

EBA Workshop

**“The application of the principle of proportionality in
the context of Institutional and Regulatory Reforms”**

July 3, 2015

GOVERNANCE

TRAINING NEEDS OF THE MANAGEMENT BODIES

**Germán López Espinosa
Master in Banking and Financial Regulation
Universidad de Navarra**

General Principle

Article 5(4) of Treaty on European Union:

Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.

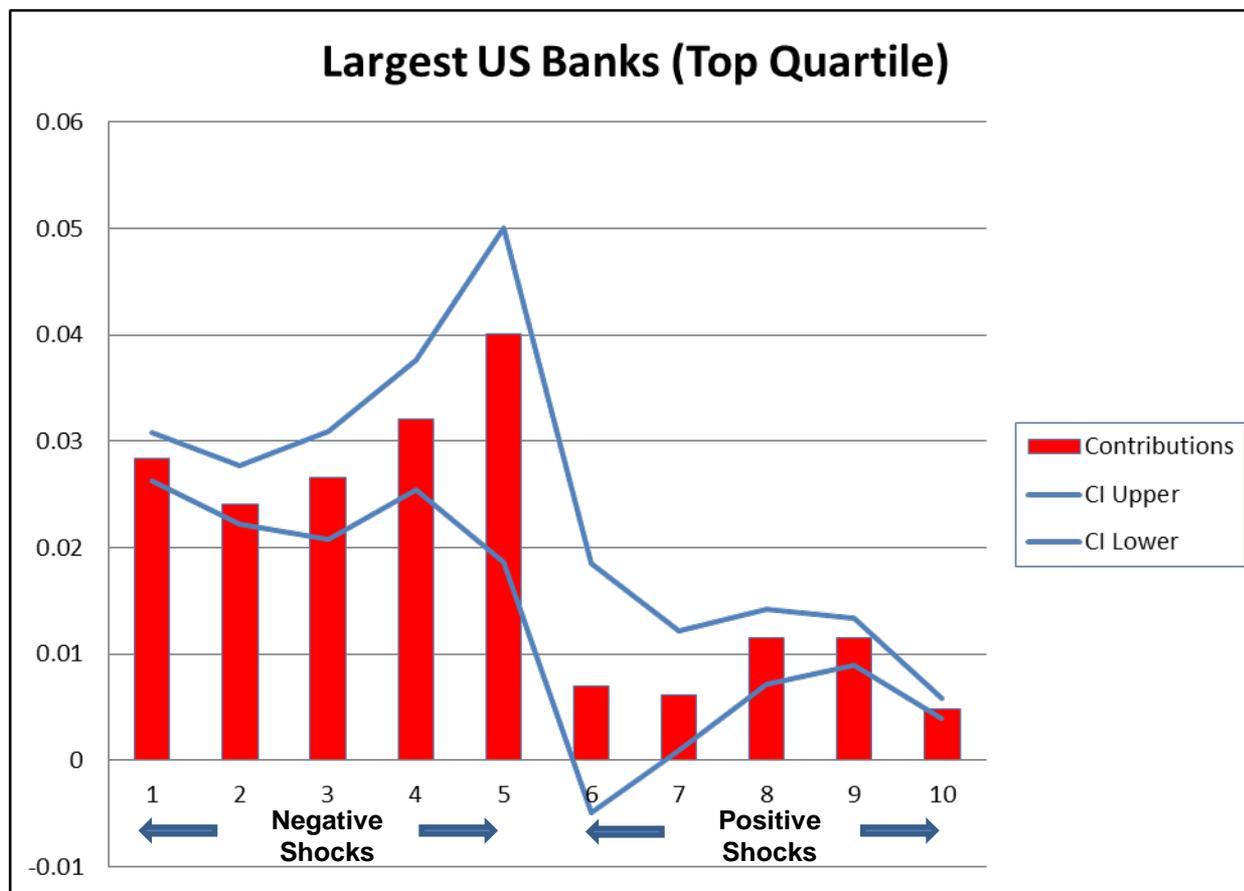
Proportionality provisions in CRD IV:

Art. 74:

*2. The arrangements, processes and mechanisms referred to in paragraph 1 shall be comprehensive and **proportionate to the nature, scale and complexity of the risks inherent in the business model and the institution's activities**. The technical criteria established in Articles 76 to 95 shall be taken into account.*

EBA Guidelines on Internal Governance (GL 44) – The EBA’s response:

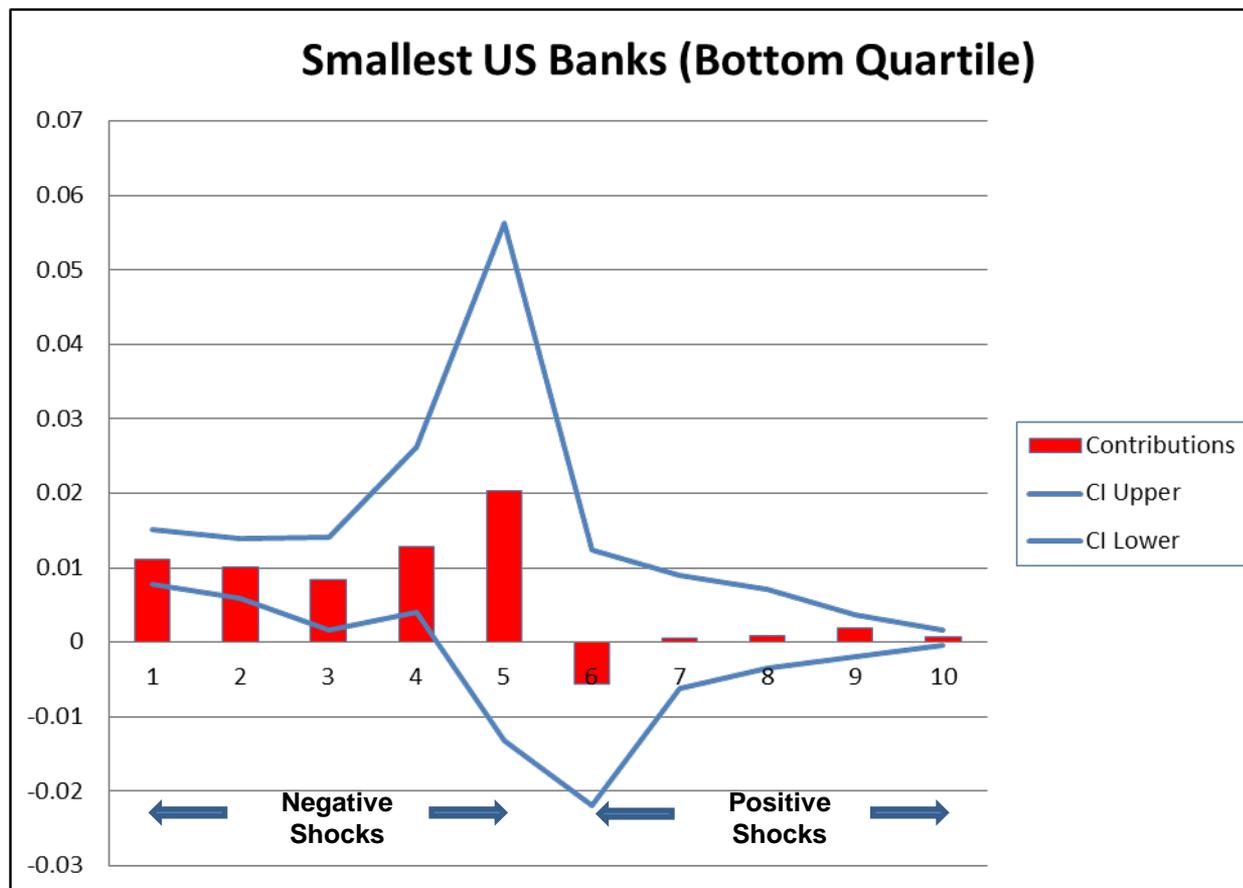
*The required qualifications of members of management bodies and their training needs differ, as the required knowledge and experience profiles differ depending on the size and complexity of the institutions concerned and their business activities. The principle of **proportionality applies**. The definition of a required knowledge profile and setting up appropriate training programmes is the responsibility of the institutes. Besides “knowledge”, other criteria also apply.*



Asymmetric
CoVaR
methodology

- Any negative shock in large banks contributes significantly to systemic risk → Highest levels of training, supervisory reporting... (proportionality).
- Management body should know all the negative spillover effects.

