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EBF response to EBA Consultation Paper on Draft Guidelines on internal governance

Key points:

- We believe that the Guidelines should adopt a wording that can be applied to all the different governance systems, without excluding national hybrid models other than the one-tier and the two-tiers ones, as they introduce a number of novelties in the internal governance field, even within the regulatory perimeter set by the Level 1 legislation (i.e. CRD IV, Art. 3).

  First and foremost it needs to be stressed that, in one-tier systems company law conceives the management body (board of directors) as one unique and inseparable body through which both management and supervisory functions are performed. All the members of the board imperatively perform all the functions assigned to it (both management and supervisory) as they are all, collectively, part of the decision-making process, and they all have the same rights and responsibilities; they are all under the same liability regime, for they act as one single collegial body. Therefore, unlike in two-tier board systems, the supervisory function cannot be required to perform its role independently from the management function, for this would amount to expecting that someone acts independently from oneself.

  Secondly, that the allocation of management or supervisory functions to a certain type of board member (executive or non-executive), is also inadequate for one-tier systems, given that no efficient or real separation of responsibilities can be implemented where company law conceives the board as one unique and inseparable body through which both management and supervisory functions are performed.

  In light of the above and as further elaborated below, some of the requirements of the draft Guidelines may be incompatible with all the different governance systems, in particular the one-tier system.

- The Senior Management function is not defined in the draft Guidelines (contrary to the CRD IV Directive). This creates a confusion between roles of Executive functions, Management functions and Supervisory functions. It should be clarified that the senior management is included in the notion of "management body in its management function".

- The specific case of entities within a Group should be more taken into account and specified (proportionality principle). Duplication of formalities and documentation required at the different levels of a Group organization must be avoided. For subjects handled by the Group, subsidiaries should have rules allowing them to benefit from exemptions or reduced obligations.

- In all its mentions Guidelines should refer to 'risk control' instead of 'risk management' as the second term includes some functions and activities that are allocated in the first line of defence. Therefore, accuracy is fundamental in this aspect.
- Guidelines refer to internal governance of institutions, therefore the reference made to the reporting of breaches to competent authorities is an element out of its scope that should be eliminated.
- In jurisdictions where there is a unitary board system, certain functions ascribed to the management body (certain general functions which are delegable) may be discharged by a committee of such body.

Answers to EBA questions and specific comments:

Subject matter, scope and definitions

Q1: Are the guidelines regarding the subject matter, scope, definitions and implementation appropriate and sufficiently clear?

As a first general remark, it must be taken into account that, pursuant to established case law of the Court of Justice, guidelines are not binding legal instruments but "soft law". Although institutions are obliged to take guidelines into account or even make every effort to comply with these, this does not imply that guidelines are legally binding for institutions. The wording of the draft-Guidelines, however is often prescriptive as if the draft-Guidelines were a regulation. For instance, paragraph 6 states that the draft-Guidelines "specify the internal governance arrangements, processes and mechanisms that credit institutions and investment firms must implement in accordance with article 74(1) of Directive 2013/36/EU". Similarly many paragraphs of the draft-Guidelines use the imperative word "should" in combination with terms as "institutions", "the management body" "the […] committee". This prescriptive/regulating approach of the draft-Guidelines towards institutions' corporate governance practices is not compatible with the legal status of guidelines.

We understand this prescriptive language against the background of EBA's intention to further harmonise corporate governance practices of institutions (Executive Summary, paragraph 7 and Draft cost-benefit analysis/impact assessment, paragraphs 22 and 34). However, we question the desirability of such a harmonisation, let alone its possibility/practicability in view of the major differences in the underlying company law framework, where hardly any harmonisation has taken place.

A set of mandatory corporate governance practices for all (or the majority of) institutions will obstruct evolution: exchanging an existing mandatory practice, how good it may be, for a better new one, may be made impossible or, at best, will be more difficult, thus there will be a handicap for institutions to adjust their corporate governance practices to the challenges they are exposed to as these evolve over time.

A set of mandatory corporate governance practices will also make institutions more similar among themselves. If the majority of institutions becomes identical or almost identical, they will be equally affected by external challenges and will be likely to respond to these in a similar way. Imposing one single model for institutions' corporate governance practices will thus result in an increase of systemic risk (the more rules, the more system; the more system, the more systemic risk).

Finally, the objective of the draft-Guidelines cannot be the harmonisation of corporate governance practices of institutions; this is manifestly out of their scope. The objective of any guidelines promulgated by EBA must be the establishing of consistent, efficient and effective supervisory practices within the ESFS, and the ensuring of the common, uniform and consistent application of Union law (Regulation (EU) No 1093/2010, article 16 paragraph 1). Thus, the draft-Guidelines should focus exclusively on the harmonisation of supervisory practices and not on the harmonisation of corporate governance practices: the latter should be only a by-product of the former and not the other way round. More specifically: there is also nothing in CRD IV mandating the harmonisation of corporate governance practices by means of guidelines promulgated by EBA. Instead, the draft-Guidelines should do what their purpose generally is: "establish the criteria on the basis of which it proposes to assess the compatibility, with [...], of [...]" (Court of Justice, Case C 526/14 paragraph 39).

Regarding the scope of the guidelines:
With regard to Paragraph 12, and more broadly Article 109 of CRD IV, the distinction between the application of CRD IV rules "on an individual basis" and their application "on a consolidated basis" should be clarified in the Guidelines. The application on a consolidated basis cannot result in the same level of constraint than the application on an individual basis. Only entities subject to CRD IV should apply CRD IV rules on an individual basis, i.e. apply all rules directly within the entity. Entities, not subject to CRD IV but which are parts of the consolidated perimeter of an entity subject to CRD IV, should only apply CRD IV rules on a consolidated basis, i.e. as if the consolidated group is an entity.

If we take the example of board committees, it is clear that an entity subject to CRD IV on an individual basis has to setup committees set forth in CRD IV (unless it is not required subject to the proportionality principle, cf. below). For entities not subject to CRD IV on an individual basis but on a consolidated basis, the setup of such committees cannot be imposed. In addition, committees of the consolidating company have a view over such subsidiaries' corporate issues.

