Consultation Response

Draft joint ESMA and EBA Guidelines on the Assessment of the Suitability of Members of the Management Body and Key Function Holders under Directive 2013/36/EU and Directive 2014/65/EU

30 October 2020

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **DRAFT JOINT ESMA AND EBA GUIDELINES ON THE ASSESSMENT OF THE SUITABILITY OF MEMBERS OF THE MANAGEMENT BODY AND KEY FUNCTION HOLDERS UNDER DIRECTIVE 2013/36/EU AND DIRECTIVE 2014/65/EU** ("the Guidelines"). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised.

Executive Summary

We welcome the opportunity to provide comments on the updated Guidelines and the work that the EBA and ESMA have done to bring the Guidelines in line with recent legislation. We raise a number of specific points below for each question, but would like to highlight the following priority areas:

- There are some instances where proportionality of application would be welcome, for example in relation to prudential consolidation and third country subsidiaries;
- Some of the proposed requirements relating to anti-money laundering and terrorist financing have been too broadly drafted and suggest that any suspicion of such activity raised by the bank will call into question the suitability of the management body; and
- The inclusion of Key Function Holders within the Title VIII assessment procedures goes beyond the CRD 5[1] mandate and we request that this is therefore removed.

[1] Directive (EU) 2019/878

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Questions

Question 1: Are subject matter, scope of application, definitions and date of application appropriate and sufficiently clear?

We note that the definition of "prudential consolidation" differs between these Guidelines and the accompanying EBA consultation on the guidelines on internal governance under Directive 2013/36/EU ("Internal Governance Guidelines")[2]. We suggest that both definitions should be amended as is proposed in the Internal Governance Guidelines. However we would also welcome proportionality of application in relation to prudential consolidation, particularly for those entities which are not directly supervised by the ECB.

In relation to the date of application of these Guidelines and the Internal Governance Guidelines, which is currently proposed as 26 June 2021, we request confirmation that this date would be amended in the event of translation delays or delays in the transposition of CRD 5 by Member States.

Furthermore, we have a concern in relation to the statement that *"Competent authorities should not implement Title VIII concerning the initial suitability assessment of newly appointed members of the management body and key function holders with regard to persons appointed before 30 June 2018"*. Even the requirement to go back only to 2018 is inconsistent with the approach taken by some Competent Authorities, which would therefore impose an additional retroactive requirement. In addition, if this is intended to be done as part of the ongoing assessment of suitability, it would not be required as a separate provision.

We would also like to raise the following points which do not fit under the remaining questions in this consultation:

We note that the Guidelines refer in several places to *"offshore financial centres"* (for example Suitability policy in a group context paragraph 17), which is not a clearly defined term. We suggest that the Guidelines use a consistent and more legally clear term such as *"third country"*, unless a distinction is established between third countries and offshore financial centres.

Legal basis: in paragraph 24, we suggest that reference is made to the Conflicts of Interest section of the EBA Guidelines on Internal Governance.

Title I Application of the proportionality principle: we request clarification as to the intent of the insertion in paragraph 20.

Question 2: Are the changes made in Title II appropriate and sufficiently clear?

In relation to paragraph 27c, there is a lack of clarity as to the intended scope. Currently, a strict reading of the proposed drafting would require a reassessment of the suitability of members of the management body whenever is it is suspected *"that money laundering or terrorist financing has been or is being committed or attempted"* in any part of a bank, i.e. as soon as a bank files a Suspicious Activity Report (SAR), regardless of whether the suspicion includes the involvement of one or more members of the management body. Furthermore, the proposed text could possibly be read as requiring a re-assessment in response to money laundering or terrorist financing originating externally, including all attempts by external actors. This could potentially require an endless series of re-assessments to be performed with a disproportionate and unreasonable level of frequency. As such, clarity with respect to the scenarios triggering a re-assessment is of particular importance.

If paragraph 27c is intended to refer to the suspicion of involvement of one or more members of the management body, this should be clearly specified.

We also request that the EBA and ESMA take into account that, were a SAR filed or investigation undertaken that led to the re-assessment of the individual's suitability, any subsequent actions such as

[2] https://eba.europa.eu/eba-launches-consultation-revise-its-guidelines-internal-governance

removal from post would likely have to be justified using that SAR/investigation information. It would be necessary to ensure that the investigation were conducted in such a way as to ensure compliance with laws on tipping off.

Similarly, if there have been specific failings identified, reassessment of the suitability of the responsible individual within the management body might be relevant. However, as noted in our response to the EBA Internal Governance Guidelines, it is not always appropriate to suggest that responsibility for the bank's compliance with Directive 2015/849/EU sits with one member of the management body. As such, under a shared responsibility model, it is requested that the Guidelines confirm the instances where it would be deemed appropriate to undertake a re-assessment of the suitability of the whole management body after a failing related to money laundering or terrorist financing has been identified.

