ABI Associazione Bancaria Italiana

Response to the consultation

Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders

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General remarks

Before addressing specific comments, we wish to raise some general remarks concerning the legislative framework within which the Guidelines will be placed, and their scope.

The regulation in consultation can be fully ascribed into the wider process of European integration.

This process, although based on a mechanism of transfer of sovereignty from Member States to the European Union, must respect the boundary marked by the fundamental constitutional principles in force in the national systems, with which it must be compatible.

These national constitutional principles, therefore, represent the *rule* and the *limits* of European integration.

The regulatory framework at the basis of the European Supervisory Authorities (ESAs) powers, is sufficiently clear in establishing that their Guidelines are binding indications generally addressed to the national Authorities to ensure that the Union law is applied in a uniform and consistent manner. The ESAs powers to directly regulate over individual institutions are limited to few specific cases.

On the contrary, the recipients of these Guidelines are both national authorities and financial institutions, and this creates a regulatory confused framework. In fact, the legal value of these Guidelines with regard to individual institutions remains uncertain, given that the Guidelines only apply to individual financial institutions when they are transposed into national provisions. This will happen when the national legislator decides if, and to what extent, the national rules require adaptation to the European ones, with inevitable differences deriving from the lack of a system of European banking law truly harmonized.

This uncertain legislative structure may generate imbalances between different national systems, thus potentially violating the level playing field and harming the effective integration of Europe's banking system. This would cause prejudice to the legal certainty of rules and prevent from foreseeing behaviours' legal consequences.

In a context in which corporate governance laws are highly fragmented and inhomogeneous at European level, the CRD IV has appropriately chosen to intervene only on specific aspects, providing specific indications. What is proposed by EBA and ESMA in these Guidelines, even if based on the provisions of the CRD IV, introduces elements that directly impact aspects of the national legislations, giving rise to potential inconsistencies and, in some cases, open conflict with some of the principles of the national legal systems, including constitutional ones.

Given the lack of a primary common legislative framework, this regulation doesn't meet the recipients' need for clear, certain, consistent rules that can act as a level playing field for interaction among operators from different Member States.

ABI has always highlighted, and reiterate even in this occasion, the importance of a clear, consistent regulatory European framework, seen as a prerequisite for a truly integrated banking system, to prevent regulatory arbitration and divergent national interpretations that can affect competitive parity and integration of the national

markets. Only with a genuinely uniform set of corporate and banking laws in Europe, will it be possible to develop secondary regulation that is consistent and congruent with the primary provisions. Until that time, the ESAs must fully commit to operating within the limits of the European provisions, and avoid introducing any elements or provisions that do not accurately correspond with, and are covered by, the primary sources.

In other words, it is not possible to attempt to "harmonise", using the Guidelines, what has not been harmonised at Directive or Regulation level, particularly – as in this case – when the regulatory intervention affects the very essence of the institutions' organisation, with relevant effects on the operational side and the risk that banking activity loses the characteristic of business activity.

Q1: Are there any conflicts between the responsibilities assigned by national company law to a specific function of the management body and the responsibilities assigned by the Guidelines to either the management or supervisory function?

The Guidelines (GL) profess to consider all the existing corporate governance structures.

In reality some of the Guidelines provisions are not applicable to the "traditional" model of governance, which is adopted in Italy by many financial institutions.
In fact, although the Guidelines literally refer just to the "management body" in the exercise either of the management function or in the exercise of the "supervision/control" function, their application appears to refer to any body that performs the management, supervision and control functions (thus, it should refer also to the board of statutory auditors, "collegio sindacale", if applied to the "traditional" Italian governance system).

Therefore, there is a need to clarify the extent to which the GL apply to the board of statutory auditors in the "traditional" model of governance, especially since many of the current recommendations would poorly suit to the role of statutory auditor (for example, many of the skills indicated in Annex II cannot be ascribed to the auditors e.g.: negotiating ability, strategic acumen, customer and quality orientation; nor does it appear that the provisions of para. 123 can refer to the board of auditors ("the supervisory body should include a sufficient number of fully independent members").

