Brussels, 27 January 2017

# EACB Answer to

# Consultation on EBA Guidelines on internal governance EBA/CP/2016/16

## 27.1.2017

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,050 locally operating banks and 58,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 210 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 79 million members and 749,000 employees and have a total average market share of about 20%.

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***Question 1:***

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

As a broader matter, the EACB has a concern whether the EBA has level 1 legislation based power to give further guidance and regulations on, inter alia, the composition of the specialized committees (including recommendations on independent members.

The independence criteria regarding the members of the management body should not be introduced in these guidelines and be left to national laws or regulations. CRD IV does not contain a requirement on independent members of the committees. Thus, the draft guidelines go beyond the level 1 legislation on this matter.

We find that, for example, Article 74 of the CRD IV cannot be applied as a "catch all" clause in this extent. According to the Article 91 (12) of CRD IV, EBA is merely entitled to give detailed guidance on the specific aspects mentioned in that Article (time commitment, collective knowledge, skills and experience, reputation and independence of mind, induction and training and diversity).

Moreover, the definitions set forth in the Guidelines should fully comply with national corporate laws1 (please see recital 55 of CRD IV) and more generally, such recommendations should not lead to redrafting the level one legislation (CRD IV) and/or amending the national laws that have been recently adjusted to comply with CRD IV and create legal instability as a result of new requirements recommended (i.e. not provided for in the CRD IV for minimum harmonization giving the primacy to national company laws).

The text in 'Rationale and objective of the guidelines' (20.) briefly describes the "three lines of defence" based on quotes of Basel Committee on Banking Supervision's Guidelines 'Corporate governance principles for banks' but lacks the original context of the principles. We think the following text is confusing "further identifying, measuring, monitoring, and reporting risks". These activities are primarily to be executed by the first line itself and should be stated there. The following BCBS guidance is relevant: "The [risk management] function should promote the importance of senior management and business line managers in identifying and assessing risks critically rather than relying only on surveillance conducted by the risk management function." (see para. 41 of the abovementioned Basel Guidelines). Also "ensuring compliance" is primarily the task of the first line itself as provided in BCBS Guidelines on paragraph 93. The text should not only state 'monitoring' but should also only be specified to the compliance function not the RMF. In general the use of "ensure' in relation to the activities of the second line should be reviewed thoroughly to avoid misunderstandings.

[1] For example, the criteria related to personal, professional or economic relationships with the owners of qualifying holdings in the institutions with the institution's or any subsidiaries is not compatible with legal provisions governing the French savings banks (e.g. Article L.512-106 of the French Monetary and Financial Code).

## Definitions

***Key Function Holder***

The Guidelines should clarify what is the relationship between the terms "senior management" and "key function holder". EACB understands that they are overlapping to some degree, but that senior management would not comprise control functions, since the latter would not be seen as "executive".

***CEO***

The definition of "CEO" should rather underline the responsibility for the day-to-day management. On the other hand, the reference to the "steering of the overall business" should be deleted since it could be misunderstood as responsibility for the bank strategy, which is not allocated to the CEO in all banks.

***Senior management***

The definition of "senior management" in the CRD IV should also be referenced in the terminology of the Guidelines for reasons of clarity.

According to the Articles 3 and 1(9) of the CRD IV "senior management" means natural persons who exercise executive functions within an institution and who are responsible, and accountable to the management body, for the day-to-day management of the institution. The guidelines should either make a reference to CRD IV (the management body in its management function refers to or enclosed the senior management) or refer to national company law when it is not possible to distinguish between the senior management and the management body in its management function (recital 56 of CRD IV).For example regarding the one-tier system, clarifications should be added to reflect the overall direction function of the collegial management body in addition to its supervisory function and irrespective of the daily management function of the senior management.

***Chief Risk Officer***

The definition of Chief Risk Officer (CRO) is missing, and it should be included in the Guidelines.

