

24 January 2017

## ECODA RESPONSE TO CONSULTATION PAPER EBA & ESMA

### DRAFT GUIDELINES ON THE ASSESSMENT OF THE SUITABILITY OF MEMBERS OF THE MANAGEMENT BODY AND KEY FUNCTION HOLDERS

#### General Remarks

ecoDa would like to express its appreciation for the **thorough guidance** on the assessment of the suitability of the board and its individual members. The guidance should perhaps stress more clearly how the (national) **supervisor** (or in case of systemic financial institutions, the ECB) and **the individual financial institution** could develop an effective and efficient **interaction** in respect to periodic/annual assessment. To this end, ecoDa would like to stress the fact that the individual 'fit and proper' dossier obliged for each (re)nomination has to be developed by the board. A professional assessment needs to include a judgement on the hard skills as well as on the soft skill of the nominee. Although the supervisor will have a key role in evaluating such fit and proper dossier and -where considered relevant- will execute additional testing, the effective performance of a board member can only be judged by its peers (in regular board evaluation exercises). This element is insufficiently addressed in the guidance.

Another general remark relates to the fact that the 'management' body is (supposed to be) a collegial body. Therefore, ecoDa wants to stress that judging **'the fit' of an individual board member should be done in light of the composition of the global board**. This prerequisite deserves more attention.

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 the supervisory function?

1. For the ecoDa reaction to this question, please refer to our reply on the draft guidelines on internal governance (see point 1).

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

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

2. ecoDa appreciates the **clear distinction between the suitability assessment at individual level versus the collective suitability** of the members of the management body. Since boards are considered a collegial body this second element is of paramount importance (see also the general remarks).
3. For **defining the role and assessing the suitability** of the members of the ‘management body’ it might be good to make the following **distinction**, taking into account the nuances in board models (see also remarks on Q1):
  - the non-executive members, being responsible for the supervisory function of the board and in some board models also for more strategic and leadership decision-making;
  - the executive members, being responsible for (part of) the management function;
  - the CEO, even if he is not a member of the ‘board’.Additionally, it might be relevant to include in the guidance also clear definitions of what is meant by respectively non-executive directors, executive directors.  
This distinction is very relevant for assessing the individual suitability, but also the collective responsibility of respectively the contingent of non-executives versus that of executive directors (see also point 63, p33). Moreover this distinction is also relevant for defining the necessary degree of independence of non-executives (see point 18 p45), certainly in their relationship with management and the company in its totality.
4. Although the guidelines give a brief description of the definition of key function holders, a more detailed analysis of whom to include might be relevant (especially whom to include in the ‘other’ category).

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

5. The calculation of the number of acceptable directorships (point 52, p30) does not include mandates as director in organisations which do not pursue predominantly commercial objectives. This is in line with internationally accepted practices that stimulate taking up societal duties as professional directors. However, ecoDa appreciates that such mandates need to be taken into account when assessing the time commitment. In more general terms, the fact that the guidelines propose to **define sufficient time commitment in a much broader perspective than just the number of other mandates** (point 39 p28) deserves applause. But it would also be relevant, according to ecoDa to include in the guidelines that more time commitment and limitations on the number of directorships inevitably will lead/need to lead to higher director fees.
6. The proposal to make directors well aware of the expected time could be complemented by the proposal to **include the estimated time commitment in the nomination letter** that complements a formal nomination or re-nomination.

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

Q 10: Are the guidelines within Title V regarding the suitability policy and governance arrangements appropriate and sufficiently clear?

7. The guidelines make an **interesting distinction between ‘independence of mind’** (point 10, p 36) **and ‘independent members of the management body in its supervisory function’** (point 18, p45). However, ecoDa would prefer that the two sets of guidelines are combined, and that a more explicit statement is made as to whether ‘independence of mind’ is a requirement for all board members, also in their management function.
8. ecoDa is of the opinion that the detailed **definition of independence of mind** (point 75, p36) is very useful, and can even be extrapolated to all types of organisations. However, some points deserve additional information: this is the case for point 77d (relationships with other members of the management body) and point 77f (political influence or political relationships).
9. **A clear distinction is made for directors that are shareholders:** for independence of mind (point 78, p37), it is explicitly mentioned that holding shares is not considered in itself to give rise to a situation of conflict of interest, impacting the independence of mind of a member of the management body. At the other hand a ‘substantial shareholder’ has a material financial connection and can therefore not be considered independent (point 124a p45). This distinction will be highly appreciated by directors that are substantial shareholders.
10. The use of the term **‘material’ and ‘significant’** to define situations that impede independence will need further substantiation, either by the EBA or by the national supervisors. This is the case for point 124c (material advisor, consultant), 124d (material supplier or customer) and point 124e (significant fees or other benefits).