However, it shall also be kept in mind that in certain specific situation, the consolidating company is not in position to impose the application of specific rules to other group entities (ex. existence of a shareholder agreement with veto right).

Furthermore, the scope of these draft Guidelines should be specified taking into account smaller and non-complex group entities. Indeed, according to the proportionality principle, for subjects handled by the Group, those entities should have rules allowing them to benefit from exemptions or at least lighter requirements.

For instance, one could question the obligation to setup board committees at each and every level in a banking group which can be very burdensome for certain smaller and non-complex group entities. Many issues could be handled at the parent company level from a group perspective.

In the same way, paragraph 85 of the draft Guidelines states that "the management body should develop, adopt, adhere to and promote high ethical and professional standards". It should be useful to specify that group entities shall refer to group standards.

Another example of this duplication of rules, formalities and documentation for subsidiaries is when an entity is incorporated in a country, its shareholder incorporated in another EU Member State, and the shareholder of its shareholder in another different Member State.

Indeed, it is too burdensome to apply cumulatively the rules of each of those countries to the entity. It should be clear in such case that only the rules of the top mother company shall apply, hence excluding the application of the rules of each country of the shareholding chain.

Moreover, the guidelines do not seem to address the role and responsibilities of board members elected by the employees. This should be covered by the Guidelines.

Definitions

- We welcome the inclusion of risk capacity definition.

- Staff: staff definition overextends the Level I scope; therefore, we suggest the following amendment: "means all employees of an institution and its subsidiaries, ~~**including subsidiaries not**~~ subject to Directive 2013/36/EU, and all members of their respective management bodies". We assume that "the highest hierarchical level" refers to the hierarchy within the relevant function itself; otherwise board members, having ultimate responsibility for the entire institution, including the relevant functions, would by default qualify as "Head of internal control".

- Chief Financial Officer (CFO): "means the person that is primarily responsible for managing the financial resources ~~**and risks**~~, financial planning and reporting and record-keeping".

- Instead of a mere general definition on *`Head of internal control'* we suggest adding specific definitions about **CCO** (Chief Compliance Officer), **CRO** (Chief Risk Officer) and **CAE** (Chief Audit Executive). In a Group context, we need a confirmation on the possibility to account for these functions at Group level only.

- A definition of three **lines of defense** will be very helpful. Such definition should be identical with the definition already contained in BCBS 328, which the EBA is already referring to in paragraph 18 on page 8 of the Consultation Paper.

- No definition of senior management is provided. A clarification is needed on this point in the draft guidelines, being understood that it seems that the Senior Management is the "management body in its management function".

  Indeed, an important comment on the draft Guidelines is that the definition of Senior Management, as provided for in CRD IV, has completely disappeared. We need to ask for a clarification on this point in the draft guidelines, being understood that we consider that the Senior Management is the "management body in its management function". In our opinion, this term covers:
  (i) the CEO, COOs and the persons having a large delegation to act in the name of the company for a very wide range of topics;
  (ii) the management board in systems having such board;

  Please see in this respect Article 91 (8) of CRD IV: "Each member of the management body shall act with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making".

  In fact, this definition concerns a very limited range of persons in the institution.

- Key function holders: the reference to key function holders and especially the notion of "other key function holders" should be deleted from this guideline; if maintained, the key function holders should be only considered at the level of heads of these functions of a Group.

  Such definition, which was not provided for in CRD IV, appears in the draft guidelines. We need to challenge the EBA on the opportunity of such definition and, as a consequence, on all the provisions that the EBA intends to apply to such persons, as **they are not referred to in CRD IV**. As such, and even if this notion of key function holders was already used in the EBA guidelines on suitability of 2012, we think that the EBA goes beyond the mandate given to it by the directive.

It is adequate to align definitions in this Guidelines with definitions in the joint EBA/ESMA 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.

Title I - Role of the management body regarding internal governance

Q2: 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, in particular within paragraph 23, to either the management or supervisory function?

Answer

Notions of Management Body in its supervisory function and management body in its management function needs to be clarified in the draft guidelines.

Indeed, the different corporate legal systems within Europe can be synthetized as follows:

- One tier system (ex. UK or Spain): one single collective body performs both Executive and Supervisory Functions;
- Two tier system (ex. German or France for system with supervisory board and management board): one collective body is in charge of the Executive Function and one other separate collective body is in charge of Supervisory Function;
- Hybrid system (ex. France for system with board of directors and CEO/COO): one collective body is in charge of the Supervisory Function and also of the determination of the institution's strategy, whereas the Executive Function is ensured by one or more physical persons. In such system, the CEO/COO can be allowed to be member of the board ensuring Supervisory Functions but when acting as such, they do not conduct executive missions (they act as every other board member).

According to our understanding of CRD IV, a distinction shall be made between the Executive Function and the Supervisory Function, irrespective of the corporate legal system applicable. This general principle is observable throughout the whole CRD IV and can be illustrated in particular in its article 88.1.d. according to which "the management body must be responsible for providing effective oversight of senior management".

This being said, we welcome the EBA draft Guidelines on internal governance as they distinguish the Management Function and the Supervisory Function of the Management Body. We understand those guidelines as putting forward three definitions:

- The Management Body in its supervisory function: corresponds to the Supervisory Function;
- The Management Body in its management function: corresponds to the Executive Function;
- The Management Body: corresponds to either the Supervisory function or the Management Function.

This is the way article 70 seems to define these Management body functions: "The management body should define, adopt and maintain a governance policy to implement a clear organizational and operational structure with well-defined, transparent and consistent lines of responsibility taking into account the aspects set out in Annex I of these guidelines. The management body in its management function is responsible for the implementation of that policy. The management body in its supervisory function is responsible for overseeing its implementation and that it is fully operating as intended and should ensure that the institution's policy is aligned with the institution's overall internal governance arrangements, corporate culture and risk appetite".

This example clearly shows the allocation of functions between the Management body in its Supervisory function and the Management body in its Management function.

Those definitions clearly match with the objectives of CRD IV as regards the separation of functions between Executive and Supervisory Functions.