***Conflict of Interest***

The definition of "conflict of interest" in the EBA Guidelines on Internal Governance (p. 14) focuses on the conflict between the duty of a person and private interests of an individual (which could improperly influence the performance of his or her duties and responsibilities). We appreciate this approach because in practice it is really necessary to distinguish between private interests of an individual and common interests of a group of stakeholders. For example representing a shareholder always requires to take into account the legitimate dividend interests of all shareholders. An employees' representative in a supervisory board needs to consider also the interests of the employees when questions of remuneration or concerning the restructuring of an entity (and consequent job reductions) are discussed. Members of the management body always have to pursue the benefit of the entity first but it is typical that at the same time they have to consider the interests of all shareholders, employees or other stakeholders. It would not be appropriate to require from shareholder representatives in the supervisory board to abstain from their voting right when decisions regarding the annual account and the possible dividends have to be made in the supervisory board. It is simply necessary to reconcile all these interests properly. Mitigating and managing conflicts of interests

therefore really as indicated in the definition is a question for conflicts with private interests of a person. The problem is that the draft Guidelines do not recognize this in paragraph 77 especially when relationships with owners of qualifying holdings are considered to possibly create conflicts of interests.

**Scope**

According to the proportionality principle, the entities which are not subject to CRD IV should only apply CRD IV rules on a consolidated basis and should not suffer from an excessive level of requirements. Otherwise, there would be overwhelmed with reporting and heavy formalities at the level of the management body and the subsidiaries would suffer from a severe competitive disadvantage (compared to non EU groups).

It is not entirely clear to what extent these guidelines should be applied to entities belonging to banking groups. EBA should clarify which entities within a group (from a prudential consolidation point of view) need to be fully compliant with these guidelines.

The content of the box on page 19 should be included in the introductory part of the guidelines as it is important to achieve a comprehensive understanding of the guidelines.

**Recognition of different governance structures**

Member states' national legislations provide different company law frameworks (such as unitary or dual board structures). Moreover, banks are organized in different forms of companies including cooperative entities. Cooperatives are a well-recognized form of business entities, as stated in the Statute for a European Cooperative Society (Reg. 1435/2003) and Art. 54 of the TFEU. of The Guidelines have to provide enough flexibility to the competent authorities so that they apply the provisions in the governance systems provided by national company law.

Due to the varieties of legal frameworks and governance models among the Member States, EACB suggests that the Guidelines should expressly state that they do not intend to give guidance on the allocation of tasks (such as competence on company strategy) between different legal and organizational bodies. It should rather underline that the governance structure should result in an efficient system of "checks and balances".

***Question 2:***

***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, in particular within paragraph 23, to either the management or supervisory function?***

***Strict compliance with the Guidelines could lead to circumstances where a supervised entity is required to reform its governance in a way that is unfamiliar with the structures common in its Member State and allowed in the national company legislation. The Guidelines should clearly provide that they do not advocate any particular governance structure nor interfere with the allocation of tasks of different governance bodies as governed by the national laws. Derogations from these guidelines with regard to proportionality aspects and national company law must be possible.***

## General remarks

Member states' national legislations provide different company law frameworks (such as unitary or dual board structures), including regarding cooperative entities. Cooperatives are a well-recognized form of business entities, as stated in the Statute for a European Cooperative Society (Reg. 1435/2003) and Art. 54 of the TFEU. The competent authorities should have a enough flexibility to apply the provisions of the Guidelines in the governance systems provided by national company law.

Due to the diversity of different business entities and governance structures it should be clarified that the guidelines do not advocate any particular governance model or structure. This would also be in line with the CRD recital 55 that states: Different governance structures are used across Member States. In most cases a unitary or a dual board structure is used. The definitions used in this Directive are intended to embrace all existing structures without advocating any particular structure. They are purely functional for the purpose of setting out rules aimed at a particular outcome irrespective of the national company law applicable to an institution in each Member State. The definitions should therefore not interfere with the general allocation of competences in accordance with national company law.

Furthermore, recital 56 of CRD IV states that "a management body should be understood to have executive and supervisory functions. The competence and structure of management bodies differ across Member States. In Member States where management bodies have a one-tier structure, a single board usually performs management and supervisory tasks. In Member States with a two-tier system, the supervisory function is performed by a separate supervisory board which has no executive functions and the executive function is performed by a separate management board which is responsible and accountable for the day-to-day management of the undertaking. Accordingly, separate tasks are assigned to the different entities within the management body."

EACB believes that the dichotomy between executive function and supervisory function within the management body, established by the CRD and maintained in these Guidelines, leads to an uncomplete picture and does not fit into national company laws of the Member States. In fact, it does not mention other central roles of statutory bodies, such as competence of deciding on company strategy and/or the overall direction (see recital 56 of the CRD IV regarding unitary board structure). These other roles are very important for the understanding of the specific governance system.

