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ECODA RESPONSE
TO CONSULTATION PAPER EBA

DRAFT GUIDELINES ON INTERNAL GOVERNANCE

General remarks

ecoDa would like to congratulate the EBA for a very thorough analysis of the internal governance challenges financial institutions are faced with today and for developing a useful reference framework for developing and evaluating governance structures, processes and policies. Quite some recommendations and guidance elements are relevant beyond the financial sector (see detailed reflections below).
However ecoDa also would like to make 2 explicit demands as to the further valorisation of this guidance:

- Please be aware that such detailed guidance & recommendations cannot have the same status as regular regulations and directives, because these are not based on the same scrutiny and thorough discussions within and between the European Commission, the European Parliament and the European Council (for more details, see responses to the questions below). ecoDa would appreciate if this could be explicitly mentioned in the Guidelines.
- As the guidance is directed towards supervisors, it is normal that the focus in developing internal governance (and suitability assessment) is placed on monitoring and control. However ecoDa would like to explicitly stress the fact that in order to create a sustainable financial institution, there should additionally be an extra emphasis on strategy and leadership as key priorities for governing bodies. The danger might be real that by interpreting this important EBA guidance on internal governance as the reference framework for judging governance quality and governance effectiveness of financial institutions, we are not giving the fundamental roles on strategy and leadership the full attention they deserve.

Q1: Are the guidelines regarding the subject matter, scope, definitions and implementation appropriate and sufficiently clear?

Q2: 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. As a general remark, ecoDa would like to suggest that the EBA clearly outlines **the meaning of the term 'internal governance'**. This term is often used to define governance of subsidiaries, but can

also refer to governance beyond the corporate board level, certainly of relevance for large multinational groups[1]. The difference with 'external' governance, a term that is seldom used in governance literature, might well be that the relationships with shareholders and other stakeholders (one of the key focuses of corporate governance) are not considered in the guidelines of the EBA.

2. The most important general remark ecoDa wants to make is to suggest to carefully **reflect on the division between the management and the supervisory function as well as on the definition of the respective responsibilities of executives and non-executives**.
   It is to be applauded that the EBA guidelines are developed for all types of board structure, 1-tier or 2-tier. However the reality is much more nuanced than this dichotomy: in practice many intermediate formats exist and also the same term, e.g. Chair or CEO may cover a quite diverse governance context and content. Whatever the board format might be, the EBA refers in the guidelines on internal governance to the central governance body as the 'management board' (a terminology that we already critiqued in our previous position paper (in July 2012). The guidelines make a distinction between the management board, in its supervisory function, respectively in its management function. From the guidelines (point 17 p15), it becomes clear that the 'supervisory function' is seen as the responsibility of the non-executive directors, whereas the management function is defined as the responsibility of executive members. This is a simplification of European governance practices that might be acceptable in some 2-tier models, but is certainly not correct for 1-tier models. Although also in a 1-tier model the alignment between supervisory function and non-executive directors is correct, it is **not correct to define the management function as the sole responsibility of executive directors**. In such models the non-executive directors not only play a supervisory role, they also have a prominent role in setting the direction (strategy, general policy) and deciding on the leadership of the firm.
   To this end, ecoDa would like to point to the following more detailed remarks:
   - The specific responsibilities of the supervisory function, as defined in point 33 on p 19 are: overseeing and challenging management and providing appropriate advice; this oversight role includes reviewing the performance of the management function, its decision-making and the achievement of objectives, and ensuring the integrity of financial information as well as sound and effective risk management and internal controls. This definition is clearly in line with all types of European board models. The problem is more in the definition of the management function (see next point).
   - The specific responsibilities of the management function: In point 19 on p8 and in point 33 on p.19 it is stated that the management function sets the direction for the institution and is responsible for the day-to-day running of the institution. This definition can be in line with the 'management' tasks of the lower tier of the 2-tier model (the so-called management board/Vorstand). However in a 1-tier model this function is split in a tailored way (according to the delegation from the board) over the board (with majority non-executive directors) and over the management (committee, directors or not). Whatever

[1] For more information see e.g. Lutgart Van den Berghe; 'Internal Governance', GUBERNA Governance Insights, Intersentia, 2015.

the delegation level might be, it is not management that decides on setting the direction[2]: this is the duty of the 'board' (majority non-executive directors), whereas the day-to-day running of the institution is clearly the duty of the 'management' (function/committee).

- Although it is understandable that the EBA-guidance for the supervision of financial institutions is extensively focused on internal governance from an internal control and risk management perspective, one may not forget the important role boards have to play in developing the organisation and its strategy. Limiting the role of non-executives to the description of the supervisory function as defined in points 23-24 (p17) clearly ignores the important strategic role non-executives are playing in a 1-tier model.
- Since the central internal governance concept of 'management board' encompasses all management functions, this further complicates the understanding of who is responsible for what. In point 10 on p.12 it is therefore explicitly mentioned that any reference to the members of the management body should be understood to also apply to the CEO, even if he or she is not a formal member of that board.
- Point 9 on p 12 should be further clarified: 'In Member States where the national legislation does not distinguish between the management and the supervisory function of the management body, references to the supervisory function should be understood as applying to the management body which is responsible for that function according to the national law. What does this mean?

