient flexibility** to the Member States and hopes that the competent authorities will use the same approach in order to offer the **flexibility needed in the very diverse landscape of financial institutions** under their supervision. This approach seems more feasible to ecoDa than opting for different official systems within each Member State, depending upon some scope and scale criteria ([Question 1](#)).

*Clarification needed as to the definition of the scope of this guidance*

The definitions of the scope given throughout the Guidelines (see below) are not consistent and certainly open for further clarification.

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<sup>1</sup> As demanded by the EU Directives, like the upcoming CRDIV.

- 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 (as in the title of the document) (p4).
- These guidelines are not limited to members of the management body acting in its management function, but extend to the members of the supervisory function in order to assure adequate oversight (p4).
- The persons in scope are not limited to persons who effectively direct, i.e. not limited to members of the management body in its management function, but include the management body in its supervisor function and key function holders (p6).
- The guidelines are applied regardless of the governance system... either a unitary or a dual board. The management function sets the direction... The supervisory function oversees the management function and provides appropriate advice and challenge.
- 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 and supervisory function.

**Although, at first sight, one could assume that the guidance is oriented towards all the members of the top governance bodies, whatever the board system used, the contrary is stated in the last definition.** ecoDa wants to question why non-executive directors are included in the scope of these Guidelines only if they operate through a unitary board, while they are apparently not included when a dual board structure is used? In a two-tier or dual board structure the management body is completely separated from the supervisory board. In such dual board, 'the supervision on the company in general and the management body more specifically' is the duty of the supervisory board (notwithstanding that from an internal governance perspective top management has a supervisory function towards subordinates and subsidiary companies). **ecoDa wants to propose not to use the term 'management body' as the main reference group, but rather the term 'board'**. Whatever board model used, the term board applies to the one or two top organs that govern the company. On the contrary using the term 'management body' might be misleading for both models. If one speaks of a management body this excludes all non-executive directors in a two-tier board model (as explicitly stated in the definition given above), whereas the one-tier board model cannot be perceived as a management body either.

*ecoDa would like to ask more attention for the feasibility of enlarging the scope far beyond the board*

**ecoDa welcomes the interest the EBA attaches to Internal Governance.** ecoDa is indeed convinced that good governance does not stop at board level. On the contrary, good governance needs to be embedded throughout the organisation and should be an attitude at all levels of decision-making. **However, ecoDa doubts to what extent the competent authorities have to intervene directly into the assessment and the nomination of numerous other key function holders.** This does seem a bridge too far, from a cost-benefit perspective as well as from a governance perspective. ecoDa wants to highlight the practical difficulties faced by regulators in assessing the suitability of key position holders at financial institutions. Although their involvement in this process is understandable (particularly since the financial crisis), regulators are not optimally qualified to make this assessment (taking into consideration the important number of people involved as well as the mobility of such functions) and consequently the process might become extremely superficial. Based on the governance checks and balances principle, it is the duty of the board and top management to take care of the nominations of key decision-makers and key function holders. Beyond the senior managers, the head of internal control and the head of a branch or subsidiary, the board should also pay attention to the nomination of the directors of the (important) subsidiary boards. The group board should be explicitly made responsible for the assessment of the board members of those subsidiary companies and of the key function holders and this assessment should be based on comparable criteria as the ones laid down in the EBA Guidelines. (Question 2)

### *Defining suitability*

Generally, suitability means the degree to which someone has the right qualities for a particular purpose. Although the definitions given in the EBA Guidelines might seem straight forward or even 'common sense', it is important to look more deeply into the elements that constitute a suitable profile. The EBA defines the suitability of the 'members of the management body' as the degree to which such persons have **good reputation** and have **sufficient experience** to fulfil their duties as members of the management body. The experience of a person consists of a synthesis of **educational** and **professional** aspects. The EBA Guidelines explicitly include a third category of assessment criteria, the **governance criteria**. Under this last heading a quite divergent set of criteria are included, such as: potential conflicts of interest, ability to commit sufficient time, the overall composition of the management body, the collective knowledge as well as the independence (independence being defined in relation to previous positions and relationships within the larger group and with controlling shareholders).

