

## EBF response to the EBA Consultation on draft Guidelines on the assessment of the suitability of members of the management body and key function holders

Launched in 1960, the European Banking Federation is the voice of the European banking sector from the European Union and European Free Trade Association countries. The EBF represents the interests of almost 5000 banks, large and small, wholesale and retail, local and cross-border financial institutions. Together, these banks account for over 80% of the total assets and deposits and some 80% of all bank loans in the EU only.

### Key Points

- The EBF fully understands the importance of an appropriate assessment of members of the management body. It is indeed in the company's own interest to choose the most competent people and to take into account a certain level of diversity of skills corresponding to the company's operation, structure and needs.
- The EBF is in particular very much concerned and questions the opportunity to extend the Guidelines to "key function holders". The EBF is concerned not only by the disproportionate broadening of the Guidelines but also by the potential risks – in the absence of a clear legal basis – that the application of the guidelines would be challenged by employees against their bank employers. In the EBF's opinion, competence for assessing the suitability of key function holders should stay with the credit institution.
- Another main concern is the sequencing proposed by the draft Guidelines, which in our opinion, might not reflect the reality. The different stages of the assessment process in which the competent authority will intervene are not in our view clear enough. In practice, banks would reach out informally to the regulator and review the candidate and requested criteria, before starting the paper work. It would therefore appear, more realistic to invite banks to liaise with the competent authority as early as possible.
- EBF members are also concerned by the high requirements regarding experience and education which may not take into account sufficiently other criteria such as the diversity of views and experiences

## I. General Comments

The European Banking Federation (EBF) welcomes the opportunity to comment on the European Banking Authority (EBA) Consultation Paper on draft Guidelines for assessing the suitability of members of the management body and key function holders of a credit institution (the 'draft Guidelines').

The EBF makes the following observations with the aim of ensuring consistency, clarity of understanding and practical application of the future final Guidelines. It is also important to have a strong focus on proportionality. For many provisions, the EBF also notes a strong overlap with the EBA Guidelines on Internal Governance and questions whether it would not be more suitable to amend them instead of creating new rules. In addition, many local supervisory authorities already have their own local requirements in place. Consequently, the EBF assumes that, where there are conflicting interests, some local direction will be provided by national supervisory authorities or variations in requirements recommended. Finally electing members of the management body in its supervisory function is also a fundamental right of shareholders (and sometimes employees' representatives) and therefore any interference or regulatory oversight should be carefully assessed.

The EBF's main concerns are:

**Firstly**, the EBF is very much concerned about the extension of the draft Guidelines to "key function holders", the level below the board which comprises a group of people to be defined by the credit institutions. The draft Guidelines do not explain why such expansion is needed, nor do they specify any legal basis (the wording 'broader in scope than the mandate' in the par. III.2 adds doubts about the legal basis). The EBF is concerned not only by the disproportionate broadening of the potential constraints and burdens associated with the application of the future final Guidelines but also by the potential breach of the fundamental principle that authorities should act within the mandate assigned to them by the legislator. The risk is indeed that the legal basis of the draft Guidelines' would not only be challenged by banks (which may be less the case) but also by employees suing their bank's employers (which may be more frequent). In conclusion the competence for assessing the suitability of key function holders should stay with the credit institution (see also answer regarding question 2).

**Secondly**, another main concern of the EBF is the sequencing proposed by the draft Guidelines, which in its opinion, does not reflect the reality. The different stages of the assessment process in which the competent authority will intervene are not, in the EBF's view, clear enough. In its understanding, it is indeed requested that the credit institutions start with a self-assessment, a comprehensive process, and documentation requirements. In reality, banks would reach out informally to the regulator and review the candidate and requested criteria, before starting the paper work. It would therefore appear, more realistic to invite banks to liaise with the competent authority as early as possible.

**Thirdly**, EBF members are also concerned by the high requirements regarding experience and education, which may not take into account sufficiently other criteria such as the diversity of views and experiences

As another general comment, the EBF does not agree with the following statement in the executive summary (page 4): *“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.”* It should be re-drafted as follows: *“Weak governance arrangements, in particular, inadequate oversight by and challenge from the supervisory function of the management body may have been contributory causes of the financial crisis.”*

Please find below the EBF detailed comments on the draft Guidelines’ consultation document.

