27/01/2017

European Banking Authority
European Securities and Markets Authority

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

The Swedish Bankers´ Association (SBA) appreciates the opportunity to comment on the draft joint ESMA and EBA guidelines on the assessment of the suitability of members of the management body and key function holders, hereinafter referred to as the draft guidelines. We support the views presented by the European Banking Federation, EBF, in their opinion on the consultation. In addition we would like to add the following.

We oppose the introduction of an ex-ante assessment
Initially the SBA wants to highlight that we oppose the introduction of a requirement for an ex-ante assessment. There are several reasons for this, please see our comments on the subject under question 12-15 in the document.

As was presented at the hearing, 5th of January 2017, a reason behind the introduction of an ex-ante assessment is that competent authorities in some member states may have problems with replacing unsuitable members of the management body appointed by the institution. However, deficiencies or weaknesses in national law should primarily be addressed in the context of national law. The CRD IV is clear in this area, article 102 and 104, and enables competent authorities to take necessary measures when an institute does not meet the requirements in the directive.

The draft guidelines do not consider different corporate structures
The SBA fully agrees with the EBF´s position that the draft guidelines do not take sufficient account of the different corporate structures within the EU. The draft guidelines are too detailed and do not provide sufficient flexibility which makes them very difficult, and to some extent impossible to apply in a unitary board structure. It must be considered that in a unitary board structure the board´s decisions are made collectively, and that it hence is not logical to impose strict requirements on individuals.

Besök (Visit):
Blasieholmsgatan 4B
Stockholm
Sverige (Sweden)

Post:
Box 7603
SE-103 94 Stockholm
Sverige (Sweden)

t: +46 (0)8 453 44 00
f: +46 (0)8 796 93 95
e: info@swedishbankers.se
www.swedishbankers.se

It is also important to clarify how employee´s representatives in the management body should be treated.

Additional detailed requirements risk being counterproductive
The rationale behind the introduction of new and more detailed requirement is not persuasive. Although there may be reasons to further harmonize the supervisory practice there is no explicit analysis showing that there is a need for a new package of far-reaching and detailed rules. It is necessary that new demands are based on evidence and carefully analyzed in advance. E.g. the proposal lacks an impact assessment regarding the consequences of individual suitability and the grading of skills against responsibilities.

There are multiple regulations on the same matter – national legislation, EBA guidelines, ECB guidelines and individual supervisory practices – which contribute to a very complex system which needs to be applied by credit institutions. The increasing level of detailed requirement in terms of diversity, specific competencies, education, experience, maximum number of directorships, independence, independence in mind etc. leads to an, in practice, unsolvable equation due to the large number of terms to be taken into account. It cannot be ruled out that the combined set of rules may be counterproductive when it comes to the objective of establishing the optimal composition of members. It is also important to stress that additional detailed requirement, on top of what is already required in diverse legislations and the risks for individual sanctions, will further complicate populating the boards going forward.

The administrative procedures also need to be made more efficient. For example institutions, should not in cases where members of boards and management already have been assessed by one EEA supervisory authority need to repeat the exercise, e.g. in connection with M&A transactions, restructurings etc.

It would be desirable if the draft guidelines, on a general level could focus on significant issues rather than dive deep in details. Detailed requirements that do not take the specific character of a board assignment into account may ultimately make it more difficult for board members to carry out their tasks and impede the effectiveness of boards.

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?

On a general level, there must be a clear difference in the competence requirement for members of the management body in its supervisory function – according to

Swedish law the board of directors – and members of the management body in its management function, and a greater level of flexibility allowing for the proper implementation of the draft guidelines notwithstanding requirement as to structure etc. imposed under national law.

The Swedish Companies Act stipulates that companies must have three decision-making bodies in a hierarchical relationship to one another; the general meeting, the board of directors and the CEO. It is relevant to point to the fact that under Swedish law, board of directors does not undertake executive functions. The responsibility for the actual management of the institutions is placed with the CEO. The Swedish company law does not impose a requirement for institutions to appoint a "management team" and such requirement cannot be imposed by guidelines. As regards individual requirements imposed on members of the management body it should be stressed that under Swedish law the board is a body where decisions are taken collectively, no such authority is placed at individual level with the directors. Against this background, it is not logical to impose stringent requirements on individual positions as these rules should be imposed on the collective forum of the board, please see e.g. subparagraph 40 that the SBA suggests should be deleted.