The requirements differ depending on the credit institution's nature, scale and complexity of its activities and the position concerned (p8). According to ecoDa the **assessment of the suitability of non-executive directors deserves special attention**. Indeed, whereas most attention (also from a historical perspective) has been attached to the

assessment of 'managers', the specifics for assessing the 'non-executive' directors is only given in a footnote (footnote 17, page 20), where it is pointed out that there should be a **differentiation in the experience criteria applicable to the management function versus the supervisory function of the management body** (footnote 17, p20). In essence the level and the nature of the experience required are **less technical for the supervisory function**. The non-executive directors need to demonstrate that they have (or will acquire) the technical knowledge necessary to understand the business and its risks, while allowing them to provide constructive challenge and effective oversight (of the management function). Such experience may be gained from managerial, academic, administrative or other activities related to the financial sector. But also management or supervision experience in non-financial institutions is a valid experience (p21). Interesting is the listing of disciplines related to the management of a financial institution, such as strategic planning, risk management, management of teams of employees, assessing the effectiveness of the business, creating effective governance, oversight and control and interpreting the financial information. These descriptions might be relevant for nomination committees to evaluate the director's experience as well as the quality of its educational and professional development programs (such as director education programs).

Since the members of the management body perform specific functions and roles, it is assumed that the assessment process and criteria can differ (p7). **ecoDa wants to point out that this 'functional' approach should be adapted for the assessment of the suitability of directors**. Notwithstanding the increased role played by board committees, the legal assumption is that the (supervisory) board functions as a college. Any individual director assessment should therefore be judged within the framework of the overall board suitability. The assessment of the suitability of an individual (non-executive) director should be based on a double set of criteria: the general criteria for a professional board mandate should be coupled with the specific needs of a vacancy. This last element has to be defined in relation to the necessary diversity and complementarity in experience. Moreover special attention might be paid to the increasingly important role of the chairman of the board.

Complementary to the intervention at the time of the nomination, the competent authorities or **regulators should place greater emphasis on what happens after the appointment**, e.g. in terms of induction, training and ongoing professional development. In that context, they will have an opportunity to influence the attitudes and approaches of the appointee in a way that reflects their distinctive responsibilities in running a major financial institution.

Another requirement to which the EBA Guidelines point is the requirement that directors should **devote 'sufficient time' to their board mandate**. In contrast to the CRDIV, the EBA however does not substantiate what such requirement means in practice. ecoDa wants to explicitly warn for making simple limitations, such as 5 board mandates. There is no such thing as a simple and single rule to judge the 'time available' for a specific board mandate. Careful analysis is essential to judge the time investment associated

with combinations of quite divergent types of non-executive functions coupled with or without executive responsibilities.

*A plea for more complementarity in the role to be played by the governance bodies and the supervisory authority*

**Although ecoDa welcomes the in-depth guidance on the assessment of the directors and managers of the financial institution, ecoDa also would like to warn against double and even triple assessment levels.** Would it not be possible for the EBA to develop further the fine tuning of the respective roles of the supervisory authority, the board and its nomination committee<sup>2</sup> and the shareholders? ecoDa's proposals are the following:

In principle, as far as the nomination of directors and top management is concerned, the nomination process starts off at the nomination committee. All governance codes devote special attention to a more professional selection and nomination process, which has to be taken care of by the nomination committee. This could form the starting point for applying the criteria set out in the EBA Guidelines. In a second step, the board of directors (unitary) or supervisory board (dual model) discusses the proposals of the nomination committee and decides on the candidate to be nominated. Here the supervisory authority steps in, to validate the candidate proposed. It is only after such approval that a formal proposal for nomination by the shareholders meeting -if needed- can be made. As to board members (unitary board/supervisory board) the nomination rights finally belong to the shareholders meeting. **In these Guidelines, nowhere is reference made to the key role shareholders have to play when it comes to assessing the suitability of directors. This contrasts with the CRDIV proposals that explicitly mention that this is a fundamental duty of the shareholders.** More transparency on the nomination methodology used could be the route to stimulate a more professional governance process. **ecoDa is of the opinion that improved transparency** towards controlling authorities and shareholders of the nomination process and the suitability at the point of nomination as well as on a continuing basis **might be the best guarantee for a flexible as well as efficient assessment process.**