However, as each national law is different and because CRD IV expressly mentions in Recital 55[1] that "the definitions used should not interfere with the general allocation of competences in accordance with national company law", **we strongly recommend that the guidelines expressly clarify that when the term "Management Body" is used, it refers to either the management function or to the supervisory function and that the missions allocated by the "Management Body" shall be allocated to the right body under applicable national law.**

For example, article 106 of the draft guidelines states that: "The management body should approve and regularly review and update the outsourcing policy of an institution, ensuring that appropriate changes are implemented in a timely manner". In some member states the role of the Board of directors is to review this policy but not to update such policy. The update of such policy is clearly within the role of the management function (in some member states the CEO and its deputies (or, as the case may be, by way of delegation)).

In order to be compliant with national laws, we would also recommend to delete the paragraph 24.a. of the draft Guidelines, which provides that *"the management body in its supervisory function should have suitable members who do not perform executive function in the institution"*. It should be clarified that some members of the Management body in its Supervisory function could perform executive function. In fact, CEO/COOs shall not be

[1] "Different governance structures are used across Member States. In most cases a unitary or a dual board structure is used. The definitions used in this Directive are intended to embrace all existing structures without advocating any particular structure. They are purely functional for the purpose of setting out rules aimed at a particular outcome irrespective of the national company law applicable to an institution in each Member State. The definitions should therefore not interfere with the general allocation of competences in accordance with national company law."

prevented of being part of the management body in its supervisory function if it is allowed under national law. Paragraph 17 of the draft Guidelines raises the same concern.

This clarification is consistent with article 27 of the draft guidelines which states that "the chair of the management body in its supervisory function should be an independent or non-executive member. Where the chair is permitted to assume executive duties, the institution should have measures in place to mitigate any adverse impact on the institution's checks and balances (e.g. by designating a lead board member, a senior independent board member or having a larger number of non-executives members within the management body in its supervisory function)". This article seems to allow some members of the Management body in its supervisory function to perform executive functions.

In some member states the CEO and its deputies can be members of the Board of directors but when acting as such, they do not conduct executive missions.

Paragraph 16: It is our view that the draft Guidelines (in paragraph 16) might create the misconception with supervisory authorities unfamiliar with the two-tier board system, that the management board does not have ultimate and overall responsibility for the institution. This is incorrect: the management board indeed has its own ultimate responsibility and is accountable for that to the general meeting; in addition thereto, it is also accountable to the supervisory board, while the supervisory board is accountable to the general meeting for the performance of its supervisory function.

Q3: Are the guidelines in Title I regarding the role of the management body appropriate and sufficiently clear?

Answer:
Please see our answer to Q2.

The CRD IV does not require the risk committee to be composed of independent members, apart from members of the management body who do not perform executive functions. Also, the nomination committee, apart from the members of the management body who do not perform executive functions and members of the supervisory body, does not have to be composed of independent members. We suggest that instead of "[…] the specialised committees should be composed of a sufficient number of independent members […]" there should be "[…] the specialised committees may be composed of a sufficient number of independent members […]". These requirements, as they stand at present, go beyond of what is established in CRD IV.

Should the requirement of independence be maintained in the guidelines, it should only refer to the independence of mind. Furthermore, the notion of independence should be adapted for fully owned subsidiaries; an independent member could be a parent company employee who does not report to the Business Line of the subsidiary in which he is appointed.

In any case, the independence criteria should be left to national law or soft law and deleted from these guidelines.

For example, in France, for listed companies, independence criteria are already provided for by soft law. If the company does not comply with these requirements, it has to explain

why in its publicly available registration document. If the independence criteria are maintained in the guidelines, and because those criteria differ from the ones it has to apply according to French soft law, listed companies will not be able to apply both set of rules.

As it is already in practice very difficult to comply with all the existing requirements for the constitution of specialised committees (such as specific skills, prohibition for the chair of the supervisory board to chair the risk committee or the audit committee) the prohibition of a dual chair of all committees and the proposed rotation requirement would aggravate the problem.

In jurisdictions where there is a unitary board system, functions ascribed to the management body in its management function may be discharged by a committee of the management body. This can be useful to better differentiate the functions of such a management body and to ensure more appropriate consideration of documents such as the ICAAP, ILAAP and the Recovery Plan.

Moreover, the reference to the audit committee is out of scope. Indeed, CRD IV does not refer to the audit committee which is covered by other directives and national laws.

Specific comments:

The draft-Guidelines are not appropriately clear as they seem to require that all members of the management body, individually, have full understanding of the risk strategy and the risk appetite of the institution.

The following observations are intended as preliminary general remarks to the EBA CP 2016/16, focusing on questions (Q) 1-3 regarding potential conflicts with national law and the extent to which the draft Guidelines are sufficiently clear, in terms of the role, duties and responsibilities assigned to the management body.

Unitary or dual board structures

As regards the existence of unitary and/or dual board structures, the Guidelines state and defend that there exists no preference between one or the other structure, and that they are "intended to embrace all existing governance structures" (paragraph 19, under the subtitle "rationale and objective of the guidelines"). This idea is reinforced when describing the Guidelines' scope of application, where paragraph 9 stresses the following:

"*Member States usually use one of two governance structures - a unitary or a dual board structure. In both structures the management body in its management function and the management body in its supervisory function each play their own role in the management of the institution, directly and when established with the assistance of committees.* ***In Member States where the national legislation within a Member State does not distinguish between the management and supervisory functions of the management body, references to the supervisory function should be understood as applying to the management body which is responsible for that function according to national law***."

To this extent, the scope of the Guidelines appear to be clear, in so far as there is a recognition that they have been drafted taking into account the intrinsic differences between one-tier and two-tier systems. However, some provisions are not adapted to one-tier system and shall be deleted/amended.

By way of example one could bring forward the following paragraphs of the draft Guidelines where attribution of duties and responsibilities is done exclusively to the management body in one of its functions, rising implementation issues for one-tier systems:

Paragraph 17. "The duties of the management body should be clearly defined distinguishing between the members of the management body in its management function (executive members) and members of the management body in its supervisory function (non-executive members). The responsibilities and duties of the management body should be described in a written document and duly approved by the management body in its supervisory function."