## II. Detailed Comments

In contrast to the European Banking Authority (EBA) Guidelines on Internal Governance, the proposed draft Guidelines do not state that the definition of management body “must be seen in the context of national law”. Due to the various legal systems in the Member States, a clarification is necessary.

Regarding the assessment of the suitability of the supervisory board members, the draft Guidelines should at least state that the criteria defined for supervisory board members has to be fulfilled by the body as a whole and not necessarily by each single member. Furthermore, the EBF points out that the company itself, as well as supervisory authorities, have only limited impact on the election of supervisory board members as they are elected by the shareholders.

Background, III.8, 4th sentence: The statement that the “oversight role” assigned to the supervisory function “includes developing the business strategy” neither properly reflect certain legal frameworks where this is a clear task for the management board. Nor - in CRD IV and EBA Guidelines definition - the management body acting in its management function. The EBF believes that it would be preferable to just draw on the definitions in the CRD IV instead of stating it differently in the draft Guidelines.

### Article 2 d

It is suggested that the draft Guidelines should also apply to “key function holders” defined as *“those employees outside of the management body whose positions give them significant influence over the direction of the credit institution”*. As stated above, the EBF strongly believes that the competence for assessing the suitability of key function holders should stay with the credit institution.

If, despite the EBF’s strong concerns, the EBA includes key function holders in the draft Guidelines, the EBF would urge at least a more narrow definition of them in keeping with the principle of proportionality, especially concerning the smaller banks, which may be organised differently.

### Article 4.2

Article 4.2 states that the Nomination Committee “should actively contribute to fulfilling the credit institution's responsibility *and* adapting appropriate internal policies on the assessment of the suitability of members of the management body and key function holders”. The EBF

suggests that the “and” in italics above, be replaced by “of”, since this is the Nomination Committee’s key role.

However as stated above, this article also extends the role and remit of the nomination committee beyond board and senior executive positions to key function holders which as currently envisaged could be a sizable group of persons below board and executive level. As currently drafted this would create disproportionate requirements on nomination committees and it seems not feasible for a committee of non-executive directors to review all key function holders if defined widely.

#### Article 5, 6, 7 and 8

Article 7: As stated above, the EBF would clearly prefer deleting paragraph (2) on key function holder or at least restrict its scope (definition)<sup>1</sup>. Please refer to the general comments provided above.

Currently, Articles 5, 6, 7 and 8 contain criteria for general assessment by institutions. The EBF is of the opinion that those articles are not necessary, since the EBA Guidelines on Internal Governance already contain sufficient requirements and regulations. These requirements are found in:

- B1. 10.2. c: The management body in its supervisory function should monitor the performance of the members of the management body in its management function against those standards.
- B2. 11.2: An institution should set the size and composition of its management body, taking into account the size and complexity of the institution and the nature and scope of its activities. The selection of members of the management body should ensure sufficient collective expertise.
- B2. 11.3: The management body should identify and select qualified and experienced candidates and ensure appropriate succession planning for the management body, giving due consideration to any other legal requirements regarding composition, appointment or succession.
- B2. 11.4: The management body should ensure that an institution has policies for selecting new members and re-appointing existing members. These policies should include the making of a description of the necessary competencies and skills to ensure sufficient expertise.
- B2. 11.5: Members of the management body should be appointed for an appropriate period. Nominations for re-appointment should be based on the profile referred to above and should only take place after careful consideration of the performance of the member during the last term.
- B2. 11.6: When establishing a succession plan for its members, the management body should consider the expiry date of each member’s contract or mandate to prevent, where possible, too many members having to be replaced simultaneously.

It would therefore be more suitable to amend the EBA Guidelines on Internal Governance if further requirements for the credit institutions are deemed necessary. In addition it may also be necessary to look at each Member State’s corporate governance rules, specifically regarding the yearly evaluation process of the management body; the reporting requirements and the rules in the company laws regarding the requirements on information to shareholders.