While in some jurisdictions the company strategy is more in the hand of the executive function and the supervision of its implementation in the hands of the supervisory function, the company law in other jurisdictions may stipulate that it is the supervisory function which has the decisive role regarding the credit institution's strategy. Other jurisdiction may even have a specific body to define and monitor the implementation of the company strategy and the overall direction of the institution. These differences are recognized also in the Basel Committee's Corporate Governance Principle for Banks (2015, see p. 6). Similar reflection should be included in the EBA Guidelines. In particular, the management body in its supervisory function should not be understood in all cases as mere monitoring and overseeing body.

Due to the different varieties of the governance models among the Member States, EACB suggests that the Guidelines should expressly state that it does not intend to give guidance on the allocation of tasks between different legal and organizational bodies to the extent that such approach would contradict CRD IV which fully recognizes different governance structures within

the EU which are governed by national company laws. It should rather underline that the governance structure should result in an efficient system of "checks and balances". This is also fully in line with the CRD IV, which clearly allocates in Article 3(1)(7) to the "management body" the power "to set the institution's strategy, objectives and overall direction", but then does not allocate it either to the executive or supervisory function (Article 3(1)(8),(9)).

Some Member States' corporate laws do not recognize the direct reporting line between the heads of internal control functions and the management body in its supervisory function. For example, in Germany, reporting of internal audit function can also be carried out via the executive board, provided that this does not cause significant delay in the information flow to the management board in its supervisory function. And the content of the reporting is identical. Therefore, paragraph 24(g) should be amended to better recognize such established structures in the member states' corporate laws.

EACB believes that with regard to the aforesaid the wording for the tasks of the management body in its supervisory function (para. 23 et. seq.) and the management body in its management function (para. 30 et. seq.) should be revised:

- The management body in its supervisory function, depending of the jurisdiction, may not only have to "oversee and monitor the strategic objectives", but also decide on the strategy (para. 24 e).
- Not in all jurisdictions the management body in its supervisory function is really in a position *"to ensure the integrity of the financial information and reporting, and internal control framework, including effective and sound risk management"* (para. 23). In many juridictions the proper organisation of the bank's business is in the hand of the management function and the supervisory function can only monitor and oversee whether such processes are properly implemented.

**Specific aspects**

We also believe that the wording of para. 23 et. seq. should be adjusted to better reflect Art. 91(7) CRD IV: "*The management body shall possess adequate **collective** knowledge, skills and experience to be able to understand the institution's activities, including the main risks*" (see in particular paragraphs 24(a),(d)).

It should be clarified that the requirement to establish a code of conduct (para. 19(j), see also para. 85) does not necessarily require to establish an own, institution-specific code. The declaration to adhere to a more general or sector code should be sufficient. Moreover, particularly in the case of very small, non-complex institutions with a low number of staff members, a code of conduct could complicate processes and procedures and impose an administrative burden without improving the risk situation. For this reason, the need to establish a code of conduct and its substance should be subject to proportionality aspects.

**Information to supervisory function**

We consider the delay for information from the management function to the supervisory function too undifferentiated: Generally information should be provided in the normal course of business without undue delay. Only information regarding material developments should be provided without delay.

## *Question 3:*

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

**Duties and responsibilities of the management body**

Regarding paragraph 19, EACB has the following specific remarks:

(b) Definition "measures to ensure that the management body devotes sufficient time to risk issues;" should be further elaborated.

(c) It should be clarified how an internal control framework can be 'independent'? The framework itself is owned by the business.

(i) The term "audit plan" should be clarified and further specified whether the internal audit or statutory auditor is required or not. It does not appear in paragraph 19 (i) but is included paragraph 24 (i).

(j) Whereas promoting good practices on ethical behavior is important for EACB members, EACB suggests that smaller institutions would be allowed to adopt sectoral, banking group-wide or similar codes of conduct as an alternative for establishing their own code of conduct. This would help the smaller institutions to comply with the good practices, but also to avoid administrative burden.

(k) There is an overlap in responsibilities between this text and 23 regarding "ensure the integrity of the financial information and reporting".

Regarding paragraph 20, the term "communications" should be defined. EACB assumes it means external and financial communications, such as in the context of investor relations and financial reporting.