In the described context, there should be an express mention (for example in Title VII, "Assessment of suitability by competent authorities") of the possibility for the national authorities, when implementing the GL, to make any variations or adaptations they consider necessary or appropriate if their governance systems have peculiarities compared to the "dualistic" or "unitary" models expressly mentioned in the GL.

Q2: Are the subject matter, scope and definitions sufficiently clear?

With safeguard of the concerns expressed above in relation to the scope and prescriptive nature of these Guidelines, **we consider that the text should be**

simplified as it currently addresses many issues in a fragmented way resulting not accessible or easy to read.

To that end, we suggest making a distinction between the principles in relation to which the conformity (or non-conformity) of each national system must be measured, and the application criteria that identify (also through examples) the actions that would typically be necessary to achieve the objectives indicated in the principles.

With reference to the identification of key function holders (KFH), we ask to clarify how to identify additional KFH "*where identified on a risk based approach by the CRD-Institutions*".

It is necessary to define provisions regarding the entry into force of the GL, considering the substantial changes contained in the provisions and the fact that each institution will have to review, or if necessary prepare, procedures for identifying and managing conflicts of interest, policies, special registers and to provide disclosure (see paragraphs 77, 79, 80 and 81) in order to comply with ("*on an ongoing basis*", see paragraphs 20 and 144) the GL indications.

It must be clarified that the GL will apply to the first election of the management body (as a whole) after the GL enter into force, so that each institution can adapt to the new system of rules gradually, and so that all members of the management body are equally placed, when it comes to examining their individual positions.

Q3: Is the scope of assessments of key function holders by CRD-institutions appropriate and sufficiently clear?

We consider that the assessment of key personnel cannot be based on the same criteria, methodologies and processes used to assess the adequacy of the management body *("the assessment… of key function holders should be based on the same criteria as those applied for the assessment of such suitability requirements of the members of the management body"*).

Subjecting a board member and a manager of a control function to the same requirements and assessment procedure is inappropriate, and may significantly increase workload (as the same procedure would have to be reproduced for all the roles, as well as for the Board). From another perspective, this confuses the roles of the board members and the managers, as they are all asked to respect the same standards, in contrast with the differing functions and responsibilities within the organisation (Board members cannot be considered "highly specialised experts").

Therefore, we suggest to differentiate the requirements referring to the Board and those referring to the KFH (see also below).

Q4: Do you agree with this approach to the proportionality principle and consider that it will help in the practical implementation of the guidelines? Which aspects are not practical and the reasons why? Institutions are asked to provide quantitative and qualitative information about the size, internal organisation and the nature, scale and complexity of the activities of their institution to support their answers.

To avoid overburdening smaller entities (non-listed institutions with provincial or regional structures, whose "traditional" operations are mainly if not exclusively locally-based) with obligations that are disproportionate to the benefits, the principle of proportionality needs to be made effective.

There should be an express provision that excludes smaller banks from having to comply with the more onerous obligations, for example in terms of the documentation to be requested, prepared, updated and made available to the regulators throughout the process of evaluating the management/control bodies, starting from the initial appointment of each member and along the mandate, in relation to circumstances that may change over time (conflicts of interest, time commitment and limitations on the number of board memberships, training).

Q5: Do you consider that a more proportionate application of the guidelines regarding any aspect of the guidelines could be introduced? When providing your answer please specify which aspects and the reasons why. In this respect, institutions are asked to provide quantitative and qualitative information about the size, internal organisation and the nature, scale and complexity of the activities of their institution to support their answers.

We ask for clarification:
- as to how the principle in paragraph *j* (which refers to the nature and complexity of the products, contracts or instruments offered by the institution) is relevant in the application of the proportionality principle
- whether the principle of proportionality only applies to the definition of the internal policies and processes regarding the composition, selection and training of the management body, or also to the evaluation of the total number of board memberships (see paragraph 34).
With regard to the "sufficient time commitment" requirement, we consider that the obligation for the bank to estimate and monitor the time dedicated by each board member is excessively onerous, and that the procedure (see paragraphs 40-42) is complicated and not consistent with the proportionality principle. We suggest considering the verification procedure described in those paragraphs as a best practice, instead of imposing it as an obligation.