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<sup>1</sup> In any event, the introduction should read the same and consistently speak of "selection and assessing" (like in (1)) or only of "assessing" (like in (2)).

This may also require a harmonisation of the evaluation process and the reporting requirements.

#### Article 10.1

The draft Guidelines provide that competent authorities *should ensure that the process applicable to the assessment of the suitability of members is publicly available*. The EBF understands (although it is not sufficiently clear), that the reference to the process and its publicity here refers to the process to be undertaken by the competent authority and the requirements set forth in this connection. It does not refer to the process to be undertaken by the credit institutions, which should remain confidential or only be subject to disclosure according to the company law rules and corporate governance regulations.

#### Article 11.3

It is essential that members of the management body in its supervisory function are elected by the General Assembly or the Board of Representatives subject to any powers in the company's constitution that permit the management body to appoint new members with that appointment to be subsequently ratified by the shareholders (for the institutions having such a body), and that members of the management body in its management function are employed by the management body in its supervisory role. Appointing members of the management body is already a complex task and is governed by formal rules. As a result, further ruling in this area might not be appropriate. Consequently, interviewing of management body members by the competent authorities should remain exceptional.

The principle of proportionality should also apply in this context.

#### Article 11.4

The EBF notes that the draft Guidelines point to assessments being completed 'within good time' (Article 11.4). The EBF suggests that a more specific timescale be given here, to ensure that candidates are not left waiting, unduly, or suitable candidates discouraged from applying for positions.

#### Article 11.6

If indeed the purpose of the EBA draft Guidelines is to harmonise supervisory practices further, the EBF is of the opinion that the results of a suitability assessment by another EEA regulator should mandatorily be taken into account. The wording "may" should therefore consistently be replaced by "shall".

#### Article 11.8

Assessing the suitability of key function holders is a matter of employment law. Competent authorities should not be empowered to make specific demands as to the suitability of key function holders apart from demands that are specifically laid down in the legislation (i.e. specific requirements for employees who carry out investment advice).

The process of employing key function holders must be kept as confidential as possible since the institutions may wish to employ certain key function holders for strategic or competitive reasons. Publicity in respect of the criteria for assessing the suitability of key function holders may compromise the trade secrets and strategic matters of the institutions. Furthermore, the relevant key function holders will expect that the employment process be kept confidential.

The only information to be made publicly available should be in relation to the general processes and criteria that the authorities may apply, and should not be specific to any institution.

## Article 12

With reference to supervisory corrective measures, the following is proposed in Article 12.1: "*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*". This proposal contradicts Article 13 in the EBF's opinion (a member of the management body should be considered of good repute, should there be no evidence to suggest otherwise and no reason to have reasonable doubt about his or her good reputation. 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 country in which any related events occurred), and the EBA Guidelines on Internal Governance B2. 11.

The EBF further believes that the draft Guidelines are not sufficiently clear when it comes to the applicable consequences of a disagreement between the supervisor and the credit institution regarding the suitability of a member. Nor are they in regards to the corrective measures that the supervisor may adopt in cases where the credit institution's response is "inadequate".

## Article 13

With regards to the *reputation criteria*, the draft Guidelines establish a wide range of factors which may cast doubt on a member's good reputation. The EBF finds that many of these factors are vague and may give rise to arbitrary actions taken by the competent authorities.

It should be noted that many jurisdictions, such as Spain, already have laws in force for the assessment of the reputation of management body members which focus on more tangible factors such as the existence of criminal records for fraudulent crimes and disqualification by competent authorities to hold certain positions. This approach is more reasonable, since having a long list of undetermined factors may not only give rise to different interpretations by home jurisdictions, creating thus a sense of uncertainty, but also to discretionary decisions by the competent authorities in charge of the assessment process. In any event, factors to be taken into account regarding reputation should be qualified in relation to their material impact.

In article 13.2 EBA uses the expression "*material doubt*", but it is unclear what kind of evidence is required before a "*personal and business conduct gives rise to any material doubt about...*". Furthermore, it should be clear, that the assessment of whether the criterion is fulfilled or not should be made by the management body, and not by the competent authority. Finally, it should be an obligation for the management body and not the competent authority to take corrective measures, if a member is not performing as expected.

