

Draft Guidelines for Assessing the Suitability of Members of the Management Body and Key Function Holders of a Credit Institution

Consultation Paper of the European Banking Authority

Reply of the European Federation of Financial Services Users (EuroFinuse)

18 July 2012

The European Federation of Financial Services Users (“EuroFinuse”) (formerly European Federation of Investors, in short EuroInvestors) counts more than fifty national and international member and sub-member organizations. In turn those count about four million individual members. EuroFinuse acts as an independent financial expertise center to the direct benefit of the European financial services users (shareholders, other investors, savers, pension fund participants, life insurance policy holders, borrowers, etc.) and other stakeholders of the European financial services who are independent from the financial industry.

EuroFinuse has experts participating in the Securities & Markets, the Banking and the Pensions Stakeholder Groups of the European Supervisory Authorities, and the EC Financial Services User Group. Its national members also participate in the national financial regulators and supervisors bodies when allowed. For further details please see our website: www.eurofinuse.org.

ID number in Transparency Register: 24633926420-79

The European Federation of Financial Services Users

76, rue du Lombard, 1000 Bruxelles - Belgium
Tel. (32) 2 514 37 77 - Fax. (32) 2 514 36 66
e-mail: info@eurofinuse.org - <http://www.eurofinuse.org>

Executive Summary

Introduction and executive summary

The European Federation of Financial Services Users (EuroFinuse) welcomes this Consultation from the European Banking Federation as we believe that the appropriate selection of the members of management boards as one of the key principles of corporate governance. More explicitly, we believe that this issue has big implications not only for shareholders and clients, but also for taxpayers and citizens (who had to bail out credit institutions whose troubles were in most cases directly linked to an bad governance of its management boards) as well as for the stability of the European financial system.

When speaking about problems regarding suitability of the management board of European credit institutions, we should refer in particular to the paradigmatic case of Spain, which since the beginning of the financial crisis has experienced a true turmoil in its financial sector. The management of several Spanish savings banks, with inappropriate portfolio diversification and high exposures to sub-prime real estate mortgages, resulted in extremely burdensome public bailouts and foreclosures. This case has proved that there is indeed a problem of suitability of credit institutions' top managers deeply affecting listed and non-listed credit institutions.

In our opinion, the active involvement of shareholders proves to be the best solution for corporate governance-related problems. The most appropriate solution is to promote measures that empower shareholders to effectively supervise and judge the suitability of management board members. At the same time, EuroFinuse believes this is the fairest solution from the equity point of view, as shareholders (and equivalent equity holders for savings banks) are the party whose interests are most damaged by the unsuitability of members of the management board.

Euroshareholders (founding member of EuroFinuse) has been actively working on shareholders' engagement to improve these important questions related to corporate governance, as shown by the publication of its *Euroshareholders Corporate Governance Guidelines* from 2000 followed by the numerous responses to Position Calls related to corporate governance issues from the European Commission and other EU institutions throughout the following years until now We also believe that the Shareholders' Rights Directive from 2007 did not significantly contribute to certain issues related to shareholder engagement such as cross-border voting that could contribute to improve the suitability of the members of the management board.

These are the main reasons why EuroFinuse and Euroshareholders created the EuroVote web-based service facilitating the exercise of voting rights cross-border by offering individual investors an easy, trustworthy and free of charge proxy process as well as testing the implementation of the 2007 Shareholder Rights Directive.¹

Besides these crucial requests, we would like to answer specifically to the following questions raised by the EBA:

Question 1:

While the principle of proportionality is a general principle within European legislation, it may be desirable to spell out this principle in more detail for the application of the Guidelines. Which criteria could be applied by institutions and competent authorities to differentiate the assessment process and the assessment criteria regarding the nature, scale and complexity of the business of the credit institution and how should such a differentiation look like?

EuroFinuse believes that every credit institution should face high requirements regarding their management boards' qualification, as even for small sized credit institutions bad governance can cause extremely high risks and losses not only for shareholders but also for taxpayers (public bailouts). This is why we believe the size of the credit institution (in terms of assets, turnover, etc.) should not be the criteria for differentiating requirements for credit institutions' management boards.

At the same time, we are aware that in general banking business involves a number of different activities of a widespread nature. This is why despite the EU given definition of credit institutions in the Directive 2006/48/EC - an undertaking whose business is to receive deposits and grant loans - credit institutions are involved in more complex activities, generally classified as investment banking. Currently, only a few certain small institutions, such as credit unions and credit cooperatives, stay out of the investment banking business.

¹ For more information, visit <http://www.euroshareholders.eu/eurovote>

In order to not endanger this beneficial market diversity (coexistence of big and small, for profit and non-profit actors), and establish too burdensome requirements for some of such credit institutions, we believe in establishing a high degree of requirements that would however allow for the exemption of the aforementioned institutions that fit into the strict definition of *credit institution*. Any measures that promote the separation and differentiation of commercial banking and investment banking would be welcomed by our organization, which previously advocated this strategy in [our response to the European Commission Consultation on Changes to the Capital Requirements Directive](#)².

In conclusion, there should only be two well-differentiated regimes: a simplified one for credit institutions strictly matching the definition (that only accept deposits and supply credit) and another regime with more demanding requirements for those credit institutions involved in investment banking and/or other non-commercial banking activities.

We would also like to add that ex officio enquiries should not be considered the only way for institutions and competent authorities to intervene in the event of inappropriate qualifications or skills of the management board. Institutions and competent authorities should establish channels to receive complaints on lack of qualification of the management board by shareholders and financial services users to start any necessary investigations. To this extent, the associations that represent the interests of shareholders and financial services' users interests should be considered a preferential interlocutor in order to assure the non-discrimination of individual investors and retail consumers.

Question 2:

Should competent authorities be required by the Guidelines to assess the policies of institutions for assessing the suitability of key function holders aiming to ensure that institutions have appropriate policies in place ensuring that key function holders would fulfil the suitability requirements?

EuroFinuse believes that the final Guidelines should allow competent authorities to request the request the establishment of policies for credit institutions' suitability assessment because without a credible threat no changes are likely to happen. Soft regulation (such self-regulation and corporate social responsibility) has certain limitations from which a public intervention is more efficient as private actors are unlikely to respond.

²<http://eurofinuse.org/upload/positions/EFI%20response%20CRD%20consult%202010%2004161283856542.pdf>

Assessment by competent authorities is not easy due to the aforementioned inadequacy of one-size-fits-all criteria. Then, shareholders would approve this suitability assessment policy before any new board member can be proposed and elected. After the decision of the General Assembly on the policy, the board should apply the policy and annually report back to the GA on how they implement it. By every proposed board member the board should inform the GA on how the candidate scores on the requirements mentioned in the suitability policy. We definitely believe in the key influence that shareholders should have in the assessment of the suitability of credit institutions' board members.

EuroFinuse would like to underline that transparency is key to increase shareholder engagement in corporate governance of companies. All the relevant information about the management board's curricula and skills should be publically disclosed to shareholders. Shareholders would automatically reward or punish better and worse corporate governance practices.

To conclude, we would like to refer to the Article 7.1 f) of the Draft Guidelines, on the obligation for credit institutions to publish the requirements for the positions whose candidates are to be elected by the shareholders before they choose a candidate. We are convinced of such requirements should not only be disclosed for positions whose candidates are to be elected by shareholders, but for all management board positions. Shareholders should be allowed to raise questions on the curricula of management board members at General Assemblies. We are convinced that an active involvement of the shareholder associations in the GAs would ensure that the voice of shareholders is more loudly heard and that this "sword of Damocles" mechanism works effectively.