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

Increased detailed suitability requirement beyond those already applicable regulations will create very complex appointment structures for financial institutions. The difficulties are also associated with the fact that the requirements are to be found in different regulations both at national and EU level. Even though the SBA appreciates harmonisation we believe it is essential that a cumulative impact assessment is made of the overall regulatory framework.

It is necessary to clarify how the draft guidelines shall be applied on a consolidated basis. As currently construed, they leave ground for an interpretation to the effect that institutions covered by CRD IV are responsible for ensuring these CRD IV/MiFID II derived requirements are imposed also on individual level in respect to subsidiaries not themselves covered by CRD IV/MiFID II (e.g. non-licensed institutions and non-EEA institutions). Such expansion of the suitability assessment requirements are not provided for in article 109(2) of CRD IV, as referred to in the draft guidelines. In comparison article 92 of CRD IV places a direct obligation on competent authorities to ensure application on remuneration requirements *"at group, parent company and subsidiary levels, including those established in offshore financial centres"* i.e. individual level. This provision had not been necessary if the EU legislators had deemed article 109(2) to place the same obligations on the competent authorities, cross refers to Section II, Chapter 3 (Title VII), in which Article 92 is included. Also, it is not logical to apply the draft guidelines, to some part focusing on knowledge and competence of the financial sector, on the board of directors of such companies.

Further, it must be clarified how the draft guidelines should be applied towards employee´s representatives in the management body taking into account article 91 (13) of CRD IV.

It should also be explained whether there is an intended difference between "the collective suitability of the management body" in subparagraph 25 and "the collective suitability of *the members of* the management body" in subparagraph 26?

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

The SBA refers to the EBF letter, rightly noting that there is no authority for EBA/ESMA to impose requirements in respect to the assessment of key function holders. The inclusion of key function holders is a remnant from the existing guidelines.

It is unclear how the requirement in subparagraph 30 c. should be interpreted and it must be clarified. Subparagraph 20 c. does not refer to key function holders but the unclarity is the same for both paragraphs.

Q4 Do you agree with this approach to proportionality principle and consider that is will help in the practical implementation of the guidelines?

See below.

Q5 Do you consider that a more proportionate application of the guidelines regarding any aspects of the guidelines could be introduced?

The part on proportionality only refers to institutions. It should be clarified how the proportionality principle relates to other entities in consolidating situations.

On an overall level, the view of the SBA is that there should generally be a more proportionate application of the draft guidelines in the sense that now suggested requirements are not proportionate taking into account the level of details. Also, as stated above, there should be different requirements for members of board of directors and executive management and key function holders should not at all be in scope for the draft guidelines. Otherwise, we agree with the EBFs view.

Finally, the section on proportionality (subparagraphs 33-36) should be moved to the beginning of the guidelines, clearly stating that the principle of proportionality is applicable to all statements in the guidelines.

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

Even though the SBA believes the draft guidelines are sufficiently clear, we believe they go beyond the scope of the underlying acts and the actual objective with imposing requirement on the assessment of suitability.

Regarding subparagraph 39 j. it will not be possible to find appropriate and relevant benchmarking on time commitment. Further, it is not reasonable to record in writing the expected time commitment for each position within the board of directors, subparagraph 40, and as stressed above focus should be on the competence of the board of directors as a whole. There is no need for such detailed requirement and it is not effective to regulate time commitment in hours. The expected time commitment will differ from time to time depending e.g. on the company´s development phase and business activities.

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

Even if the SBA believes that the notions of suitability are to a large extent appropriate and sufficiently clear, we believe the requirements must be related to the requirement on e.g. diversity. Moreover, although the criteria for what constitutes "independence of mind" are set out in subparagraph 75, it appears very difficult to assess this in a meaningful way.

Further, data protection rules have to be considered as to how and to what extent information regarding an assessed individual may be collected and stored. Alignment is needed with coming requirements in the GDPR.

The requirement in subparagraph 77 f. must be clarified. What is meant by political influence or political relationship?

As to the rating of individual´s competence it needs to be underlined that there are no official accepted tests or other ways of establishing which grade a specific individual should have. Also, the possible consequences of a certain grading e.g. in terms of liability, is not analysed. We suggest that Annex II is deleted since it represents an example of the overzealous attempt to regulate areas which should be left for institutions to judge and develop. The requirement on knowledge about the language where the company is domiciled is one example.

In addition, too detailed requirements will lead to a situation where an assignment as a board member more or less will become resemble to an ordinary employment contract.

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?

The requirements in subparagraph 84 and 85 must be read in the light of subparagraph 59 to 62 and since the requirements are so extensive it may be difficult to meet them in six months´ time. The same holds true with regard to subparagraph 83, i.e. the one-month period for induction. It will be difficult to provide a sufficiently comprehensive induction within such a short time span.