## Article 13.3

It should be clarified in Article 13.3 that only those administrative sanctions that affect the candidate's professional reliability should be taken into consideration. Furthermore, in the EBF's opinion, it is important to recall that administrative criminal law is not yet harmonised on a European level. As a result, this may create a LPF issue.

### Article 13.6 b and c

Reference to current investigations and/or enforcement actions may need to be considered (see also annex 1) but due consideration should also be given to the principle of the presumption of innocence. This should be clearly expressed and explicitly mentioned.

### Article 13.7 a

This paragraph states that attention should be paid to "*any evidence that the member has not been transparent, open and cooperative in its dealing with supervisory or regulatory authorities*". It is unclear who is going to judge the quality of the evidence. Is it the competent authority itself? There is a high risk that this would end up being a matter of opinion. If the criterion is kept in the future final Guidelines, the EBF suggests that the word "deliberately" be added. The criterion should be that the member has deliberately not been transparent, open and cooperative.

### Article 13.7 c

As dismissal from employment can take place for many different reasons, it does not appear to be a relevant criterion in assessing the reputation of a member of the management body.

### Article 13.8

Article 13.8(a) requires credit institutions to consider any inclusion on unreliable debtors' lists or negative credit bureau records. First those lists are not always available in every country or may be very different from one country to another. Adding the word 'if available' appears therefore to be essential. The EBF is also concerned that this may oblige institutions to carry out mandatory searches of such records, which the EBF would consider overly burdensome and onerous. We also note that it is unclear whether these searches would adversely affect the individuals' credit record. The EBF believes that a person's financial soundness may be better assessed through the use of judgement debt searches. Furthermore, one or more current/previous missed payments on a credit bureau record are not necessarily an indication of financial delinquency.

In addition, the EBF is concerned about the reliability and feasibility of carrying out multiple credit bureaux searches in the event of a person having lived in more than one jurisdiction.

Similarly, in relation to Article 13.8(d), the EBF is concerned that institutions may be required to opine on the outcome of legal proceedings, etc. before the outcome is known. The EBF also feels that the existence of a 'large' loan/investment is not indicative of financial difficulty; nor would credit institutions be able to make an assessment as to its impact without requiring individuals to disclose details of their (or their family's) personal wealth. A definition of "large" would also be appreciated.

### Article 14

As per the *experience criteria*, the EBF finds the requirements set forth in the Guidelines, differ to a certain extent from what has been traditionally required from financial institutions regarding "diversity" on the board. Indeed, diversity within the board should be a key factor to take into account when assessing the suitability of its members. This approach is also shared by the Proposal for CRD IV.

Hence, requiring members of the management body in its supervisory function to have gained experience from activities *related to the nature, size and complexity of the business of the credit institution* limits the field from which to find suitable candidates. It also prevents a diverse composition of the board (as regards age, gender, geographical provenance, educational and professional backgrounds) and hence a variety of views and experiences.

It is important to point out that the draft Guidelines consider that a person may be appointed as a member of a management body in its management function if he or she has experience from a managerial position in a credit institution or another relevant firm offering comparable services. Although the EBF generally agrees with the principle that members should have gained sufficient experience from a managerial position, the EBF fears that a strict interpretation of this Guidelines' criterion could make the appointment of a person without a prior experience in companies belonging to the banking sector, or to the investment or insurance activity, difficult, even if this person had the relevant experience from previous positions in companies in other sectors. Conversely, the experience gained in companies other than financial institutions is allowed for management body members in their supervisory function (art. 14 par. 3). In the EBF's opinion, this criterion should also be applied to the members of the management body in its management function.

If this is not the case, the requirement for experience acquired in a credit institution (Article 14.2.) combined with the focus on education relating to banking and financial services (Article 14.5) will have a significantly negative impact on the number of candidates for the management body. The EBA acknowledges this issue on page 29, no. 8, but the EBF's does not agree with the conclusion. On the contrary, it sees no reason for hindering experienced managers from other companies from being candidates. At least, this, so long as the members of the management body have sufficient collective expertise and are able to fulfil the requirements in the laws and regulations, and the EBA Guidelines on Internal Governance etc.