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<sup>2</sup> It is important to mention that in some countries (like Sweden and Norway) the nomination committee is not a committee of the board, but is entirely composed of 'outside' shareholders, who have no board seat. The statement given by ecoDa mainly refers to the situation where the nomination is an advisory committee of the (supervisory) board.

APPENDIX : RECAP OF REPLY TO THE TWO QUESTIONS SEPARATELY PUT FORWARD BY THE EBA
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#### QUESTION 1: Principle of proportionality

The EBA expects all competent authorities and financial market participants to whom the guidelines apply to comply, unless otherwise stated. **ecoDa welcomes that the EBA confirms that for governance matters a comply or explain approach is the most feasible route to offer sufficient flexibility** to the Member States and hopes that the competent authorities will use the same approach in order to offer the **flexibility needed in the very diverse landscape of financial institutions** under their supervision. This approach seems more feasible to ecoDa than opting for different official systems within each Member State, depending upon some scope and scale criteria.

#### QUESTION 2: Assessment of the suitability of key function holders

*ecoDa would like to ask more attention for the feasibility of enlarging the scope far beyond the board*

**ecoDa welcomes the interest the EBA attaches to Internal Governance.** ecoDa is indeed convinced that good governance does not stop at board level. On the contrary, good governance needs to be embedded throughout the organisation and should be an attitude at all levels of decision-making. **However, ecoDa doubts to what extent the competent authorities have to intervene directly into the assessment and the nomination of numerous other key function holders.** This does seem a bridge too far, from a cost-benefit perspective as well as from a governance perspective. ecoDa wants to highlight the practical difficulties faced by regulators in assessing the suitability of key position holders at financial institutions. Although their involvement in this process is understandable (particularly since the financial crisis), regulators are not optimally qualified to make this assessment (taking into consideration the important number of people involved as well as the mobility of such functions) and consequently the process might become extremely superficial. Based on the governance checks and balances principle, it is the duty of the board and top management to take care of the nominations of key decision-makers and key function holders. Beyond the senior managers, the head of internal control and the head of a branch or subsidiary, the board should also pay attention to the nomination of the directors of the (important) subsidiary boards. The group board should be explicitly made responsible for the assessment of the board members of those subsidiary companies and of the key function holders and this assessment should be based on comparable criteria as the ones laid down in the EBA Guidelines.

#### **CONTACT DETAILS**

## About ecoDa - The European Confederation of Directors' Associations

[www.ecoda.org](http://www.ecoda.org)

ecoDa's objective is to promote board members' skills, professionalism and impact on society. By contributing to a professional framework for both current and future board members, ecoDa hopes to help them to develop and add value to their organisations, both in the commercial and non-commercial sectors. ecoDa proposes solutions to the key corporate governance questions facing Europe today, including the challenge of helping board members to operate effectively across all the European Union Member States. ecoDa aims to be an active partner of the European Union and of its institutions – especially the European Parliament and European Commission.

ecoDa's members: IoD, GUBERNA, IFA, ILA, IC-A, Hallitusammattilaiset ry, the Slovenian association of supervisory board members, the Croatian Association of certified supervisory board members, the Polski Instytut Dyrektorow, the Norwegian institute of directors (Styreinstitutt), the Norwegian StyreAkademiet, the Baltic institute of directors, the Swedish StyrelseAkademien and the Macedonian FYR Institute of Directors.

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