Hopefully, the guidelines of the EBA can be **translated in each jurisdiction to adapt the wording of the guidance to the specific national legal and governance context**. This would combine the best of both worlds: having a European guidance that is applicable to all governance models with a national interpretation per Member States that is clearly adapted to the local prescriptions and governance practices. However special attention will have to be given to this translation in the many different Member States, not only from a language perspective, but also from the wide diversity in board contexts around Europe.

3. In the Executive Summary reference is made to the fact that the increased attention for governance recently has increasingly been focused on conduct-related shortcomings and activities in financial offshore centres. ecoDa wants to stress the fact that more generally, all organisations need to devote sufficient, if not **increasing attention to conduct and behaviour**. The stress of governance codes and recommendations on governance structures and procedures needs indeed to be complemented with more attention for governance attitude and behaviour. In the same line, the background paper correctly points to the **importance of professional decision-making as a key ingredient of good corporate governance**.

4. ecoDa applauds that the EBA is **giving further strength to the use of the comply-or-explain approach in governance matters** by allowing the competent bank supervisory authorities to notify the EBA as to whether they comply or give the reasons for non-compliance. However there is also a negative aspect to the proposal to use the comply-or-explain approach: ecoDa would like to express a concern, namely that these guidelines increasingly receive the status of rules, notwithstanding the fact that they are **not based on the regular political process of democratic**

[2] As a clear proof of this statement, please refer to the Belgian law on the 'executive committee', that states that -even in this most far-reaching delegation to management-, the 1-tier board cannot delegate its responsibility to set the strategy and the general direction.

law-making. This is not only the case for these EBA guidelines but is also relevant in respect to the guidance developed for reporting on non-financial reporting, etc.

Q3: Are the guidelines in Title I regarding the role of the management body appropriate and sufficiently clear?

5. In describing the role of the board, EBA is correctly pointing to the importance of **constructive dissent** (point 32). However, the question remains how to judge the quality of board discussions and decision-making: this is a tricky issue (certainly for outsiders!). To this end it might be relevant to point to the importance of (externally-supported) board evaluations[3]. Board effectiveness is a key challenge for boards, a challenge that goes far beyond judging structural elements such as board composition and the definitions of roles and responsibilities. A key driver lies in board dynamics, where independence (of mind) and professionalism play a crucial role.
6. As to the **role of the board in HR matters**, the duties go beyond the remuneration policies and their application for the members of the governance/management body and top management. The board also has a role to play in approving the broader picture of human resources policies and their execution.

7. In the general references to the board committees, **a more complete set of committee references might be advisable** in the sense that in numerous parts of the guidelines reference to the audit and the remuneration committee is missing (this is the case in the points 34 & 35, 36, p20; 46 on p22).

8. It is applauded that the guidelines plead for a **good interaction** between the respective board committees. However the proposal in point 49 to develop **'mixed' members** that sit on both/different committees has its limitations, not only with respect to specific expertise per committee, but also because of the legal and physical limitation of the number of board committees a board member can sit on. On the other hands, setting up a number of specialist board committees might put special pressure on **smaller boards**. So this point might need more 'proportionality' elements than it is the case in the actual guidance.

Q4: Are the guidelines in Title II regarding the internal governance policy, risk culture and business conduct appropriate and sufficiently clear?

9. The EBA guidelines are especially welcomed because of the in-depth analysis of governance within a group context, with special attention for the group context, the risk culture, corporate values and codes of conduct, conflicts of interest, internal alert procedures and outsourcing policies. To this end these guidelines might be **inspirational for a more general reflection on 'internal governance'** from the perspective of a conglomerate or industrial group and all of its constituent companies and business units.

[3] On top of the attention paid to board evaluation in the guidelines on suitability assessment - see further.

10. The same holds for the inspiration Annex I could bring to further develop internal governance policies in non-financial institutions.

Q5: Are the guidelines in Title III regarding the principle of proportionality appropriate and sufficiently clear?

11. Nuancing the guidelines to take proportionality criteria into consideration is an effort worth applauding. The guidelines stipulate what criteria might be used as arguments for applying proportionality measures. However **it remains to be decided** whether the EBA leaves the individual institutions the freedom to use some of these general criteria for explaining why they do not fully comply with certain recommendations (in whole or partly) or whether EBA will demand that national supervisors fill in the blank spots and set more strict limits to each of the criteria of proportionality. This Title certainly deserves more discussion and in-depth reflection how to use these general guidelines in practice. Since these guidelines are to be considered as guide rather than as line/rule, ecoDa would prefer to leave sufficient flexibility at the level of the individual institutions.

Q6: Are the guidelines in Title IV regarding the internal control framework appropriate and sufficiently clear?

12. ecoDa appreciates the fact that the guidelines point to the need for developing a risk management framework that integrates the risk appetite, risk culture and risk management within a **holistic approach**. This is all the more valid in a widely dispersed conglomerate with a complex web of companies and locations all-over the world.

Q7: Are the guidelines in Title V regarding the transparency of the organisation of the institution appropriate and sufficiently clear?

13. The guidelines developed for the transparency could be **linked to the so-called governance report** that all listed companies are obliged to publish annually in their annual report. It would be worthwhile to align the two requirements for listed as well as unlisted financial institutions. Moreover the detailed guidance given in point 202 (p52) could also inspire non-financial listed companies to further develop their governance reporting.

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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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