The European Central Bank reports time-varying estimates of systemic risk in the Eurozone computed according to the symmetric CoVaR: <http://sdw.ecb.europa.eu/browseSelection.do?node=bbn3357>



Asymmetric
CoVaR
methodology

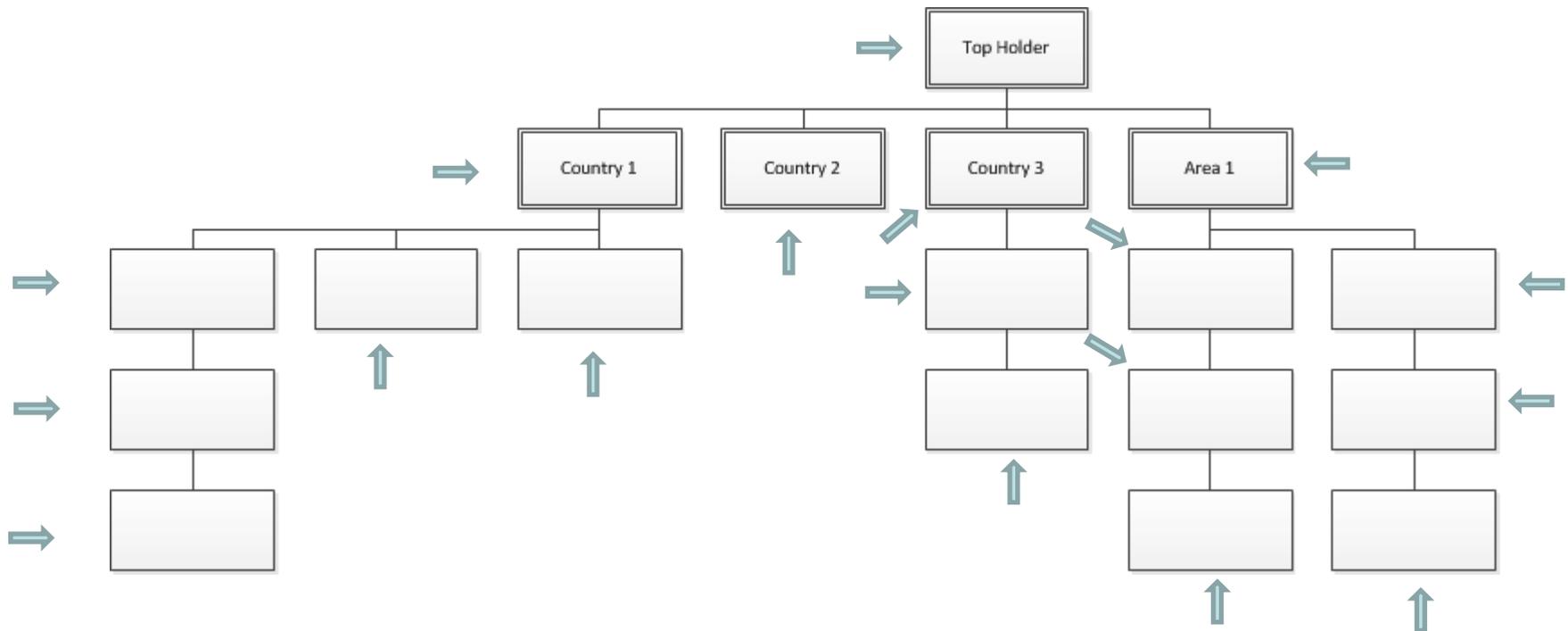
- Only large negative shocks in small banks contribute to systemic risk (lower magnitude) → lowest level of training, supervisory reporting... (proportionality).