Q6: Are the guidelines with respect to the calculation of the number of directorships appropriate and sufficiently clear?

Paragraphs 45-53 of the Guidelines specify the criteria for applying the limit on the number of directorships, as contained in Article 91(3) of the CRD IV, without making any distinction based on the size of the companies in which the same person hold the position of board member: in this sense, they are not, therefore, appropriate.

By applying the Guidelines in consultation, a board member holding an executive position in a listed bank, and two positions as a non-executive board member in another two listed companies/banks would be appointable, while the same executive board member of the listed bank that holds two executive positions in a limited liability company (S.r.l.) or in a small or medium-sized joint stock company (s.p.a), would be not appointable.

Also under these Guidelines, it is clear that the positions of non-executive board members in two listed companies/banks may be much more demanding (in terms of time) than two executive positions in a small S.r.l. or S.p.A.

We therefore ask that a size criterion be introduced into the assessment of the total number of executive board memberships, so to take into account the complexity and size of the organisation in which the position is held.

Regarding the list of organisations that do not "pursue predominantly commercial objectives" (see paragraph 53), we suggest including a reference to the other entities identified by the national authority in accordance with the general principle established in Art. 91 CRD IV (in the light of the various types of associations that may be present in the various legal systems).

Q7: Are the guidelines within Title II regarding the notions of suitability appropriate and sufficiently clear?

With regard to the "non-technical" skills referred to in paragraph 7, , we consider that it is entirely disproportionate to require the entity to consider "at least" all of those listed in Annex II.

The long list of skills in Annex II does not apply to all the management body members (nor is it reasonable to expect that they will all meet them). Actually, requiring that all the board members have, or acquire through appropriate training, those skills can only have the effect (which is certainly not within the intentions of the Guidelines) of triggering a proliferation in the offer of training services; while in fact, those skills should be expressed by the group as a whole and not (necessarily, and for all) at individual level. At this regard, the Guidelines go beyond the provisions of the L1 regulation (CRD IV) creating regulatory uncertainty and potentially giving raise to judicial disputes.

The possession of the skills listed in Annex II needs to refer clearly only to the body as a whole, as is also clearly provided for in CRD IV (Art. 91.12(b): "*Collective skills, expertise and experience that are adequate to the management body*").

With regard to reputation as referred to in paragraph 9, there are issues concerning both substantive and procedural regulation (para. 135).

On the substantive side, the GL recognise that harmonisation cannot be maximised because of differences in national criminal and administrative law, with regard, for example, to the type of offence (criminal or administrative) that affects the possession of the said requirement, the penalty imposed and so on, and that the envisaged regulation applies "*without prejudice to the presumption of innocence*" (para. 70).

However, despite these initial observations, which we share, the provisions laid down in the GL leave no room at all for an application that considers the peculiarities highlighted above. This creates a basic contradiction, that is particularly delicate as it deals with the rights of the individual, which in many legal systems are governed by the Constitution (for example Article 27 of the Italian Constitution establishes the

presumption of innocence, according to which "*The defendant is not considered guilty until the final conviction"*) and most importantly by Article 6(2) of the European Convention on Human Rights. This provision establishes that "everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law". This principle, far from applying exclusively to personal liberty, has a general, universal scope and must be considered applicable to every aspect of the individual, including his or her integrity.

Furthermore, in national legal systems where criminal proceedings are obligatory (such as Italy), the launch of the investigation into the suspect is an automatic consequence; in some alleged offences, the proceedings go ahead regardless of the actual involvement of the suspect in the disputed facts. In such cases, therefore, a person's reputation might be affected merely because of an automatic procedure. Also, the fact of being under investigation may not be known to the person for even quite some time after the launch of investigations, or may be kept secret.

