

**Response of Nedcommunity (Italian member of the European Confederation of Directors Associations, ecoDa) to the European Commission DG-FISMA consultation on the implementing the final Basel III reforms in the EU**

December 2019

Nedcommunity, the Italian association of non-executive and independent directors, is pleased to provide you with its comments on the online consultation entitled “*public consultation document implementing the final Basel III reforms in the EU*” (the “**Consultation**”) published by the European Commission Directorate-General for Financial Stability, Financial Services and Capital Markets Union, on 11 October 2019.

Nedcommunity will limit its comments specifically to the Section 9 “*Fit and Proper*”, paragraph 9.2 “*Competent authorities’ assessment of the suitability of members of the management body*”, referred to in the Consultation.

On the basis of our experience as non-executive and independent directors in financial companies, we believe that regulation has so far contributed to enhance governance effectiveness and the average quality of board of directors, both in their composition and functioning. The suitability criteria set the bar at a very high level and forced boards and shareholders to carry out a more structured and documented selection and appointment process for board members. Uncertainties remain in a few countries, as for instance Italy, because of delays in the approval of implementing decrees of CRD IV by the competent political authorities. Nevertheless, the supervisory action already contributed to the enforcement of the principles and rationale of the Directive in individual cases through moral suasion.

Despite our endorsement to the banking regulation on corporate governance in its current state, we strongly oppose a further tightening of legislation on directors’ responsibilities, which might contradict the principle of independence of selected board members (i.e. non-executives), who are requested, in virtue of their role, to carry out mainly supervisory activities.

Moreover, in spite of the fact that an ex ante suitability assessment would be preferred in order to avoid removals following the appointment of directors by the shareholders meeting, and consequent reputational effects on the bank, this would result to be not consistent with the legal framework of some countries (i.e. Italy) and relating shareholders’ rights.

We further elaborated on our view below in relation to the proposed questions.

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**FIT AND PROPER**

***Ex ante and ex post approval and ex post notification***

- 197) Please explain what you consider to be the advantages and disadvantages of competent authorities conducting ex ante and ex post approval, respectively, of suitability of members of the management body.

There is a clear advantage of conducting an ex ante approval of the suitability of the management body. The risk of a disapproval by SSM of a board member – once already nominated – could damage the reputation of the supervised entity.

- 198) If, in your jurisdiction, institutions are required to request approval for the appointment of members of the management body only after they take up their position, please explain what, if anything, would make it difficult for you to adapt to an ex ante system.

In some EU countries an ex ante approval is not feasible due to the board nominating system according to national law and relating shareholders rights. For example, in Italy the Board of Directors is nominated by law upon proposal by the shareholders and the election is finalized in the shareholders' meeting through the slate voting (so called "*Voto di Lista*") and therefore it is not possible to structure an ex ante evaluation by SSM.

Such ex ante evaluation could be performed only in few companies where the board has the right to submit a proposal in the shareholders' meeting on board renewal.

- 199) One issue that has been raised in the past in relation to ex ante assessment is avoiding vacant positions on the board. Please explain, based on your experience, to what extent this can be overcome (if it is an issue in the first place) giving examples and making reference where appropriate to succession planning and procedures in place for identifying skills/experience that could be particularly difficult to replace.

In the case of ex ante assessment, problems might be mitigated if the process is finalized in a reasonable timeline (See below n. 201).

- 200) Which specific positions within the board and/or senior management of institutions do you believe should be considered as part of an ex ante assessment, given the responsibilities they hold and the risks they may pose? Please provide evidence and/or examples to support your views.

Whereas it is not feasible according to some jurisdictions (e.g. Italy) to perform an ex ante assessment of the Board members, there are no hurdles to perform such type of assessment for the Key Function Holders (Chief Risk Officer, Chief Compliance Officer) as they are appointed by the Board of Directors according to the applicable regulation. To some extent (i.e. delegated powers) this also applies to the Chief Executive Officer.

