



Board composition & Board functioning

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EBA proportionality workshop

Session 3.2. Governance

London, 3 July 2015



Issues for discussion

1. Governance models
2. Board composition
3. Board functioning
4. Board committees
5. Board assessment



1. Governance models (1/4)

- ❖ Governance arrangements are a key factor in the CRD & EBA guidelines
 - CRD 2006/48/EC: credit institutions & investment firms need *robust governance arrangements*
 - EBA 2011 GL 44 (IG): more attention needed for *checks & balances in group structures* and for *composition of management body & board committees*
 - CRDIV 2013: institutions shall have robust governance arrangements, including *clear organisational structures* with well-defined, transparent and *consistent lines of responsibility*
- ❖ However the governance practices across the EU are quite diverse
 - With models *ranging between 1- & 2-tier boards*, and many shades in between
 - With great diversity in *group structures*
 - And huge differences in *shareholder models*
 - Hence, great differences in board composition and board functioning



1. Governance models (2/4)

- ❖ But Recital 55 of CRDIV clearly states that the requirements apply to all existing structures without advocating any particular structure
 - Hence the importance of an ‘effective and targeted’ approach, pragmatism, and *proportionality*
 - Danger of an unequal playing field as to the definition of ‘significant’ institutions?
 - Why not opting for a *comply or explain* approach as the better alternative with approval & monitoring by the competent supervisory authority?
 - While correctly focusing on internal governance (beyond corporate governance)
 - Governance arrangements should be proportionate (organisation structure, lines of delegation...)



1. Governance models (3/4)

- EBA Guidelines & CRDIV refer to ‘the management body’ as the subject of attention
 - Aim is to find a common ground of guidelines for all types of governance/board models (1-tier/2-tier)
 - Focus on those that ‘effectively direct’ the organisation (Recital 55 CRDIV)
 - Making the distinction between their managing function and their supervisory function (GL 44; CRDIV)



1. Governance models (4/4)

- However, management and governance are quite different responsibilities
 - Importance that EBA guidance brings more nuances in this respect
 - Governance = to direct (decide on the direction) and control (supervise), excluding operational issues and daily management; governance is more than supervision, even in a 2-tier model!
 - Manage = to prepare & develop options for direction as well as to execute decisions taken, including daily management; is different from deciding on ‘direction’ even in 2-tier
 - This distinction is valid throughout simple as well as complex groups, however (complex) groups will have several layers of ‘internal’ and ‘corporate’ governance
 - Parent company managers may well be non-executive directors in subsidiary group boards
 - Also important to distinguish between executive and non- executive directors
 - non-executive’ directors = members of the top tier in a 2-tier board and those members of the 1-tier board that do not hold an executive position in that firm
 - ‘executive’ directors = top executives that are members of the 1-tier board; members of the second tier in a 2-tier board



2. Board composition (1/4)

A. General governance recommendations (CRDIV):

- ❖ Collective suitability
 - Adequate and collective knowledge, skills and experience
 - Collectively a full understanding of the business and its risks
- ❖ Appropriate mix
 - A real challenge = How to combine a mix of capacities with diversity and independence (while not ignoring eventually shareholder representation) within the limits of effective board dynamics
 - Specific attention for gender diversity
- ❖ Individual director
 - Qualified and remaining so (see point B)
 - Adequate resources for the induction and training of directors (disclosure?)
 - Personal qualities of professionalism, good reputation and integrity



2. Board composition (2/4)

B. Fit & Proper assessment (art 91)

- ❖ 2 main checks
 - FIT = Sufficient knowledge, skills and (recent and relevant) experience & understanding of the business and its risks
 - PROPER = Of good repute (no opposite info), personal and business conduct (no factors that may cause doubt)
- ❖ Policy on selection, monitoring and succession
 - Importance of the fit between the individual profile and the collective suitability
 - Suggestion: to create a tailored competence matrix
 - Assessment by competent authorities (& interviews)



2. Board composition (3/4)

C. Proportionality issues

- ❖ Sufficient experience, knowledge and skills in line with the duties to perform
 - Competence matrix in line with the specifics of the business lines, the complexity of group structures, the international exposure, the main risks, ...
(much more than size!)
 - Important to further distinguish in assessment approach for
 - Executive directors versus non-executives
 - Chairman versus member of board and/or board committees
 - First nomination versus re-nomination
 - Shareholding model might well have an important impact as well!

- ❖ Why should there be any attention for proportionality reflections as to ‘honesty, integrity and independence of mind’???