However, where there is no link between the suspected money laundering/terrorist financing and individual members of the management body, we suggest that the risk is external to the institution. In this case, reassessment of suitability would not be appropriate or proportionate and the requirement set out in 27c should be removed.

Paragraph 30 states that *"institutions should ensure that the overall composition of the management body reflects an adequately broad range of experience"*. In this context, we would agree and suggest that it is recognised that each member of the management body will bring a different set of expertise and that there is not a general expectation that all members will have the same level of expertise and skill sets.

Question 3: Are the changes made in Title III appropriate and sufficiently clear?

In relation to the reassessment of collective suitability after suspicions of money laundering/terrorist financing activity in paragraph 32c, please see our comments with reference to paragraph 27c. The management body is responsible for ensuring a proper risk management framework regarding money laundering and terrorist financing. However, it is not proportionate to state that any suspicion of a breach on this matter would entail a new collective reassessment of the Board, unless there had been serious collective failings identified.

In relation to paragraph 74(a)(iii), while we support the EBA's focus on addressing financial misreporting and misconduct, economic and financial crime, we suggest that the inclusion of a specific reference to dividend arbitrage schemes is more granular than the other offences listed in this paragraph and that it may be better to retain higher-level categories such as "tax offences".

If the reference to such schemes is retained, we would also raise a concern with the use of the language *"illicit dividend arbitrage schemes"* (emphasis added) as it suggests that it is specifically within the remit of these Guidelines to declare particular practices illicit.

In relation to paragraph 74(b) we are concerned that the insertion of *"findings"* may present issues when an investigation concludes with a settlement rather than a sanction.

In relation to paragraph 77, there is also concern that the requirement to consider a *"serious allegation based on relevant, credible and reliable information"* without the due process of a proper investigation could open the firm to legal risk.

In relation to the insertion in paragraph 83g that conflicts of interest should be particularly considered *"in situations where a member of the management body is a Politically Exposed Person as defined in Directive (EU) 2015/849"*, we note that this may not automatically be considered detrimental in terms of independence of mind. For example, this would include situations where Board members are members of the administrative, management or supervisory bodies of State-owned enterprises. We request that reference is made to the criteria adopted by the 2017 ECB Guide to Fit and Proper Assessments[3] where it is specified that *"the materiality of the conflict of interest depends on whether there are specific powers or*

[3] https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.fap_guide_201705.en.pdf (page 17)

obligations inherent in the political role which would hinder the appointee from acting in the interest of the supervised entity" and that a timeframe for consideration is added e.g. appointments from the preceding 12 months.

On a related point, we note the addition to the potential conflicts of interest under 5.1f of Annex III Documentation requirements for initial appointments *"and in particular any relationship or association with a Politically Exposed Person as defined in Directive (EU) 2015/849"*. This also seems to expand the situations considered as potentially relevant in terms of independence of mind, by requiring disclosure about any relationship or association with a Politically Exposed Person (PEP). The concept of "relationship" is too broad and generic and would lead to disclose a lot of relationships which are inconsistent with the independence of mind requirements. We suggest that the same reference to the ECB Guide to Fit and Proper Assessments is included as we propose under paragraph 83g.

In relation to paragraph 86, we request clarity as to what should be included within *"affiliated entities"*.

Question 4: Are the requirements in section 12 sufficiently clear; are there additional measures that should be required to ensure that diversity is appropriately taken into account by institutions and that the principle of equal opportunities for all genders is appropriately reflected?

Paragraph 108 requires that *"in order to support a diverse composition of staff, institutions should have policies that ensure that there is no discrimination based on gender, race, colour, ethnic or social origin, genetic features, religion or belief, membership of a national minority, property, birth, disability, age, or sexual orientation"*. AFME and its members support the intent behind this drafting. However, we suggest that its inclusion here goes beyond the remit of these Guidelines, as they relate to assessment of members of the management body and key function holders. If the EBA wishes to require this, it should be a responsibility placed on the management body and may therefore be more appropriate to include within the Internal Governance Guidelines instead.

Question 5: Are the changes made in Title VI appropriate and sufficiently clear?

The amendment to paragraph 120 states that *"the EU parent undertakings and subsidiaries subject to Directive 2013/36/EU must ensure that the suitability standards applied by the subsidiary located in a third country are not lower than the ones applied in the European Union"*. However, we are concerned that situations may raise in which the is a conflict between this requirement and local rules, for example in relation to gender balance.

In addition to this, we suggest that undertakings should not necessarily be treated in the same manner as subsidiaries, as the weight of influence/control of the credit institution in the entity might be not enough to impose all governance standards. Lastly, it is not possible to ask the same degree of detail in the application of suitability standards in third countries (such as the counting of hours to calculate the time commitment where there is no regulation on the number of directorships).

