



Response to the consultation on “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 (EBA/CP/2016/17)”

General remarks

On the basis of our experience as non-executive and independent directors, we believe that there is room for further improvement in the structure and functioning of management bodies in both their supervisory and management functions.

We acknowledge the fact that the role of bank directors is partially different from that of non-financial institutions’ directors, as the former have to ensure sound and prudent management. In our opinion, in view of the specificity and the growing complexity of banking and financial systems, it is fundamental to better qualify boards in terms of time commitment, knowledge, experience, independence and awareness of individual and collective responsibilities. Hence, we welcome the new Guidelines and the spirit of the European regulatory framework.

Although we support in general terms the aims and criteria of the suitability assessment, we deem the level of detail proposed for the assessment process excessive, while the principles set forth are at times too vague. We believe that a surfeit of rules, coupled with the vagueness of certain principles, might lead to solutions and behaviors aimed at ensuring formal compliance without enhancing governance culture and effectiveness. Even the existing rules and standards (as well as Corporate Governance Codes) are often applied in a more formal or procedural, rather than substantive, manner. Moreover, also in light of the proportionality principle, the proposed assessment process looks too burdensome and costly for smaller banks.

The co-existence of two levels of control – the first carried out by the management board and the second by supervisors – both characterised by an equal level of detail and structuring, might result redundant. In addition, the suitability assessment could have critical implications in those jurisdictions in which it has to be carried out after the appointment of the directors, respectfully of shareholders’ rights. Even in this context, where the regulation could play a leading role in guiding shareholders’ decisions, fewer but more precise rules could be more effective.

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 EBA/ESMA document is based on the distinction between management and supervisory board. We wish to highlight a peculiar governance institution of Italian corporate law: in the so-called *traditional* (and by far most used) Italian governance model, the management and supervision functions are both vested in the board of directors (although the board can delegate some, but not all, of its functions to one or more

executive directors), while the control function is assigned to a separate body, also appointed by shareholders, called *collegio sindacale*.

The *Collegio sindacale* is not a supervisory board in that it has no competence whatsoever regarding management and strategic matters, but rather verifies that the board of directors acts in compliance with the law and the corporate charter and respects the principles of correct administration. It oversees the adequacy of the organizational, administrative and accounting systems of the company and its actual functioning. The *Collegio sindacale* has a pure control function.

We ask whether the policy indications for supervisory boards and non-executive board members are consistent with duties and responsibilities of the *Collegio Sindacale*.

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.

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. The application of the proportionality principle should be more clearly specified in order to avoid misunderstanding. Currently, some statements appear to contradict each other.

Within the suitability assessment process we believe that the proportionality principle should not apply to the following requirements: i) reputation, honesty and integrity and ii) independence of mind. **Hence, it should be clearly stated that the same criteria and the same procedures should apply to banks of different size and business model.**

As regards the other suitability requirements, **it should be detailed how the proportionality principle can be applicable in assessing the theoretical and practical experience and the time commitment of board members and key function holders.** Proportionality should apply to both:

- 1) the contents of the requirements: for example, the extent of knowledge/skills required, the time span of previous experience, the level of time commitment, etc.
- 2) the procedures to be implemented in order to verify the individual and collective suitability: for example, in small institutions, the documentation to be provided (See Annex III) could be simplified, the frequency of re-assessment (Point 145) could be lower, the competent authorities' assessment procedures (See Title VII) could be simplified, etc.

Lastly, Point 36 should limit the list of criteria to be considered for proportionality to those practically measurable (for example, excluding i and j), also considering that some of the listed items are mutually dependent.

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

With regard to **requirements of adequate knowledge, skills and experience** (Sections 7 and 8), we strongly agree on the necessity to ensure that board members have an adequate understanding of the business of the institution and its risks (Ref. Point 54).

We also welcome the remark that it is the board's (and the shareholders') responsibility to assess the suitability of board members, respectively before and after nomination or re-nomination. Supervisors need to play their role according to the regulation, but mainly relying on the board's activities and respectfully of shareholders' rights.

Hence, the detailed assessment of knowledge, skills and experience aimed at ensuring that the board and the individual directors possess this adequate knowledge shall not, in our opinion, go beyond what is concretely feasible by the board itself in terms of available evaluation methods and reasonableness. Otherwise, we believe that the only practicable solution would be a direct examination of individual candidates by the Supervisors themselves.