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

11. Before analysing the guidelines on the assessment of suitability, ecoDa would like to point to the fact that it is **foremost the board (and the shareholders) that need(s) to assess the suitability** of board members, before any nomination or re-nomination, including its important role in succession planning. Moreover individual suitability is also part of the more general evaluation exercise of board effectiveness. Supervisors need to play their role in light of the financial regulation, but this assessment will mainly have to rely on the board’s work in this respect.
12. Although some paragraphs clearly make a distinction (e.g. point 140, p49), ecoDa would like that more differentiation is offered **between the assessment of the suitability of the management body in its supervisory, respectively management function**. This could help in making it clear that final decisions on appointment may be the prerogative of quite different corporate organs (e.g.

non-executive directors are appointed by the shareholders' meeting, the same may hold for executive directors in a 1-tier board structure, but this may well be the supervisory board's decision in a 2-tier board; executives that are not directors might be nominated by the management board (in its supervisory, or management function, depending on the level of the management) or by the CEO.

A clear example where such distinction is missing, is point 148 (p51): it is stated that 'the management body in its management function should take notice of the assessment report (which one?) and decide on the recommendations made by the management body in its supervisory function, or where established, by the nomination committee, and where recommendations are not adopted, document the underlying reasons'. ecoDa is of the opinion that more nuances are needed and a more general assessment report of the non-executive directors is also necessary. How such assessment may take place deserves additional attention (what procedure to follow, role of the nomination committee and the board for a self-assessment, externally supported or not, communication to the supervisor and the shareholders, etc.)!

13. The **procedure prescribed for ex-post assessments of directors**, already nominated by the shareholders' meeting, is debatable as to its realisation in practice. One should look at the practical inconveniences to cope with, when such approach would be used. Turning back a formal appointment might lead to quite some negative reputation for the candidate and the financial institution. Is this really an option that one should foresee? For non-executives, the urgency is generally not that large that the normal procedure of screening by the nomination committee, the board and the supervisor cannot be planned before a shareholders' meeting takes place or an additional shareholders' meeting is organised. As to the nomination of executives, a more urgent replacement might be needed. But here the procedure might be more easy in as far as executives can be appointed by the board, which is a more flexible corporate body to adapt to the timing of the supervisory approval, that in such circumstances might need to be speeded up as much as possible. Only when executives need to be appointed as executive directors by the shareholders' meeting a longer time interval might be necessary, but in that case the nomination as executive can already take place beforehand.

Moreover, in point 130, it is clearly stated that appointments should not be made before the competent authority has given the prior approval. This is perhaps the route to follow, which implies adapting point 127 in line with 130.

14. ecoDa is of the opinion that the **periodicity of assessments needs further reflection as well**. A thorough reflection should be made each time there is a change in the composition of the management body (either in its management or its supervisory function). In order to develop a profile for a replacement or when deciding about re-nomination an in-depth reflection is needed. Such profile should be based on the complimentary needs to constitute a management body that fits with the actual and future strategy and challenges of the financial institution. Such analysis is instrumental in developing a detailed profile and vacancy description that will be the reference for assessing all potential candidates. An annual assessment (as prescribed in point 145, p51) might therefore not be necessary and might well give rise to a more superficial formalistic approach, a kind of box-ticking. Since changes in the composition are rather frequent (either accidental or structurally linked to the (staggered) timing of the board mandates) the need for having periodical assessments will be answered in a more natural way.

15. An additional element that ecoDa wants to stress, is the need for a **tailored induction** after being nominated to the management body as well as a **periodic update and education**. This last point is important in light of the rapidly changing context from a legal as well as a business perspective. To this end, the need for educating the board members on the new EBA guidelines might be a very good example.

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### **About the European Confederation of Directors Associations (ecoDa)**

The European Confederation of Directors Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Through its national institutes of directors (the main national institutes existing in Europe), ecoDa represents approximately 55,000 board directors from across the EU. ecoDa's member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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- The "Slovenian Directors' Association"
- The "Polish Institute of Directors"
- The "Norwegian Institute of Directors"
- The Swedish "StyrelseAkademien"
- "Vereinigung der Aufsichtsräte in Deutschland" e.V., VARD
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- The "Danish Board Network"

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