***Processing of applications for fit and proper approval***

- 201) Considering a scenario in which at least some fit and proper assessments were to be conducted by competent authorities ex ante, what would be, for you, the costs and benefits of a deadline for the assessment of proposed board members being set in the CRD? What would you consider a reasonable period of time for the assessment?

There is a need of clear deadline for fit and proper assessment in either the ex ante or ex post assessment. We consider that the term should be not over 4 weeks.

- 202) Do you currently use, or have you envisaged, other timelines for approval, e.g. whereby institutions only have a limited time to provide the additional information requested, or where the length of the assessment period depends on the specific type of position? If so, please explain the rationale for these timelines.

No.

- 203) If competent authorities had a fixed time period for giving their approval to proposed new board appointments, would you nonetheless consider it preferable for a decision to be issued in cases where the competent authority decides to approve a candidate? Could you instead envisage a system of “tacit approval” (i.e. whereby, if no decision has been issued by the deadline, the institution can consider the candidate approved)?

If the tacit approval can shorten the procedure, it can be envisaged.

### ***Proportionality***

- 204) Should the scope and format of fit and proper assessments be adapted to take into account the principle of proportionality, including in relation to any new provisions such as those discussed in Sections 9.2.1.1. and 9.2.1.2.? Please elaborate on your reply and provide examples.

We consider very important and relevant the concept of proportionality and we agree that it should be expanded and further detailed.

In any case, proportionality doesn't apply to all members of the management body and key function holders, on specific topics (ESMA/EBA point 22, ECB Guide to fit and proper assessments), such as:

- good reputation, honesty and integrity;
- conflicts of interest and independence of mind.

Proportionality should apply to assess whether or not board members (EBA point 26):

- possess sufficient knowledge, skills and experience to perform their duties;
- are able to commit sufficient time.

In the case of key function holders, proportionality should apply to check if knowledge, skills and experience are suitable to perform their duties.

The assessment by the supervisory authorities should be ex ante, if feasible according to the national laws and relating shareholders rights. In any case proportionality should equally apply to ex-ante and ex-post assessment.

- 205) What specific criteria would you consider appropriate as a basis for allowing some degree of proportionality in the fit and proper assessment, including in relation to any new provisions such as those discussed in Sections 9.2.1.1 and 9.2.1.2? Views are also sought on the possibility of granting competent authorities the right to apply supervisory judgement to enlarge the scope of their assessment based on the risk profile of the institution/role.

We believe that the concept of proportionality should be defined and differentiated depending first of all on the size and the risk profile of the institution. In our opinion, an ex-ante procedure for the assessment is preferable, if feasible according to national laws.

Both aspects (size and risk profile) should be further detailed within the two groups of institutions: Significant and Less Significant.

Proportionality should also apply to Significant Institutions, because they are very different in terms of size, exposure to systemic risk (G-SIBs, etc.), structure and complexity (e.g. number of legal entities within the group), business model, risk strategy and risk profile (see ESMA/EBA Guidelines on suitability assessment, 2017, point 23).

We support an approach strongly proportioned to the risk profile (SREP results, for instance). A reinforcement of directors' competencies should be required in specific cases, such as:

- Institutions with SREP evaluation 4 and F;
- Institutions where a change in governance has been requested by the Supervisory Authorities;
- Institutions in a crisis situation (i.e. precautionary capitalisation), or in the case of a European Stability Mechanism intervention.

The fit and proper assessment on skills and time commitment de facto depends on the sensitivity of the roles and positions (CEO, Chair of the Board or Committees).

**206)** What specific risks do you see in allowing some degree of proportionality in the application of any new provisions, such as those discussed in Sections 9.2.1.1. and 9.2.1.2., on the timing of the approval of board members by competent authorities and of key function holders?

Proportionality in the timing of the approval by competent authorities of board members and of key function holders could deprive institutions of additional certainty. For this reason, we believe that all institutions should be treated the same way.

Additional certainty to institutions must be given, by including provisions on the deadline of the assessment by competent authorities (9.2.1.2).