**Supervisory function of the management body**

Paragraph 24d: EACB suggests that the text "proposals and information provided" should be aligned with paragraph 32 "propositions and information received."

Paragraphs 24 and 50a: The scope of "monitoring of effectiveness of internal control, risk management and internal audit" should be clarified if it is limited to financial reporting.

Paragraphs 24 and 50h (the scope of audit reports review): it should be specified which reports (statutory auditor or also internal audits) are meant in these paragraphs.

**Composition of the management body**

The Guidelines seem to be based on the presumption that that banks can influence the composition of the management body and its committees, that they have a say in who is appointed to both and that they could make a choice in terms of adequate knowledge, skills, experience and diversity. This presumption is not true, especially as regards cooperative banks. In the majority of cases the majority of the management body members (supervisory function) is elected by the banks' members (owners), which vote on the basis of the "one person – one vote principle". This strongly limits any possibility of pro-active control of the composition of the management body. This should be considered especially for the criteria under paragraphs 34-69.

**Role of specialized committees**

The draft guidelines develop of picture of the tasks and functions of the different committees of the supervisory function. In a two-tier structure this could lead to difficulties. We would like to reiterate our concern that the national legal frameworks should not be affected. For example, the tasks under 47 (a),(d) and (g) may differ depending the powers of the supervisory function regarding the company strategy in general.

**Specialized committees' decision-making power**

Paragraphs 34 and 36 provide that risk and nomination committees should advise the management board in its supervisory function in order to prepare its decisions. In some Member States the specialized committees have a mere advisory role, whereas in some other Member States, the management body has a power to delegate its decision-making power to its sub-committees. Such delegated power is often defined in more detail by the governance arrangements approved by the management bodies.

EACB suggests that these paragraphs should be amended in a way that the powers of specialized committees are not necessarily limited only to the preparation of the management body decision-making, but the Guidelines would clearly recognize that the specialized committees can have either a consultative role, or, under the applicable company law framework in certain jurisdictions, the ability to make final and binding decisions.

**Cross-participation in the specialized committees**

Paragraph 37 introduces a recommendation that the specialized committees should not be composed mostly of the same group of members which form another committee. EACB finds that EBA should not take categorical approach on this matter.

For instance, in remuneration and nomination committees, there is a significant overlap in terms of the responsibilities of the committees. Moreover, in both of these committees the members need similar knowledge, skills and experience. There are also links according to the CRDIV between the remuneration committee and the risk committee so that common members could also be justified (see paragraph 49). Therefore, EACB recognizes that there are more benefits, efficiency and advantages than disadvantages when having common members in the said committees. For these reasons, EACB suggests that paragraph 37 should be omitted, or at least amended so that these before-mentioned synergies should be taken into consideration.

**Independent members in the specialized committees**

Recommendations on majority of independent members in the audit and risk committees and requiring independent chairs are stricter than in the current Guidelines that do not contain such guidance. In addition, EACB has a concern whether the EBA has level 1 legislation based power to give further guidance on these issues and to recommend that the risk and nomination committees should be composed of a sufficient number of independent members.

Directive 2006/43/EC on statutory audits of annual and consolidated accounts only requires one member of the audit committee to be independent from the institution and not the majority as indicated by the paragraph 45 of the Guidelines. Therefore, the subchapters 5.5 and 5.6 should be amended so that only one 'fully independent member' would be required in the audit committee. Basel Committee's Corporate Governance Principles for Banks does not either require majority of independent members nor independent chairs for each committee. Pursuant to para 68 and 71 of BCBS principles on corporate governance only the audit committee and the

risk committee should have a chair who is independent and who is not the chair of the board of any other specialized committee (see BCBS Corporate Governance Principles for Banks (2015), pp. 16–17). This requirement shall not apply to the chair of the compensation committee and other specialized committees such as the nomination or human resources committee (see para 76 and 77 of the draft Guidelines and BCBS Corporate Governance Principles for Banks, pp. 17–18). EACB suggests that the EBA should not give stricter requirements in this extent, and deletes the recommendations on majority of independent members regarding risk and audit committees, as well as requirement on independent chairs of each specialized committee (paragraphs 42, 44 and 45).