Similarly, in **paragraph 29**: "The chair of the management body should contribute to ensure clear allocation of responsibilities between executive and non-executive members of the management body."

The obligations set forth in the aforementioned paragraphs will meet great difficulty of implementation in institutions with one-tier systems (which is the most wide-spread practice of the European Union). Allocation or division of responsibilities can hardly be accommodated in unitary board systems, taking into account that all the members of the management body (the board of directors in such systems) perform all the functions (high level management and oversight) as a unitary body, notwithstanding their executive or non-executive condition; all of them as directors are under the same liability regime.

Paragraph 23. "*The management body in its supervisory function should monitor and constructively challenge the strategy of the institution, management actions and decisions and perform their role independently from the management body in its management function. The management body in its supervisory function should oversee the management body in its management function by monitoring and scrutinizing its performance*."

The contradiction between this paragraph and the general affirmation that both board systems are taken into account is clear: if references to one or another function are to be "*understood as applying to the management body which is responsible for that function according to national law*" (paragraph 9) and under a unitary board system both functions fall under the same body, then naturally the functions will not be performed independently in the way that paragraph 23 expects. Both functions are performed, yet not independently from one another, rather in a coordinated manner. Emphasis should be made to stress the fact that, in one-tier systems, monitoring and constructive challenge will be performed altogether by the board, by all of its members; yet there is no legal framework that allows assigning supervisory duties or functions to some members in particular. Therefore, in unitary board systems the wording in paragraph 23 as it stands in the draft Guidelines can only be read as compelling the board to challenge itself and oversee itself.

Paragraph 24. "*The management body in its supervisory function should:*

*a. have **a majority of** suitable members who do not perform any executive function in the institution…"*

Where there is a one-tier or hybrid system, and the management body as a whole (including both executive directors and non-executive directors) performs supervisory functions, this requirement, if considered exclusively under the umbrella of the supervisory function, is unlikely to be met. Executive directors in a unitary board system will be

performing supervisory functions. The requirement is thus related to the composition of the board and the conditions to be met by some of its members, but it should not be included in a paragraph solely referred to the supervisory function, given that it evidences yet another example in which distortions arise in the case of a unitary system.
"*c. Provide effective oversight of the management body in its management function, including reviewing its individual and collective performance;*

d. challenge and review critically and constructively proposals and information provided by members of the management body in its management function as well as its decisions."

Where the management body in its supervisory function has taken part in the decisions taken by the management body in its management function and vice versa, it seems hard to envisage how an effective oversight of the "collective performance" of the management body in its management function could be done.

In unitary board systems, responsibilities are not only "executed collectively" by the management body – which encompasses both the management and the supervisory function – but, more importantly, "decided collectively".

One last point of collision with Member States who are under the umbrella of unitary board systems arises from some of the functions that the Guidelines attribute to the management body in its management function; functions which in the referred unitary board systems are performed by the senior management of the institution and not the board itself, whose competence extends to the matters reserved to it by European and national provisions.

In unitary board systems, matters assigned to the management body (board of directors) are defined by law (i.e. article 88(1) in CRD IV), leaving functions not directly reserved to the management body to be performed by the senior management of the institution (namely, the day-to-day running of the institution's business). And such division of functions is established and envisaged in CRD IV when defining, in article 3(1)(9), senior management as: *those natural persons who exercise executive functions within an institution and who are responsible, and accountable to the management body, for the day-to-day management of the institution.*

Therefore, the board – once again, as one whole entity and collegiate body, and not only in its management function – will supervise how those functions are implemented and executed by the senior management (who is accountable to the management body), yet it will not be "actively engaged in the business of the institution" in the way that paragraph 30 and paragraph 19 of the background section seem to imply.

To assign the day-to-day running of the institution to the management body is, therefore, not appropriate in a one-tier system in which this body is the board of directors, constituting an incorrect assignment of responsibilities which, in reality, belong to the senior management, led by the CEO.

Therefore, as explain in more details above, we ask the EBA to clarify that the Management body in its management function corresponds to the Senior Management.

Section 1.2: Supervisory function of the management body

Paragraph 24: The management body in its supervisory function should:

a. have suitable members who (…) are able to fully understand and oversee the risk strategy and the risk appetite of the institution"

The wording of paragraph 24 is generic and could suggests that all members of the management must have full understanding of the risk strategy and the risk appetite. This suggestion is incorrect as article 91.7 CRD IV requires board members to have "adequate collective [underlining by EBF] knowledge, skills and experience". The said provision of CRD IV neither requires understanding of all risks but of the "main risks". The understanding required by this provision is also not directed primarily to risks, but only indirectly as a subordinate element of "the institution's activities". Conversely, the draft-Guidelines isolate "risk" from the context of "the institution's activities" and give it overriding importance by mentioning "risk" as the first item, while the institutions activities are left unmentioned.

The idea that all members should have a full understanding of risk is also unrealistic in view of the requirement that the "overall composition of the management body shall reflect an adequately broad range of experiences" (article 91.1 CRD IV). A management body, composed exclusively of specialist risk managers, as the draft-Guidelines seem to require, can hardly be said to meet this requirement of article 91.1 CRD IV.

Section 5: Specialised committees of the management body in its supervisory function

Section 5.1: Setting up committees

Paragraph 37: *"[…] institutions should ensure that committees are not being composed **mostly** of the same group of members which form another committee"*

It could be difficult for group entities, because of the size of their management body, to have committees composed with different persons. The Guidelines should take into account these group entities and provide exemptions for them on that point.

Section 5.2: Composition of committees

Paragraph 42: The scope of this paragraph is not clear: does it apply to the risk committee, the risk and the nomination committees?

The Guidelines establish that the majority of the members of the Risk Committee should be independent. However, CRDIV already requires that members cannot perform executive functions in the entity and must have appropriate knowledge and expertise. The requirements on composition of CRD IV should not be modified. This new requirement, which goes beyond CRD IV, could be difficult to meet in particular in group subsidiaries.

It is not clear what is meant by "sufficient" (does it mean "a majority" as provided in the next sentence?). This could lead to problems in supervisory boards whose seats are filled based on parity (i.e. half shareholder representatives, half employee representatives) pursuant to the German Co-determination Act.[...] or in countries where the number of memberships in specialized committees is legally limited (e.g. Belgium).