***Roles on the management body, individual and collective suitability***

First of all, we point to the fact that the FSB Toolkit focuses on the prevention of misconduct, whereas the Consultation Paper deals more broadly with Basel 3 prudential regulation and corporate governance effectiveness. The two angles – i.e. responsibility/liability assessment and Fit and Proper assessment of board members – cannot be seen as fully overlapping. Moreover, as clearly stated in the FSB Toolkit, responsibilities depend on delegated powers.

So, while we strongly oppose an overall statement of responsibilities of each board members, including non-executive and independent directors, we suggest to clearly distinguish between executives and non-executives and thus directors who have a management role and those who merely have a supervisory task within the board.

- 207) What would be the benefits and drawbacks of designing an accountability regime whereby the management body of each institution would be required to draw up a statement of responsibilities of each of its members clearly identifying the activities for which they are responsible, beyond the sole responsibilities linked to their membership of specialised committees (e.g. risk committee, remuneration committee)?

Overall, we are strongly against an *a priori* attribution of different duties and responsibilities to individual board members, apart from the case of executives' delegated duties. This would contradict the principle of collective responsibility of the body, stated in national corporate laws. Furthermore, it would make non-executive and independent directors in charge of specific tasks and activities, thus compromising the criteria of objectivity and impartiality which characterizes these individuals in their supervisory roles. In addition, individual responsibilities would increase in an asymmetric mode, thereby enhancing the risk of being a bank director. We believe that the current assessment of the qualitative composition of the board, aimed at suggesting criteria for candidate appointment by shareholders' meetings on the basis of the required professional backgrounds, already leads to a selection of individual candidates based on the skills and competences needed in order to direct and control the bank in the coming years, and should not be further regulated.

- 208) How might the collective functioning of the board be affected by the introduction of a system where each individual has a defined set of responsibilities? Please consider the possible effects on both individual conduct and the board as a whole (e.g. the impact on the collective responsibility of the board, or on the quality of its discussions).

We point to the fact that the distinction between executives and non-executives in the boardroom already encourages a debate in board meetings, which contributes, in principle, to more effective decision-making. This can be enhanced by a proper skill-mix and a higher diversity in terms of background, experience, gender, age, etc. A potential individual responsibility, beyond the powers and duties delegated to executives, might lead to ineffective, and useless contrasts between individual board members. Moreover, non-executives and independent directors are not allowed to carry out individual investigations throughout the company or be involved in management activities apart from those expressly falling within board duties, and thus would not have the necessary levers to undertake the task.

Moreover, a similar situation would entail an increased responsibilities of individual directors towards third parties, which means that they would face a risk they might not willing to take, especially when they are well-reputed professionals. The result would be an adverse selection of directors to the detriment of governance quality and effectiveness.

In the sole case where the board delegates part of its duties to an individual (which thus is qualified as executive director) a specific and personal responsibility can be identified and could deserve a more detailed assessment of suitability. However, even in this case, it is the newly appointed board which has the power and duty to define and approve the scope and aims of the delegation. The more appropriate solution, if needed, would be to increase the frequency of reporting to the board on the exercise of those delegated powers, which in selected cases (e.g. Italy) is requested by the law at least on a quarterly basis.

We also point out that even board committees, and their members (usually mostly non-executive and independent, pursuant to the applicable regulation), do not receive any delegation of decision-making powers by the board (apart from the case when they are requested to provide binding or non-binding opinions, as on related party transactions or the appointment of the heads of internal control functions respectively, or submit proposals). Pursuant to the prudential regulation and to corporate governance codes for listed companies, board committees are set up only to support the board with consultative and advisory functions, whereas the ultimate responsibility lies with the board of directors as a whole. We thus acknowledge that committee members must be selected also taking into account the skills and knowledge requested to deeply investigate the topics covered by the individual committee, but this relates only to professional experience and background and does not entail any specific responsibility, apart from that of being up to the task. Conversely, a risk of asymmetric information at board level might arise alongside that of a concentration of power which might hinder the sound functioning of the board itself, leading to as many small executive committees as the board committees.