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

As pointed out above, there may be difficulties in meeting the requirements on suitability and at the same time meet the requirement on diversity. If problems should occur, it must be clear which requirements that prevails. The proposed requirements concerning the diversity policy, e.g. the setting of a quantitative target concerning gender representation, may overlap or even come into conflict with similar requirements in national company law.

In addition to EBF's comment regarding subparagraph 97, we would like to add that candidates for management body positions (at least in the supervisory function) are not typically recruited among staff why this subparagraph is not logical.

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

The SBA believes the draft guidelines on the suitability policy in a group context should be changed. In subparagraph 106 and 108 the term consolidating CRD-institutions should be replaced with the term institutions, otherwise financial holding companies (and mixed financial holding companies) would be excluded from the scope which will be in breach with Swedish law and furthermore, will not be in line with the Bank recovery and resolution directive, BRRD. It is also questionable if the requirement is aligned with the Commission´s proposal on new capital requirements (CRRII/CRD V). However, if the requirement only hit group-level that does not have a (mixed) financial holding company on top, this must be made clear. At least it should be clarified that other entities can hold the ultimate responsibility to implement governance policies at group level.

The BRRD requires that a financial holding company is responsible for the group recovery plan. In article 7.1 the BRRD it is stated that Member States shall ensure that Union parent undertakings draw up and submit to the consolidating supervisor a

group recovery plan. The recovery plan puts upon the parent undertaking to assess and govern the entire group. This would not be possible had the parent company not the ultimate responsibility for the arrangements, processes and mechanisms at group level.

The requirement in subparagraph 117 and 119 are in breach with Swedish law, since the management body never can identify and select new members of the board.

Requirements for independence can also cause other problems in governing/managing a subsidiary. With too many independent members in a board, problems could arise with implementing demands of governance. It could cause obstacles in situations when swift decisions must be taken. The SBA therefore suggests that the demands for independent members will be less conditional and allow a lighter regime to smaller entities and entities with special conditions and overall allow flexibility.

The twelve years limitation should also be reviewed. In the Swedish Corporate Governance Code which is recommended for listed corporations the same limitation was first introduced and then abandoned. The reason to abandon seems to have been that it is in fact not promoting knowledge and experience and besides that seems inflexible.

Q11 Are the guidelines within Title VI regarding the assessment of suitability by institutions appropriate and sufficiently clear?

The requirement of independence (subparagraph 123 and 124) must be reviewed. By setting up detailed requirement for independent directors/members a number of problems can follow. One problem is that an institution can be owned directly or indirectly by its customers. The institute can also be directly or indirectly owned by cooperative and/or mutual companies/entities. A rule that requires independent members must reasonably be very flexibly designed.

Which is the purpose of the suggested rules on independence? If the purpose is to facilitate constructive challenge and discussion by monitoring customer or the public interest, it can be noted that an institution that is customer-owned, directly or indirectly, in many cases, already meet this requirement trough customers elect members. In such cases it would lack in proportionality to "impose" a high proportion of independent members. It is therefore essential to clarify that the purpose of the term “sufficient” is not to demand a high proportion or even majority of members. The EBA must also take into consideration that national law puts upon the companies to have a certain amount of employee representatives.

Subparagraph 125, see also subparagraph 135 and 136, states that the management body in its supervisory function should ensure that the management body is suitable which is in contradiction with Swedish company law and corporate governance established in the Swedish Corporate Governance Code. In a unitary structure this means that the members of the management body should assess themselves, which seems illogical. Even though they shall make an annual assessment it will not be an independent assessment because it will be self-assessed. This also applies for the whole Title VI, which makes it problematic to apply for unitary structures.

What is stated in the box on page 47 clearly point out problems a too detailed guidance may cause. It seems less appropriate to regulate at such a detailed level if there is a need for disclaimers.

Regarding subparagraph 130 we will return on the ex-ante supervisory assessment of the management body below under Q12-15.

Subparagraph 149 states that the institutions should inform the supervisory authority about the outcome of a reassessment. This appears to be an unnecessary administrative burden for both the institutions and the supervisory authority. The institutions should, according to subparagraph 150 and 158, inform the supervisory authority without delay of any shortcomings identified concerning the members of the management body why subparagraph 149 should be deleted.