Paragraph 43: "Members of the risk committee should have individually and collectively appropriate (…) professional experience concerning risk management .."

This paragraph requires that all members of the risk committee should have appropriate professional experience concerning risk management. The adjective "professional" suggests that all members must be able to look back on a career as a risk manager. This requirement does not match with those of article 76.3 CRD IV.
The latter provision does not require any experience at all, but only knowledge, skills and expertise. Also the requirement of 76.3 CRD IV is qualified by "to fully understand and monitor the risk strategy and risk appetite of the institution" which qualification is not reflected in the draft-Guidelines. Accordingly, the Guidelines could exclude a board member who meets the requirements of CRD IV and permit the inclusion of a board member who does not meet such requirements.

Paragraph 44: This paragraph goes again beyond CRD IV. There is already a limitation of 12 years and it is difficult to cover some roles that require very specialized skills and capacities. Elimination of this paragraph is proposed.

~~**Paragraph 44**: Each committee should have a chair that is an independent member of the management body in its supervisory function. Members of the management body in its supervisory function should not chair as a general principle multiple committees unless this is justified taking into account the overall composition and experience, knowledge and skills of the management body. Institutions should consider, the occasional rotation of chairs and members of committees taking into account the specific experience, knowledge, skills which are individually or collectively required for certain committees.~~

Paragraph 45: The reference to the audit committee is out of scope. Indeed, CRD IV does not refer to the audit committee which is covered by other directive and national laws. Moreover, this paragraph goes beyond the requirements of Directive 2014/56/.EU amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, as according to art.39§5 the audit committee can be exempted from the independence requirements if all members of the audit committee are members of the supervisory body. Accordingly this paragraph should be deleted.

Paragraph 46: The description included in this paragraph seems to relate mostly to the risk committee and not the nomination committee.

Section 5.4: Role of the Risk Committee

Paragraph 47: *"Where established, the risk committee should: (…) e. review the proposed appointment of external consultants that the supervisory function may decide to engage for advice or support; (…) g. examine the alignment between all financial products and services offered to clients and the business model as well as the risk strategy of the institution. The risk committee should assess the risks associated with the offered financial products and services and examine the alignment with the prices assigned and profits gained from those products and services."*

As regards sub-paragraph e., CRD IV provides that the Risk Committee should have adequate access to external expert advice and, therefore, it should be able to engage advisors. However, it is not justified that the Risk Committee should review any appointment of external consultants engaged by the Board of Directors. Each corporate body should be entitled to appoint its own consultants.

Additionally, regarding sub-paragraph g., article 76.3 CRD IV refers to the review of whether the prices of assets and liabilities offered to clients (not the products and services themselves) take into account the business model and risk strategy of the entity. However,

the Guidelines attribute to the Risk Committee additional duties that are not related to the risk strategy, either because such duties are too detailed and technical (e.g. "assess the risk associated with the offered financial products and services"), and therefore more appropriate for the risk management function, or because they exceed the supervision of risk (e.g "examine the alignment with the prices and profits gained from those products and services").·

Paragraph 49: *"(…) The management body members of the Risk Committee should be able to participate in the meetings of the remuneration committee, where both committees are established, and vice versa."*

This paragraph 49 seems to go beyond CRD IV requirements. There should be coordination among the Board and its Committees, but entities should be able to implement those coordination mechanisms they deem more appropriate in accordance with their corporate governance system (e.g. cross memberships in Committees).

Section 6: Organisational framework and structure

Section 6.1: Organisational framework

Paragraph 56: To avoid overloading the management bodies, and interference of the management body in its supervisory function in day to day management of the institution, only material and important changes on the group structure should be considered for the purpose of assessing the impact on the soundness of the institution's organisational framework.

Section 6.2: Know-your-structure

Paragraph 60: *"The management body should ensure (…) and that the institutions within the group comply with all supervisory reporting requirements."*

Paragraph 61: "*Any flow of significant information between entities relevant to the group's operational functioning should be documented and made available promptly, when requested, to the management body, the internal control functions and competent authorities, as appropriate."*

In accordance with article 88 of CRD IV, as regards reporting obligations, the management body must ensure "the integrity of the accounting and financial reporting systems" and "oversee the process of disclosure and communication". Therefore, the management body should ensure and supervise that the entity has the adequate processes and systems to comply with its reporting obligations.

Additionally, group entities may be incorporated in third counties, and therefore, will be subject to reporting obligations to the local supervisory authorities for the compliance of which they will have their own processes and systems. Guidelines should acknowledge that local regulations may establish restrictions to the disclosure of information to third parties (including consolidated supervisory authorities).

The requirement to document any flow of significant information between entities and to make it available to competent authorities is undetermined. In this sense, at least "any flow of" should be eliminated in order to clarify the text and to be coherent with the proportionality principle: "~~***Any flow of***~~ *significant information between entities relevant to*

the group's operational functioning should be documented and made available promptly, when requested, to the management body, the internal control functions and competent authorities, as appropriate…"

Section 6.3: Complex structures, non-standard or non-transparent activities

This section over extends the scope of the GL, especially **paragraph 68**, "*Institutions should take the same risk management measures as for the institution's own business activities when they perform non-standard or non-transparent activities for clients (e.g. helping clients to form vehicles in offshore jurisdictions; developing complex structures and finance transactions for them or providing trustee services) which pose similar internal governance challenges and create significant operational and reputational risks. In particular, institutions should analyse the purpose why a client wants to set up a particular structure".*

Title II - Internal governance policy, risk culture and business conduct

Q4: Are the guidelines in Title II regarding the internal governance policy, risk culture and business conduct appropriate and sufficiently clear?

Answer:

We believe that most parts of the draft Guidelines in Title II are appropriate and clear, assuming that our proposal to clarify that when the term "Management Body" is used, it refers either to the management or to the supervisory functions and that, as a consequence, the missions allocated by the "Management Body" shall be allocated to the right body under applicable national law and not to both bodies, is retained (cf. our comments above).

However, we consider necessary the clarification of what is considered an internal governance framework, an internal governance policy and their relation, as well as a clear definition of each of them (taking into account that an internal governance policy should not be understood as a mere document).