The GL in question, in requiring the entity to appraise several insufficiently defined elements, introduce a great degree of discretion into the assessment of the individual's reputation; this, in view of the entity's responsibility for the presence or absence of this requirement, can give birth to a delicate confrontation with the individual.

We therefore ask that there be a more precise identification of the cases that are relevant for the purposes of evaluating reputation – which, moreover, as it is described, is significant at a "perceived" level and not at an effective one – by providing more certainty to the various factors (particularly, the reference to current investigations must be excluded)

From a procedural point of view, there is a provision that the entity must ask the individual to demonstrate his or her "appropriateness", by supplying, at least, the documentation to be produced to the supervision authority as provided for in Annex III. Annex III states that also the entity is involved in verifying the information provided by the individual ("*validate, to the extent possible, the correctness of information provided by the assessed individual"*), **whereas it should be clarified that the provision of information intended to determine reputation lays exclusively in the responsibility of the interested party (by means of self-certification), with no obligation to "validate" on the entity. There should also be an express reference to the need for the appropriateness assessment to be carried out in accordance with the individuals' right to confidentiality.**

We consider the lengths of time granted to the entity (three weeks, para. 43) and to the Authority (minimum 3 months, maximum 4 months, para. 166) to complete the validation of the individual's appropriateness, to be excessively imbalanced. Considering the complexity of the assessment process (which involves the nomination committee) and the circumstance that in many legal systems it is not possible to carry out an ex-ante assessment (prior to the appointment) due to the regulatory framework (election by the meeting of shareholders, voting lists), **we ask that the length of time available to the entity be extended to 6 weeks, and that the length of time available to the Authority be reduced to 6 weeks, possibly extended by one month in the event of requests for additional documentation (currently, that extension is 6 months).**

The entire process of determining the suitability of the board member (and the board as a whole) could thus be contained within a reasonable period of time (three and a half months), avoiding ongoing uncertainty about the outcome of the assessment (currently, this uncertainty can last up to 10 months), whereas it is clearly in the entity's interest to complete the assessment as soon as possible.

There is a need to clarify the contents of paragraph 166, where there is confusion between the completeness of the information provided and the completeness of the documentation supporting the assessment.

Regarding the evaluation of independence of mind, we suggest clarifying the time period to be considered when applying the provisions in paragraph 76 "*when assessing the independence of mind …* their past behaviour *within the institution or in other positions should be taken into account*" and 77 "*At least the following situations that can create conflicts of interest should be considered: c)* past or present positions held".

Q8: Are the guidelines within Title III regarding the Human and financial resources for training of members of the management body appropriate and sufficiently clear?

Paragraph 84 provides that each member of the management body (without any distinction between those who manage and those who supervise) should possess all the skills indicated in Annex II.

We consider it necessary, for the reasons given in Q7, to clarify that not all the members of the Board must possess all the listed skills, and that the requirement clearly refers only to the board as a whole.

It would also be desirable to clarify which cases are referred to in paragraph 84, which highlights the possibility of overcoming any gaps in knowledge or skills with induction or training.

Regarding the terms applicable for the provision of key information and induction for newly-elected members (the former to be provided immediately and the latter within no more than one month), we recommend, in line with the proportionality principle, an extension of these periods in the case of complex organisations, increasing them respectively to 3 months for the induction and to one month for the key information.

Q9: Are the guidelines within Title IV regarding diversity appropriate and sufficiently clear?

Paragraph 97 refers to the need for a "diversity policy" for all staff, with a view to "facilitating the adequate diversification" of the pool of candidates for the management body.

As CRD IV links these policies only to the management board, we ask that this obligation be eliminated, or included as an option.

Q10: Are the guidelines within Title V regarding the suitability policy and governance arrangements appropriate and sufficiently clear?