- 209)** What would be the benefits and drawbacks of designing a similar accountability regime for key function holders (e.g. information on key function holders, their responsibilities, details of the firm's governance and structure)?

With regard to executives (possibly extending this to C-suite and key function holders), a more strict fit and proper assessment by competent authorities might be envisaged, although with some limitations. Apart from specific cases (e.g. the heads of internal control functions), it is the CEO who is in charge of selecting its management team.

- 210)** Would the assessment of individuals proposed for positions on the board or as key function holders be more accurate and/or reliable if the responsibilities the individual would be taking on were clearly defined, including in relation to any new provisions, such as those discussed in Sections 9.2.1.1 and 9.2.1.2?

Following the aforementioned considerations, we do not believe that the assessment of individuals proposed for positions on the board, or the board work itself, would benefit in any way from an *a priori* definition of the responsibilities of individual board members, especially in

the case of non-executive and independent directors. Conversely, in the case of key function holders more tighten suitability criteria might apply, even if this could undermine the top management authority in selecting its staff.



***Cultural factors influencing conduct***

- 211) Do you consider that corporate culture could and should be taken into consideration as part of the fit and proper assessment? If yes, please explain how this could be most effectively achieved.

We strongly acknowledge that culture matters and can even be the main driver of serious misconduct. Corporate culture, and particularly risk culture, is essential for prudent and sound bank management and governance.

Culture affects individual and social behaviors within organizations: it is an integral part of bank management and the foundation of any internal control system. A sound corporate (and risk) culture enhances the effectiveness of risk-taking policies and the quality of decision-making, and thus influences firm performance.

Consequently, we agree that risk culture is also relevant from the supervisors' perspective, because they are in charge of monitoring behaviors of supervised entities and compliance with the rules.

Culture is established by leaders, whose behaviors set the tone for the organization, and then is communicated and reinforced through various methods, ultimately shaping employee perceptions, behaviors and understanding. Cultural traits of the leaders (board members and key function holders) are somehow represented in their knowledge and background, honesty, reputation and independence of mind, i.e. all those profiles which are already covered by the current fit and proper assessment scheme.

At the same time, corporate culture is a product of social dynamics and cannot be traced back solely to individual personality traits. Moreover, culture is a soft area and it requires an organizational analysis of soft variables: these are very different from traditional forms of financial supervision (self-assessment, interviews, attendance at meetings, climate, and employee satisfaction analysis, etc.).

- 212) What do you consider would be the benefits of, and/or difficulties encountered in, including the ability to create and promote the organisation's desired culture as part of the "fit and proper" assessment of members of the management body?

Risk culture shall be a part of a business and not simply of the supervision, which is not necessarily a good proxy. Therefore, it concerns decisions and actions on a daily basis, such as the way information is shared, the people being asked, when something went wrong, the capacity to represent risk inside the organization and the understanding and correct use of documents.

Therefore, it is essential that authorities maintain a certain distance from banks' strategic and policy choices in order to accompany the growth and consolidation of a risk culture, tailored to individual business models and corporate characteristics. In other words, the culture cannot (only) be a matter of compliance with regulatory requirements, especially if these are particularly invasive. A "regulatory risk culture" could prove to be ineffective over time in supporting a sound and prudent management of financial institutions, because it is not sufficiently internalized and therefore not very persistent. It would only create a cultural mainstream in several banks, fed by the influence of regulation, and prompt conduct and behavior in line with the supervisors'

expectations, which does not necessarily result virtuous from the standpoint of the financial system as a whole (for example, in the case of a common reaction to external events, which might amplify procyclicality and systemic risk).

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**Nedcommunity** is the Italian Association of non-executive and independent directors.

Founded in 2004 it has more than 700 associates, most of which are directors or members of the board of statutory auditors of listed companies or large non listed companies.

It is the official member for Italy of ecoDa, the European Confederation of Directors Associations.

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