Based on this consideration, the detailed description of the individual requirements could be proposed as suggestions and should not represent strict rules, because they could prove to be difficult to apply and/or to be concretely verified. As an example, *"the knowledge acquired and demonstrated by the professional conduct of the member of the management body"* (Point 56 d. on page 31) might be difficult to assess by third parties which did not have any direct knowledge of the previous professional context of the candidate.

To this end, we would like to point to the following more **detailed remarks and requests for clarifications**.

- With reference to Point 57 (*"To properly assess the skills of the members of the management body, institutions should consider using the non-exhaustive list of relevant skills set out in Annex II to these guidelines"*), we note that Annex II "Skills" requires institutions, in line with Title II, to consider a long set of relevant personal skills. These are typical soft skills, which are usually assessed through behavioural interviews or similar performed by specialised head hunters or psychologists.

Although we recognise that all these soft skills can enhance the active and constructive role played by a board director, we see some difficulties concerning the serious and professional assessment of the same by the board itself. Among different methodologies, we can thus figure out that the best solution would be the appointment of a head hunter or similar consulting firm with a specialised expertise or, as an alternative, the carrying out of a self-assessment procedure implying directors' peer reviews of one another, but many companies and boards may have some reservations to peer evaluation.

- These considerations also apply to **"independence of mind"**: beyond the issue of conflicts of interest, a proper assessment can only be based on direct observation of behaviours, which again requires peer evaluation.

We do not agree with the proposal to involve the human resource function (See Article 119, page 44¹) into the process, since all corporate functions are under the monitoring responsibility of the board of

¹ *"Without prejudice to the shareholder's rights to appoint members, when recruiting members of the management body, the management body in its supervisory function or, where established, the nomination committee should actively contribute to the selection of candidates for vacant management body positions in cooperation with human resources and should..."*

directors and should not be involved in the selection, assessment, etc. of board members, i.e. their supervisors.

Again, a far better and more efficient solution could be the direct assessment of bank candidate directors by the Supervisors prior to their nomination by the Shareholders General Meeting.

In view of these considerations, **the Regulators could either:**

- **eliminate Annex II, since not easily applicable within a board self-evaluation, or**
- **better clarify the alternative procedure that Banks should follow to carry out the required assessment, considering however that the mandatory contracting of an advisory firm or external expert would enhance the costs of the whole process.**

- Within the required knowledge and experience and overall in the definition of directors' duties we believe that the focus on board monitoring should be balanced by a corresponding **attention to the strategic function of the board**. In our view, the board has first of all the responsibility of setting the strategic direction of the company in a long-term perspective, taking into consideration the expectations and interests of the different stakeholders. For this reasons, board strategic skills are of primary importance. **This function and the related competences might be enhanced within the Guidelines and set at the same level as monitoring and management supervision.**
- **The Regulators could better clarify the differences in terms of skills required of individual directors vs. the board as a collective body.** Given the variety and complexity of the issues at stake, it might be difficult to find professionals experienced in the entire universe of matters relevant to the bank's activities. Indeed, it is difficult to imagine that all individual members could reach the required level of knowledge and skills within 6 months from the appointment through induction and training, especially in fields such as risk measurement and management, as well as in all soft skills cited in Annex II. Moreover, the effectiveness of directors depends not only on their skills, but in the first place on their commitment to decision-making. The Guidelines put much more emphasis on suitability criteria as knowledge and experience, than on the diversity principle. **Conversely, we believe that EBA could stress that fit & proper requirements (Point 60, page 32) apply first and foremost at a collegial level (as under Section 8).** Since boards are collegial bodies, this element is of fundamental importance. Board effectiveness very much depends on diversity in terms of the experience, as well as the professional and personal profiles of the individual members. It is therefore appropriate to ensure the presence of different competences *"to achieve a variety of views and experiences and to facilitate independent opinions and sound decision-making within the management body"* (EBA, Point 92, page 39).
- The Guidelines never refer to director compensation and specifically to non-executive directors' compensation. We observe that the demand for high skills and professional qualifications and experience, together with increasing duties and responsibilities of board members, as well as stricter requirements in terms of time commitment, raise the point of the level of remuneration required to attract skilled and qualified directors. Indeed, the remuneration must be defined in accordance with the professional profiles and the requested time commitment, and surely a proportionality principle must apply. However, it is clear that even for small banks the minimal requirements in terms of knowledge and experience impose the search for highly compensated individuals. A remuneration level perceived as not adequate might trigger an adverse selection mechanism, which may frustrate the effect of the requirements in terms of directors' quality. By contrast, a remuneration package proportionate to the requirements set forth by the Guidelines, may result in higher governance costs, which could be particularly burdensome for small non-listed banks. **We believe that the Guidelines should refer to directors' compensation and include a statement on the need to balance commitment and reward. Moreover, they should assess that more time commitment and limitations on the number of directorships inevitably will lead to higher director fees.**