Specific comments:

Section 7: Internal governance policy

Paragraph 70: "*The management body should define, adopt and maintain a governance policy to implement a clear organisational and operational structure with well-defined, transparent and consistent lines of responsibility taking into account the aspects set out in Annex I of these guidelines. The management body in its management function is responsible for the implementation of that policy. The management body in its supervisory function is responsible for overseeing its implementation and that it is fully operating as intended and should ensure that the institution's policy is aligned with the institution's overall internal governance arrangements, corporate culture and risk appetite."*

Our concern is that the Management Body in its supervisory function is not overloaded with tasks that are of an executive nature. Otherwise, it would not be able to efficiently ensure its supervisory mission. As such, the Management body in its supervisory function

is competent to oversee the implementation of the **global governance policy**, but not, as the case may be, all the governance policies within the Group.

Paragraph 73: "*The management body in its supervisory function should monitor the effects of the policy and carry out a periodical review of the design, implementation and effectiveness of the governance policy taking into account the recommendation from the relevant internal committees, when established, and the internal audit function. Where appropriate, policy should be amended."*

As regards **paragraphs 70 and 73**, please refer to comments to Title I on the unitary or dual board structures and the implementation issues for one-tier systems resulting from the attribution of duties and responsibilities to the management body in one of its functions (management or supervisory).

Paragraph 72: "*Internal control functions should provide effective input in accordance with their roles regarding the policy. Notably, the compliance function should analyse how the policy affects the institution's compliance with legislation, regulations and internal policies and should report all identified compliance risks and issues of non-compliance to the management body."*

As rightly pointed out in paragraph 113 the compliance function is just one of the internal control functions. Similarly, paragraph 115 rightly points out that the "internal control framework" of an institution should ensure (…) compliance with laws, regulations, supervisory requirements and the institution's internal policies, processes, rules and decisions. Thus paragraph 72 is inconsistent, when defining that it is the sole responsibility of the compliance function to "analyse how the [internal governance] policy affects the institution's compliance with legislation, regulations and internal policies and should report all identified compliance risks and issues of non-compliance to the management body". Furthermore, the current wording in paragraph 72 stipulates a definition of the roles and responsibilities of a compliance function that might conflict with respective definitions already in place in Member States. Therefore, we propose to change paragraph 72 as follows: "Internal control functions should provide effective input in accordance with their roles regarding the policy. Notably, ~~the compliance function~~ they should analyse how the policy affects the institution's compliance with legislation, regulations and internal policies and should report all identified ~~compliance~~ risks and issues ~~of non-compliance~~ to the management body."

Paragraph 74: "*Any changes to the governance policy should also be duly approved by the management body. Documentation regarding the adoption of the policy and any amendments thereof (e.g. minutes of relevant meetings) should be maintained and communicated, where appropriate, to the competent authorities particularly in case of significant changes".*

Annex I includes an exhaustive list of aspects to be considered in the internal government policy. However, there should not be a requirement to have a single document approved by the management body for the following reasons:

(i) Many aspects of the corporate governance policy are determined by mandatory provisions of national law and, therefore, they are not up to the management body to decide on or approve.
(ii) The majority of the listed aspects have been already documented and approved by the relevant corporate bodies (by-laws, Board regulations, corporate governance reports, etc.) in accordance with national law requirements. Therefore, these

corporate documents should qualify as part of the internal governance policy of the institution.

(iii) Some aspects do not seem to be the subject matter of a corporate policy, which is supposed to be general strategic principles with a vocation of lasting over time. Thus, some are facts changing from time to time (e.g. range of products, subsidiaries and joint ventures, etc.), others are matters that need to be supervised, rather than approved (weaknesses identified by each internal control functions and measures taken to address them, recommendations made by the internal audit function and measures taken to implement them, etc.).

Section 8: Governance policy in a group context

As a **general comment** on this section, the expression 'Governance Policy in a group context' refers to 'Governance Framework'. Therefore all the references to 'policy' need to be updated and changed into 'framework'. This change should be as well done in **paragraph 74** as 'policy' is used when it seems to refer to 'framework'.

Paragraph 76: we propose the following text: "At the consolidated or sub-consolidated level, the consolidating institution and competent authorities should ensure **the adherence** ~~that a~~ **to the** group-wide written internal governance policy describing arrangements, processes and mechanisms ~~is implemented and complied with~~ by all institutions ~~and other entities~~ within the scope of prudential consolidation~~, including their subsidiaries not subject to Directive 2013/36/EU".~~

Paragraph 78: *"The consolidating institution should ensure that subsidiaries established in third countries that are included in the scope of prudential consolidations, have a policy that is consistent with the group-wide policy and complies with the requirements of Article 74, 76 and 88 of Directive 2013/36/EU and these guidelines as long as this is not unlawful under the laws of the third country."*

Paragraph 79: *"(…)Where an EU subsidiary of a parent undertaking in a third country is a consolidating institution, the scope of prudential consolidation does not include the level of the parent undertaking located in a third country and other direct subsidiaries of that parent undertaking.(…)"*

Paragraph 78 provides for an extra-territorial application, as the internal policy needs to be in compliance with CRD IV and apply to subsidiaries within prudential consolidation, even if they are established in third countries. Please see above our comment on Article 109 of CRD IV: an application on a consolidated basis cannot be as constraining as an application on an individual basis. This entails a competitive disadvantage of subsidiaries of EU entities in third counties vis-à-vis local entities which may be subject to less restrictive local regulations (e.g. remuneration). It may even be a disadvantage as compared to EU subsidiaries of parent companies incorporated in third countries, since such parent company and any affiliate thereof shall not be subject to the same internal governance rules.

Section 9: Framework for business conduct

Section 9.2: Corporate values and code of conduct

According to our view, the implementation of ethical standards for external service providers lays beyond the power of the institutions.

Section 9.3: Conflicts of interest

Paragraph 92: "*A duly approved written policy should identify the relationships, services, activities or transactions of an institution in which conflicts of interest may arise and should state how these conflicts should be managed. <u>This policy should equally cover the conflict of interest risk specific to the management body in its supervisory function</u>. (…)"*

Please refer to comments to Title I on the unitary or dual board structures and the implementation issues for one-tier systems resulting from the attribution of duties and responsibilities to the management body in one of its functions (management or supervisory).