The European Central Bank reports time-varying estimates of systemic risk in the Eurozone computed according to the symmetric CoVaR: <http://sdw.ecb.europa.eu/browseSelection.do?node=bbn3357>

Proportionality and Training

Proportionality and Training in Banking Groups

- The nature, scale and complexity should be evaluated case by case and should be consistent with the general assessment criteria (paragraph 5.1 Guidelines on the assessment of the suitability of members of the management body and key function holders).



- Art. 91. Management body (CRD IV):

“10. Member States or competent authorities shall require institutions and their respective nomination committees to engage a broad set of qualities and competences when recruiting members to the management body and for that purpose to put in place a policy promoting diversity on the management body.”

(60) The lack of monitoring by management bodies of management decisions is partly due to the phenomenon of 'groupthink'. This phenomenon is, inter alia, caused by a lack of diversity in the composition of management bodies. To facilitate independent opinions and critical challenge, management bodies of institutions should therefore be sufficiently diverse as regards age, gender, geographical provenance and educational and professional background to present a variety of views and experiences.

→ Diversity could create situations where decisions are driven by few board members depending on their experience (educational and practical aspects) relative to the others → Training is very relevant in order to increase the independence of mind, given a certain level of diversity.

- The training of independent members of 1-tier board structure should be similar to the training of management body in its supervisory function of 2-tier board structure (p. 14.6 EBA/GL/2012/06 and (57) CRD IV) :

- ✓ Strategy - Business Model.
- ✓ Risk exposures.
- ✓ Interaction between Business and Risks.
- ✓ Financial information accuracy.
- ✓ Remuneration Policy.



Supervisory benchmarking.

- Skills:
 - ✓ Judgement on risks.
 - ✓ Independence of mind.
 - ✓ Ability and willingness to engage in continuous learning.

Taking into account the assessment of the experience, a member of the management body may not require all of the topics covered in the global training.

Relevant aspects:

- Business Model (Strategy).
- Risk Appetite Framework.
- Contingency.
- Business continuity.
- Recovery plan.
- Resolution planning (barriers, strategy...).

This type of training will usually be developed internally.

Other training (**relevant aspects**) could be developed externally, for example:

- Ethics.
- New institutional, regulatory and supervisory framework.
- Risks (credit, liquidity, market, interest rate, exchange rate, reputational, cyber...)
- Business Model and risk.
- Basel III (Pillar I, II and III).
- MREL/TLAC.
- Remuneration policy.
- Anti-Money Laundering.

- Induction → To cover any gaps in the knowledge profile of the new member.
- When his/her experience is not related to the Banking industry:
 - Particular characteristics of the banking industry must be covered. One example: The asymmetric pattern of the banking industry (comovements are generally expected to be larger during downside periods).

In addition to general considerations applied to other sectors:

- ❖ Banks engage in key intermediation functions, which create potential channels of stress: a credit channel, a funding channel, a liquidity channel, and a collateral channel through which stress can be transmitted to a bank.
- ❖ Banks are highly connected through the wholesale interbank market.
- ❖ An idiosyncratic shock that reduces the value of assets held by a single bank may initiate a spiral of mark-to-market financial losses in the remaining banks.
- ❖ A large negative shock affecting a single bank or a part of the financial system may reduce the confidence of investors in the whole system, leading depositors and lending counterparties to withdraw their holdings from sound institutions and across unrelated asset classes and precipitating widespread insolvency.

- Ongoing → To cover new knowledge gaps generated by:
 - ✓ Updates (recovery, resolution, capital requirements, business model, strategy, RAF...).
 - ✓ Changes in financial regulation.
 - ✓ Changes in the economic and financial situation.
 - ✓ Changes in the outlook of risks and vulnerabilities.
 - ✓ Changes in remuneration policy.
 - ✓ Changes in supervision requirements.

The training is a powerful tool

Concluding remarks:

- Proportionality should also be applied within banking groups.
- Board members of larger banks should receive more training. Proportionality applies.
- The training is a mitigating measure. It could reduce the probability of failure and the cost associated with failure.
- The training for independent/supervisory board members could be different.
- Induction/Ongoing → Covering any knowledge gaps.