Regarding the identification of the suitability policies for key function holders in addition to the managers of the corporate control functions and the CFO, as already mentioned in relation to question Q2, we suggest **providing information to clarify the perimeter of such personnel *"where identified on a risk based approach by the CRD-Institutions."***

With reference to the adoption of suitability policy for the group (on a consolidated and sub-consolidated basis, including subsidiaries that are not subject to the CRD IV), and the provision that this policy should provide for adjustments for its application to subsidiaries not subject to the CRD IV ("*the policy should be adjusted*…."), we would point out that a straightforward application of the requirements as provided in the GL may in some cases be disproportionate to the profiles and activities performed by the subsidiaries. One example is the case of an instrumental company, for which asking the members of the management board to have the same requirements as those required for the legal representatives of banks, appears unreasonable.

For this reason, we ask to include in the GL an express provision stating that these adjustments can derogate from some of the GL provisions (particularly those which are closely connected to the carrying-out of banking or financial activities. We ask also to clarify which provisions of the GL do not apply to the subsidiaries that do not fall under the scope of the Directive.

We therefore ask for further specification of the scope of application of the GL and their possible extension to the perimeter of the Banking Group, particularly with reference to Directive 2014/65/EU (Mifid 2), which is expected to enter into force on 3 January 2018, in relation to the observance "on an ongoing basis" (see paragraph 10 and 144) of the indications given in the GL and the need to review or, if necessary, set procedures for the identification and management of conflicts of interest, policies, special registers and disclosures (see paragraphs 77, 79, 80 and 81).

Q 11: Are the guidelines within Title VI regarding the assessment of suitability by institutions appropriate and sufficiently clear?

See the considerations in response to Q7.

Q12: Are the guidelines with regard to the timing (ex-ante) of the competent authority's assessment process appropriate and sufficiently clear?

This question does not apply to the Italian context because of the system of appointments by the meeting of shareholders (and the voting lists), which means that it is only possible to carry out an ex-post assessment (except in the case of co-opting and appointments within a group).

Therefore, the Guidelines need to be amended in order to make them compatible with the specific features of those legal systems in which only an ex-post assessment is possible. Particularly, we ask:

- that the reference to the ex-ante assessment made in point 45 on page 12, be eliminated

- to specify that the obligation in paragraph 128 does not apply to legal systems that require board members to be elected by the meeting of shareholders, even from lists submitted by the shareholders. In general, there is a need to clarify the meaning of the provision stating that the entity must in any case ensure that shareholders have full access to the "relevant and practical" information relating to the appropriateness of the individual board members and of the board as a whole, particularly for the meaning of the term "practical".

We also repeat the observations made in response to Q7 regarding the excessive length of the period allowed for the Authority to make its assessment.

Q13: Which other costs or impediments and benefits would be caused by an ex-ante assessment by the competent authority?

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Q14: Which other costs or impediments and benefits would be caused by an ex-post assessment by the competent authority?

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Q15: Are the guidelines within Title VII regarding the suitability assessment by competent authorities appropriate and sufficiently clear?

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Q16: Is the template for a matrix to assess the collective competence of members of the management body appropriate and sufficiently clear?

The consultation document is clear in specifying that the template is merely an outline and that each bank can shape it in relation to its own specific nature and in the light of the proportionality principle. In accordance with the principle of substantive proportionality, it would also be necessary to provide a further model for smaller, less complex banks, which can be used indicatively, with no binding effect, for the template to be adopted in practice.

Q17: Are the descriptions of skills appropriate and sufficiently clear?

See the observations in response to Q3.

Q18: Are the documentation requirements for initial appointments appropriate and sufficiently clear?

The level of detail and the number of pieces of information to be gathered and documented, further confirm the need to extend the time given to the entity to receive information from the individual and to prepare the requested response.

Please refer to the observations in response to Q7 regarding the assessment of reputation. We deem necessary to underline the critical issues related to the provision in paragraph 4.1 of Annex III, which indicates that information in this regard may, among other things, be acquired also by means of "*third party investigations, testimony made by a lawyer or a notary established in the European Union"*.

Q19: What level of resource (financial and other) would be required to implement and comply with the Guidelines (IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? If possible please specify the respective costs / resources separately for the assessment of suitability and related policies and procedures, the implementation of a diversity policy and the guidelines regarding induction and training. When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

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