Paragraph 93: "*A consolidating institution should consider the interests of all its subsidiaries, and how these interests contribute to the interest of the institution and interests of the group as a whole over the long term."*

Conflict of interests among entities within a group of companies should be regulated by the relevant corporate laws applicable in each country. For example, in France, the notion of social interest of company prevails over the interest of subsidiaries.

Paragraph 94: *The conflict of interest policy should set out procedures and measures to be adopted to (…) and communicate any material actual or potential conflict of interest of staff to the management body. (…)"*

Paragraph 95: "*If any conflict of interest is identified, the institution should issue a statement as to how this conflict has been satisfactorily mitigated or remedied including a reference to the relevant parts of the institution's conflict of interest policy or any bespoke conflict management or mitigation arrangements."*

National laws already provide with mechanisms that address the most relevant conflict of interests of entities with related parties and establish transparency requirements where necessary (e.g. transactions with related parties are disclosed in financial statements). The obligation to issue a statement on any other conflict of interest is too broad, undetermined and unclear (what kind of statement? by which corporate body? to whom? how? etc.) and may raise confidentiality concerns, so we suggest that this paragraph be deleted.

Section 9.4: Internal alert procedures

Paragraph 103: "*Institutions may also consider making a member of the management body in its supervisory function responsible for ensuring and overseeing the integrity, independence and effectiveness of the institution's internal alert policies and procedures."*

The management body is a collegial body and in this provision, there is only one member responsible which is contrary to the principle of collegiality of the management body. Institutions may decide to implement those oversight mechanisms they deem more appropriate (for instance, through a group of members or a committee, within others).

In addition, where the Guidelines insist on attributing certain functions to a particular member of the management body – there will be a risk of impossibility or improper

implementation, given that members imperatively perform all functions assigned to the board of directors, as they are collectively part of the decision making process as members of one collegial body, in which all have the same rights and responsibilities.

Indeed, as far as company law in some Member States is concerned, responsibilities are not only "executed collectively" by the management body, but, more importantly, "decided collectively".

Section 10: Reporting of breaches to competent authorities

Paragraph 104: reporting of breaches to competent authorities should be eliminated as it is not an element of internal governance of financial institutions.

Section 11: Outsourcing Policy

Paragraph 109: "*The policy should state that outsourcing arrangements should not hinder effective on-site or off-site supervision of the institution and should not contravene any supervisory restrictions on services and activities. The policy should also cover intragroup outsourcing (e.g. by a separate legal entity within an institution's group) and take into account any specific group circumstances.* "
Please replace "e.g." ("e.g. by a separate legal entity within an institution´s group") by "i.e.". The example in brackets is the only situation, which could be from a legal point of view considered as an outsourcing. There is no another example and no room for an "e.g.". An "intra-group outsourcing" within the same legal entity is legally not an outsourcing and will not contravene any supervisory restrictions. This situation should be handled by fulfilment of the requirements of the internal governance.

Title III - Proportionality

Q5: Are the guidelines in Title III regarding the principle of proportionality appropriate and sufficiently clear? 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.

Answer:
In paragraph 112, a clarification is needed to provide that this is a list of indicators which is not binding.

Title IV - Internal control framework

Q6: Are the guidelines in Title IV regarding the internal control framework appropriate and sufficiently clear?

Answer:

We believe the guidelines in Title IV are appropriate and clear, subject to the below specific comments.

Specific comments:

Section 12: Internal control framework

Paragraph 113: The lack of definition of framework and policy is important for the interpretation of this paragraph. In this point we suggest the elimination of 'strong' as it implies an indeterminate legal concept and besides it may lead not only to different but inappropriate interpretations (i.e. exerting great force). Moreover, we consider necessary the clarification of what it is considered a framework, a policy and their relation.

We suggest the following text: "*Institutions should develop and maintain a ~~strong and~~ comprehensive internal control framework and a ~~strong~~ control culture that encourage a positive attitude towards control within the institution, including internal control functions with appropriate and sufficient authority, stature, and access to management body to fulfil their mission, and a risk management framework. The internal control functions should include a risk management function, a compliance function and an internal audit function. The risk management and compliance function should be subject to review by the internal audit function. The proportionality criteria listed in Title III of these guidelines should be taken into account when developing the internal control framework*".

Section 12.2: Heads of internal control functions

Paragraph 121: "*A member of the management body in its management function may be responsible for an internal control function as referred to in section 15 provided that the member does not have other mandates which would compromise the members' internal control activities and the independence of the internal control function."*

Please, refer to comments to Title I on the unitary or dual board structures and the implementation issues for one-tier systems resulting from the attribution of duties and responsibilities to the management body in one of its functions (management or supervisory).

Paragraph 122: "*When a head of an internal control function is not part of the management body in its management function, the respective position should be established at an adequate hierarchical level and be independent of the business areas it controls. To this end, the heads of the risk management and compliance functions should be directly accountable to the management body, and the head of the internal audit function should be directly accountable to the management body in its supervisory function.*

It should be clarified that the heads of internal control functions from an internal organization standpoint, may be subordinate to a senior executive who is not responsible for managing the activities monitored by the internal control area. Indeed, CRD IV only provides that the head of risks reports directly to the management body. It is not the case for the head of internal control functions.

Paragraph 124: "*(…) In any case, the heads of the internal control functions –and under Article 76(5) of Directive 2013/36/EU the head of the risk management function must-*

should not be removed without prior approval of the management body in its supervisory function."

This paragraph 124 goes beyond CRD IV under which only the head of risk is concerned. Indeed, Article 76, 5. paragraph 5 of CRD IV provides that "The head of risk management function shall not be removed without prior approval of the management body in its supervisory function and shall be able to have direct access to the management body in its supervisory function where necessary".

Paragraph 125.c.: *(notwithstanding the responsibility of members of the management body for the institution, the head of an internal control function is not subordinate to a person who has responsibility for managing the activities the internal control function monitors and controls.*

In supervisory practice the supervisory authorities often require that the internal control function should be subordinated to the CEO. Therefore, this section could be understood in such a way that the CEO could in practice not be responsible for any earning generating business areas within the institution.. Therefore, we recommend to clarify this section.