The supervisory authority shall also assess the suitability of individuals and the board of directors collectively. However, is must be clarified that the supervisory authority should not be able to transfer the responsibility for the suitability test on the institutions, in that the supervisory authority add the institute´s assessment as a base for the its own consideration. It is therefore important to clarify that the institute´s own assessment does not limit the supervisory authority´s responsibility.

The SBA does not understand why the assessment procedure and results have to be reported by the institution to the competent authority (subparagraph 133). When appointing new members to the management body the institution assesses the suitability of the person. If the result was negative, the institution would not appoint the member. But if the institution informs the competent authority about the forthcoming appointment, the member is suitable. There is no need to mention that fact to the competent authority.

Q12-15 Are the guidelines with regard to the timing (ex-ante) of the competent authority´s assessment process appropriate and sufficiently clear, etc.?

The SBA opposes the introduction of a requirement for an ex-ante assessment. Overall there has not been presented a concreate and convincing rational for changing the existing regime. On the contrary, there are good reasons to maintain a system with an ex-post assessment.

It is the shareholders responsibility, at the shareholders meeting, to decide who should be part of the board of directors. To provide the shareholders with a real opportunity to choose and decide the institutions would, in an ex-ante regime, have to designate and assess, a vast number of candidates and well in advance (at least four to six month), submit all the candidates for the approval of the supervisory authority. The decisions would be public which could negatively affect individuals who have been nominated but not chosen.

Also, the process for the institution would not be predictable in terms of timing. Even if the time limit is set for three to four months, there is no guarantee that the supervisory authority would keep such deadline. If the time limit is not kept, it would result in the institution having to hold an extraordinary shareholders meeting. In these circumstances the institution must take into account the legal requirements for notification etc. In addition, one or several directors may resign prematurely, which means that the institution has to hold a pool of directors with different skills and knowledge, who has been assessed by the supervisory authority. This will create practical problems. It is not in line with the Swedish law that the Shareholders' meeting in advance appoint members of the board in the event that one or several directors should resign prematurely.

According to the Swedish law the shareholders are free to nominate candidates at the shareholders meeting. Although this is unusual, an ex-ante requirement is incompatible with this right. Thus, an ex-ante requirement would in practice prevent shareholders from exercising their rights under Swedish law.

It is also in the institution´s interest to only appoint members of the board that may be approved by the supervisory authority. If an individual, or for that matter the collective board, would not be approved by the supervisory authority, it would result in negative publicity for the institution, creating a potentially damaging reputational risk.

Furthermore, the SBA notes that subparagraph 153 provides that if the institution´s internal assessment concludes that a present member of the management body is not suitable, that person should be replaced. This requirement is incompatible with Swedish law as regards members of the management body in its supervisory function.

An ex-ante regime is very inflexible and would never work e.g. in an M&A setting. As the competent authorities have a case handling period of three months (with the

possibility of an extension), the preapproval/ex ante process can be a significant obstacle in change of control situations where management is often replaced (and with new owners in the top company, whom would also need to be assessed and approved). From a prudential requirement/"proper running of business" perspective, an ex-ante assessment could have influence on a covered institution's choice of management etc. In critical situations an institution may easily choose to appoint persons whom have already been fit and proper approved by competent authorities to avoid long case handling periods, and not the persons most qualified. Also, the ex-ante requirement makes it very difficult to replace management in general and de facto exhausts the purpose to have covered entities perform their own assessments (which is the principle purpose of the draft guidelines) as said entities must in any way rely on the assessment made by the competent authorities prior to any appointment.

From a practical perspective, an ex-ante regime could prevent entities from being compliant with other governance requirements. The draft guidelines also entails that the requirement for ex-ante assessments by the competent authority applies to heads of internal control functions and the CFO in significant institutions (subparagraphs 159-161). Here, the practical problems and risks associated with an ex-ante requirement become quite pronounced. If such a person resigns prematurely or if the competent authority´s scrutiny of a proposed person is time-consuming, important positions in the institution concerned will not be filled and would presumably have to be held by temporary/acting heads.

Subparagraph 171 states that the supervisory authority may participate as an observer in meetings of the management body. It is questionable if it is appropriate that a supervisory authority is involved in the business or activities the authority is required to supervise. Can the independence be maintained if the supervisory authority takes part in such meetings? Further, if the supervisory authority would participate in such meetings, it would likely not constitute a normal meeting of the management body.

Subparagraph 174 states that a positive decision may be deemed to be taken by silence. We suggest amending this subparagraph so that the competent authority should inform institutions of any decision taken as soon as possible.

SWEDISH BANKERS' ASSOCIATION

Hans Lindberg Åsa Arffman