In this context, we request that the EBA considers the importance that the proportionality principle acquires in the framework of group-wide application of arrangements, processes and mechanisms, as outlined by article 109 of CRD 4[4]. The Guidelines should not impose or expect the same standards or suitability policies in subsidiaries located in third countries, not only because group policies will have to account for a wide array of legal frameworks, as outlined above, but likewise because subsidiaries will likely have very different risk profiles, business models, size, internal organisation, complexity, etc.

Moreover, the new wording of paragraph 120 introduces the notion of *"lower standards"*, which is subject to interpretation.

[4] Directive 2013/36/EU

Similarly, third country subsidiaries will have their own processes or procedures to be respected, as well as specificities (legal, organisational, structural) within their management bodies that have to be respected and might not make it possible – or necessary – for EU processes to be applied. This would potentially raise a problem for the EU parent undertaking, if it has to prove that the suitability standards applied in third country subsidiaries are indeed "not lower" than in the institution.

Consequently, we suggest that the newly-introduced phrase in paragraph 120 be eliminated, instead introducing a cross reference to proportionality principle (Title I), which is likewise embedded in the Level 1 text and of utmost importance in the context of group-wide application of European regulations.

Question 6: Are the changes made in Title VII appropriate and sufficiently clear?

We do not agree that the addition in paragraph 146b *"…including assess whether there are reasonable grounds to suspect that ML/TF is being or has been committed or that the risk thereof could be increased"* is necessary. Banks are already required to gather information on reputation, integrity and honesty of Board members under the existing text, which will already cover this. Please see also our comments with reference to paragraph 27c on reassessment of suitability upon suspicion of money laundering/terrorist financing activity.

Paragraph 146c requires firms to *"gather information on the independence of mind of the assessed individual"*. It is not clear what measurable information this is intended to refer to, beyond the existing requirements to establish actual or potential conflicts of interest under 146e. We suggest that it should be removed.

On the addition to paragraph 147 "*In this assessment institutions should take into account the existence of reasonable grounds to suspect that ML/TF is being or has been committed or attempted that the risk thereof could be increased"*, we again note our comments above under paragraph 27c and suggest that this is removed.

In relation to paragraph 152, it would be disproportionate to require evidence that every decision of the management body has *"demonstrated a sufficient understanding of ML/TF risks and how these affect the institution's activities, and has demonstrated appropriate management of these risks, including corrective measures where necessary."* We suggest that this is clarified to remove the suggestion that this is required.

In relation to paragraph 155, we note our comments on the Internal Governance Guidelines that it is overly prescriptive to require responsibility for ensuring the bank's compliance with Directive 2015/849/EU to be assigned to a specific member of the management body, Such identification might contradict national corporate law or be contrary to the principles of collegiality and joint and several responsibility that govern the management body, e.g. it may not be possible to allocate material fact or finding to one or more responsible members of the management body. Therefore this paragraph should be removed. Instead, expertise should be developed in the specialized committees (nomination, remuneration, audit and risks) of the board of directors but not on a solo basis. Alternatively, the Guidelines could include a reference to the "relevant body or person in accordance with local regulation" in order to account for the above.

Question 7: Are the changes made in Title VIII appropriate and sufficiently clear?

We are concerned by the proposed inclusion of Key Function Holders (KFHs) within the assessment procedures, as this goes beyond the CRD 5 and CRD 4 mandates. We note that, during the drafting of CRD 5, Member States chose not to require the assessment of KFHs by supervisors (potentially in part given the considerable increased burden this would place on supervisors). For this reason, we suggest that the amendments to paragraphs 53 of the "Background and rationale" section, and paragraphs 182 (referring to the heads of internal control functions and the CFO), 196 and 202 (referring to the heads of internal control functions and the CFO) should be removed. For the same reason, AML provisions should not be

extended to KFHs. If this is to become a requirement, it should be addressed as part of the Level1 legal mandate.

Please also see our comments on the implementation date for Title VIII under Question1 above.

Question 8: Are the changes made in Title IX appropriate and sufficiently clear?

In relation to paragraph 182, the heads of control functions and the CFO, where they are not members of the Management Board, are explicitly included in the suitability assessments, although collective suitability does not apply to non-board members. We suggest that this should be removed as it seems to have been included in error.

Next steps

AFME welcomes the opportunity to submit comments, and would be pleased to engage further as the regulatory process continues.

AFME Governance

We confirm that AFME has put in place internal arrangements to manage our work in compliance with the conditions set by the EBA on Adam Farkas' appointment as CEO of AFME. As part of these arrangements, Adam Farkas has not been involved in the preparation of this consultation response.

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