Section 12.5: Internal control functions, group context and outsourcing of internal control function's task

Paragraph 128: *"The operational tasks of the internal control functions may be outsourced taking into account the proportionality criteria listed in Title III, to the consolidating institution or another entity within or outside the group with the consent of the management bodies of the institutions concerned.(…)"*

According to CRD IV, the management body must ensure the integrity of the reporting systems, including financial and operational controls. This should imply an overall oversight of internal control mechanisms and processes, with no need of the management body consenting to each individual decision on whether those mechanisms are implemented internally or outsourced to an affiliate or a third party.

Section 14: New products and significant changes

Paragraph 143: *"(…)The institution should also have appropriate change policies for material changes to processes (e.g. new outsourcing arrangements) and systems (e.g. IT change processes) when these relate to new products. The management body should approve the NPAP policy and endorse subsequent reviews of the policy and consider if approved products and changes require changes within the risk strategy, risk appetite and corresponding limits."*

These are technical risk matters that should be assessed by the risk management function. It should be made clear that the "material changes" relates to products.

Paragraph 144: We suggest the change underlined in the following: "The compliance function, in collaboration with the risk management function, should be responsible for ensuring internal compliance with these policies. <u>The compliance function and the risk management function should jointly</u>, on a periodical basis, check that the policies remain appropriate and propose amendments to the management body as appropriate"

We find that this change better reflects the fact that this is a shared responsibility between compliance and risk management.

Section 15: Internal control functions

As a general comment applicable to the entire Guidelines, but especially in point 15, all the references made to "risk management" should be changed to 'risk control'. Otherwise, it may inappropriately include the first line of defence.

Section 15.1.2: RMF's role in material changes

Paragraph 160: *"Material changes or exceptional transactions may include mergers and acquisitions, including potential consequences from conducting insufficient due diligence that fails to identify post-merger risks and liabilities, setting up structures (e.g. new subsidiaries or single purpose vehicles (SPV)), new products, changes to systems, risk management framework or procedures and changes to the institution organization*."

Some of these matters are not within the scope of the risk and control management function, such as changes to the institution organization or setting up structures (e.g incorporating any new subsidiary).

Section 15.1.3: RMF's role in identifying, measuring, assessing, managing, mitigating, monitoring and reporting of risks

Paragraph 164: *"The RMF should ensure all identified risks can be effectively monitored by the business units. The RMF should regularly monitor the actual risk profile of the institution and scrutinize it against the institution's strategic goals and risk appetite to enable decision-making by the management body in its management function and challenge by the management body in its supervisory function."*

Please refer to comments to Title I on the unitary or dual board structures and the implementation issues for one-tier systems resulting from the attribution of duties and responsibilities to the management body in one of its functions (management or supervisory).

Section 15.1.5: Head of Risk Management function

Paragraph 174: we propose the following change in its text: "Institutions should establish strengthened ~~**procedures**~~ **processes** for the approval of decisions for which the head of the risk management function has expressed a negative view. The management body in its supervisory function should be able to communicate directly with the head of risk management function on key risk issues, including developments that may be inconsistent with the institution's risk appetite and strategy.

Paragraph 178: We agree that it is necessary for institutions to follow the changes to the laws and regulations applicable. We do however find that this purpose could be met without requiring an actual system, which could prove rather burdensome for especially smaller institutions. In any case, the paragraph should refer to global policy.

Section 15.2: Compliance function

Paragraph 178: *"The management body in its supervisory function should oversee the implementation of a well-documented compliance policy which should be communicated to all staff. Institutions should set up a system to regularly follow changes on the law and regulation applicable to its activities."*

We agree that it is necessary for institutions to follow the changes to the laws and regulations applicable. We do however find that this purpose could be met without requiring an actual system, which could prove rather burdensome for especially smaller institutions.

It is our understanding that this paragraph is not referring to a Code of Conduct, as this topic is covered in chapter 9.2. It would, therefore, be desirable to clarify the envisioned content of that one compliance policy that is expected to be communicated to all staff. Compliance policy frameworks typically consist of a multitude of thematic or target-group specific documents, thus not every such document must be communicated to all staff.

Paragraph 179: *"The compliance function should advise the management body on laws, rules, regulations and standards the institutions need to comply with and assess the possible impact of any changes in the legal or regulatory environment on the institution's activities."*

Similar to our comments regarding paragraph 72, we are convinced that paragraph 179 stipulates a definition of the roles and responsibilities of a compliance function that might conflict with respective definitions already in place in Member States, where the mandate of a compliance function might deliberately be focused on risk types such as Anti Money Laundering/Counter Terrorist Financing, Sanctions and Embargoes, Fraud/Anti Bribery/Corruption and Markets Compliance. Hence, the current wording in paragraph 179 disregards the possibility of assigning above responsibilities (or parts of it) to other internal control functions or the legal division. We therefore propose to amended paragraph 179 to reflect existing laws and regulations in all member states.

Section 15.3: Internal Audit function

Paragraph 187: *"The IAF should assess whether the quality of the institution's internal control framework as described in section 12 is both effective and efficient. In particular, the IAF should assess: a. the appropriateness of the institution's governance framework; (…)"*

In accordance with CRD IV, the management body is accountable for the implementation of the governance arrangements that ensure effective and prudent management of an institution. The management body must monitor and periodically assess the effectiveness of the institution's governance arrangements. Those duties cannot be delegated pursuant to law of some Member States.

Paragraph 192: we would like to note that according to the German company act (Aktiengesetz) the internal audit function is an instrument of the board of managing director (management body in its executive function) and therefore audit reports into the management body in its management function firstly. The management body in its supervisory function is informed about the audit plan but has no right to approve it. However, comments on the plan are possible and can be considered during the operational implementation of the audit plan.

Title V – Transparency

Q7: Are the guidelines in Title V regarding transparency of the organization of the institution appropriate and sufficiently clear?

Answer:
We believe the guidelines in Title V are appropriate and clear.

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