- Corporate law in different EU member States differs as to the **role of shareholders** regarding the appointment of board members. However, in the majority of cases this decision is reserved to shareholders and their freedom of choice can only be limited up to a certain extent. Of course the law can limit this freedom by introducing certain legal requirements. It is instead debatable whether this limitation could come from a discretionary assessment made by a corporate body – the board – that is not in the legal position to substitute its judgment to the shareholders’ one. **In the event that shareholders appoint a board member whom the board does not think proper – but who satisfies the formal legal requirements – is the board in the position to force the member’s revocation? Could the member claim damages? It is our impression that this issue might deserve further analysis.**

With regard to **requirements of reputation, honesty and integrity** (Section 9), we highly appreciate the useful indications of EBA and ESMA on the assessment of integrity and reputation requirements. However, we respectfully submit a few remarks on this very delicate issue.

Traditionally, integrity requirements are identified as non occurrence of certain criminal behaviour as proven by a definitive judgment in Court. The underlying logic is to set forth integrity requirements that are compliant with the rule of law, including of course the presumption of innocence throughout the criminal proceedings to its definitive outcome.

While we understand the potential advantage of broadening the scope of the assessment as to include softer reputational issues, and taken for granted that the presumption of innocence stands, we see a certain degree of risk in this perspective. The rationale of the presumption of innocence is precisely the protection of citizens against (legal, and) reputational consequences coming from any circumstance different from a definitive assessment of illegal conduct made by a Court as a result of a due process. An individual who is subjected to a criminal (or administrative) proceeding might stay in this situation for a long time (even several years), and be fully acquitted at the end. Should this individual suffer a diminution in his/her integrity as a result of this circumstance? Also, as to the reputational fallout of the involvement in a criminal proceeding, how should that be assessed and measured? Is the board safe from risk in making assessments that might be questioned as contrary to the fundamental rights of the individual?

We suggest to elaborate this matter in a more precise manner and to double-check its rationale against the principles of the rule of law and of the presumption of innocence.

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

Among the various diversity profiles (Point 93, page 40²), we would like to stress the **importance of diversity in terms of geographic provenance. This should be considered a relevant criterion not only “for institutions that are active internationally” (as stated in the Guidelines) but also for small and local/regional institutions, whose boards could benefit from members being fully independent from the local communities and networks.**

² *The diversity policy should at least refer to the following diversity aspects: educational and professional background, gender, age and, in particular for institutions that are active internationally, geographical provenance, unless the inclusion of the aspect of geographical provenance is unlawful under the laws of the Member State.*

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

The detailed matrix provided in “Annex I – Template for a matrix to assess the collective competence of members of the management body” is very complex and analytical. Although theoretically robust, it results quite **difficult to apply in practice**. As an example, how could all the sub-topics listed in the sheet “Financial information and regulatory reporting” be assessed by the board for the individual directors? And how should the metrics be applied (e.g. what is the difference between medium-low and medium-high)? How can an equal interpretation by the individual Banks of different countries be guaranteed? Should directors be examined to prove their knowledge on all these technical topics according to pre-defined common international standards? Or should the board base its detailed assessment only on an individual self-certification? We see this last solution as the only suitable method, although the consequence could be differentiated responsibilities of individual members on different topics. **In the light of the complexity and uncertainties linked to the application of the matrix provided in Annex I, we propose to eliminate it completely from the Guidelines.** The general criteria of board skills assessment are already well defined in the documents and shall be applied in a proportionate manner.

Milan, January 27th 2017

Nedcommunity is the Italian Association of non-executive and independent directors. Founded in 2004 it has more than 500 associates, most of which are directors or members of the board of statutory auditors of listed companies or large non listed companies. It is the official member for Italy of ecoDa, the European Confederation of Directors Associations.

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