2. Board composition (4/4)

- ❖ Limitation of number of board mandates is a rather rough proxy for “sufficient time” and needs more proportionality reflections
 - Be careful of unequal playing field
 - Complex group responsibilities = 1 mandate >< different small board functions = different mandates!
 - A board chair takes at least the double of a normal board mandate >< no differentiation
 - Committee memberships: not included
 - Is there an alternative solution? Ex-post assessment?
- ❖ Combination of the chairmanship of the (1-tier) board and CEO could be justified/authorised (art 88) ???
- ❖ Very relevant to look into the internal governance at subsidiaries (with sufficient attention for independent directors; see GL 44)



3. Board functioning (1/4)

A. Governance recommendations

- ❖ Board role
 - A good overview in the EBA documents and CRDIV
 - Interesting distinction made (recital 57 CRDIV) between the role of the board and the role of the Non-Executive Directors
 - Impact of board committees on functioning and role of the main board needs special attention



3. Board functioning (2/4)

A. Governance recommendations

❖ Board functioning

- Group dynamics (!)
 - Active engagement of directors
 - Objective & critical judgements
 - » Independence of mind >< *independence criteria* (e.g. EBA consultation 2012)?
- Sufficient time involvement
 - Explicit information in the appointment letter
 - Limitations on board mandates
 - Attendance records (& *attendance pay?*)
 - *Ex post assessment?*



3. Board functioning (3/4)

- Attention for conflicts of interest
 - Special attention to intra-group relations!
- Make sufficient resources available for the board
 - A plea for a more general approach than the specific demand for nomination committee (receiving appropriate funding)
 - ! be attentive for funding independence vis-à-vis the ones they have to supervise



3. Board functioning (4/4)

B. Proportionality issues

- ❖ Need for a tailored approach, beyond the (extreme) distinction of 1-tier and 2-tier boards (many shades of grey, certainly within a larger international group context and different shareholder models)
- ❖ Work load of the board is a key indicator
 - Largely depends on the complexity of the business, the health situation of the institution (crisis situations, financial distress, profitability issues versus going concern) and a steady state versus aggressive growth/expansion path
 - Organisational complexity needs to be covered by sufficient additional internal governance arrangements beyond the parent board level
 - Important to make sure that subsidiary boards (if relevant within in group context/local context) are more than paper boards (GL 44)!
 - Work load depends far less on the 'size'
- ❖ Calibrating attention for risk management and internal control (framework, specific functions...)



4. Board committees (1/2)

A. General governance recommendations

- ❖ Composition requirements for board committees are key for defining the optimal mix at board level
 - Question on rotation >< specialist knowledge?
- ❖ Board committees do not decide, they prepare and advice the full board who remains responsible
 - Hence the importance of good communication lines and reporting back



4. Board committees (2/2)

B. Proportionality issues

- ❖ Combining audit & risk committee (art 76)
 - Finding the right balance between backward looking and forward looking risk perspective

- ❖ Obligation for a remuneration (art 95) and a nomination committee (art 88) only for significant institutions
 - If no obligation, make such responsibilities are integrally part of the board's responsibilities
 - Why not foresee to have at least a combined committee for remuneration and nomination issues?



5. Board Assessment (1/2)

A. General governance recommendations

- ❖ Critical assessment of individual directors
 - Before nomination (individual vs collective profile)
 - Annual assessment of the knowledge, skills and experience (see Nomco)
 - No automatic re-nomination/re-appointment (profile update & assessment)

- ❖ Periodic board assessment
 - Structures/collective suitability: annual assessment of the composition and performance of the board (see Nomco)
 - Quid group dynamics?
 - Prevent group think through diversity
 - Make sure the decision-making in the board is not dominated by one individual or a small group of individuals (in a manner that is detrimental to the interests of the institution as a whole) => see art 88 CRDIV (definition of nomination committee responsibilities)
 - Independence of mind check?

- ❖ Board committees
 - Composition and functioning of the committees
 - Collaboration between the board and its committees



5. Board Assessment (2/2)

B. Proportionality issues

- ❖ 'Input' factors are important for board effectiveness, but even more important are board dynamics, director behaviour & attitude
 - In contrast to structural factors where proportionality needs further reflection, board dynamics (and its drivers) need attention in all circumstances
- ❖ If there is no nomination committee make the assessment responsibilities (as defined in art 88 of CRDIV) explicitly the responsibility of the board (or if present, the remuneration committee)
- ❖ Danger of overshooting and box ticking with detailed annual assessments
 - Why not opt for a mix of annual (internal) updates (changes, points of attention) and periodic (externally supported/independent) in-depth assessment exercises?



For more information

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