Concerning the experience criteria of "education" in Article 14.5, it would be appropriate to clarify that relevant practical work experience and university degrees are to be regarded as of equal value.

In the footnote to Article 14.2, it is stated that short-term or temporary appointments will usually not be counted when assessing whether the person has the required experience for the role. While the EBF notes that such appointments may not be sufficient by themselves to meet the full experience requirement, the EBF feels that all relevant experience should be considered in such an assessment.

#### Article 14.6

It does not seem appropriate to require the same level of knowledge and experience for all members of the management body. This demand conflicts with the principle of having both individual and collective criteria for the members of the management body and will contribute further to the negative impact on the number of candidates for the management body. Furthermore, it is not in the interest of the institutions or society in general to have only specialists and technocrats managing the credit institutions.

#### Article 15.2

Article 15.2 uses independence as a wide and open concept and risks, thereby, creating problems when the boards of subsidiaries are composed. Article 15 (2) should be deleted.

It reflects an unresolved (though growing) ambiguity between the subsidiary as a legal entity of its own - with a separate license - and the responsibility of the parent group to serve as a source of strength for the group. The EBF is very concerned to see that in the context of an acquisition or creation of a subsidiary, the ability of the parent group to support the subsidiary with financial and managerial means is a critical component of the change-of-control review by the subsidiary regulator: (see Article 19a (1)(c) of the Banking Directive (2006/48/EC) introduced by Directive 2007/44/EC and paragraph 61 of the Guidelines for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC issued by CEBS, CEIPOS and CESR (CEBS/2008/214; CEIOPS-3L3-19/08; CESR/08-543b)). But when it comes to the composition of the board of the subsidiary, the independence of its members, also from the parent group, becomes important. The draft Guidelines even aggravates this ambiguity: namely, Article 15(2) uses independence as a wide and open concept and does not specify its purpose, or how it relates to the source of strength requirement described above.

Annex 1.2 states that - where available - references of employers of at least three years shall be submitted. As issuing of references is not common (esp. for holding supervisory board mandates), this request would be better deleted from the information that has to be included in the notification. Should – contrary to the expectations – a candidate have such references, he or she can voluntarily submit them at any time. The EBF also questions the need for a signed Curriculum Vita. Nowadays, an electronic version should also be acceptable. The EBF also considers the level of detail required in Annex 1 .2.f to be excessive. Is experience in all institutions formally required? The EBF would suggest covering the previous 10 years, as more reasonable.

Annex 1.4 These records may not always be available to credit institutions, so that this item should be qualified accordingly (“when in their possession”). In addition, the EBF would like to point out that the notification of criminal records might contravene certain provisions of the (draft Proposal for) Regulation on General Data Protection, currently in discussion and more particularly article 9, point 1 of that Regulation. There should be at least a reference in point 4 of Annex I that the notification of criminal records applies, subject to the provisions of the Regulation on Data Protection.

### III. Reply to the questions of the consultation

#### 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?

We would assume that the principle of proportionality would apply in the same manner as it applied in the interpretation of the EBA Internal Governance Code (proportionality may take into consideration aspects such as relative size, complexity, activity, geographical outreach etc.). Whilst the EBF very much supports the principle of proportionality, we fear that spelling out the final Guidelines further would damage the objective and result in endless details, leading to an unnecessarily onerous process for both banks and regulators.

#### 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?

The draft Guidelines would substantially confer wide powers to competent authorities in connection with the assessment of the suitability of key function holders of credit institutions. This entails a high degree of regulatory oversight in the internal organisation of credit institutions, which might hinder the processes for the selection of employees and prevent the existence of a level playing field.

The responsibility of managing the company lies with the management board of the company, and it should remain there. It is sufficient that the supervisory authorities assess the suitability of management board members. The assessment of the suitability of key function holders should remain the competence of the management board members, whose responsibility is managing the company.

The assessment of the suitability of the key function holders should be left to each institution, which should have the possibility of exercising their own control in this matter. Nevertheless, the competent authority, in its supervisory function, should have the ability to check the established criteria in special circumstances.

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