Also, institutions should be given the possibility to prove the independence of mind of a member and/or take mitigating measures regarding possible lack of independence. This should be clarified by inserting the following last 3 sentences in Paragraph 42.

We suggest that the paragraph 42 should be amended as follows:

*"42. The risk and nomination committees should be composed of members of the management body in its supervisory function who do not perform executive functions in the institution concerned. Further, the specialised committees ~~should~~ may be composed of a sufficient number of independent members ~~to be able to ensure that they can perform their duties in an effective manner. In particular, the risk committee should include a majority of members who are independent.~~ Where there are not a sufficient number of qualified independent members, institutions should implement other measures to limit conflicts of interest in decisions related to risk management and nomination.* ***Where the member is not considered independent, the institutions can prove the independence of a member and/or decide on measures to mitigate possible conflicts of interests so that the member is independent afterwards. For example, the member should abstain from voting on any matter where a conflict of interest exists. This process and decisions should be documented****."*

**Access to data**

Regarding paragraph 46, subparagraph (a) provides that the risk and nomination committees should have access to all relevant information and data. This subparagraph should be clarified so that it would not require direct access to IT systems, databases, etc. operational data. This would not be necessarily even possible according to the data protection and information security regulations. In particular, more guidance is needed on what data should be interpreted as "relevant".

**Composition of Specialized Committees**

The requirements regarding appropriate knowledge, skills, expertise and professional experience, both individually and collectively, for the members of the risk committee, the nomination committee and the audit committee (para. 43) seem extremely demanding. EACB thinks that an approach is required which differentiates more between individual and collective knowledge and which reflects the size, business model and complexity of operations.

**Risk committee**

It should be clarified that the review of the appointment of external consultants proposed by the management body in its supervisory function should not be effected in practice by the risk committee (paragraph 47e).

The examination of the alignment of all financial products and services is a disproportionate role recommended by EBA for the risk committee (paragraph 47g). The risk committee should focus

its mission on the analysis of a annual reporting on this matter on the most significant risks, thus if needed according to the assessment of the new product approval policy (NPAP) framework.

We find that the requirement in paragraph 47 (g) on the risk committee's responsibilities regarding all financial products and services goes far too operational level in order to be meaningful task for a management body's subcommittee. It would lead to an excess workload of the risk committee.

**Audit Committee**

The requirement under paragraph 50(a) for the audit committee to monitor the effectiveness of the institution's internal quality control and risk management systems seems to be a too operational task.

**Specialized committees: other remarks**

As non-significant institutions do not have an obligation to establish specialized committees, it should be clarified in the paragraph 51 that it only applies to the significant institutions.

The common references to the functions of the nomination and the risk committees in paragraph 46 are unclear and should be further elaborated and distinguished for a better understanding. For example, paragraph 46b refers to the role of the risk committee but not the nomination committee as such.

Consequently, we suggest to replace the words "should be" by the words "may be" in paragraph 42 ("Further, the specialized committees may be composed of a sufficient number of independent members to be able to perform their duties in an effective manner").

**Organizational framework**

EACB finds that establishing the operational and organizational structure of the financial institution is primarily included in the duties of the senior management. For this reason, EACB find that the management body's duties in this matter as described in paragraph 53 are too operational in order to be meaningful tasks for the management bodies.

Paragraph 56 should be amended so that only material changes to the group structure should trigger the obligation to make further assessment.

**Know-your-structure**

The "know your structure" concept at the level of the management body of the consolidating institution should remain pragmatic. Therefore, in respect of "intra-group exposures", the top management at the central level should follow a risk approach and focus on major issues (which could have a global impact at the group level) concerning its affiliated banks within a banking cooperative group. A too much detailed and individual "entity by entity" approach by the management body of the central body (on risks regardless of their nature, activities, organization, purpose,…) should not be envisaged, rather a relevance-focused approach (paragraph 60).

In addition, EACB considers that in a group context, and according to the proportionality principle, a written, clear and detailed description of the operational structure should be mainly applicable to the heads of group, significant entities and listed companies, but not necessarily to all entities within a group.

We have the same observation regarding know-your-structure as stated in paragraph 57. Therefore, these paragraphs should be clarified that the management body's duties regarding the organizational framework and know-your-structure would be focused on the main features, but should not be too detailed. By way of application the proportionality principle, paragraph 53 should deal with the overall written, clear and organisational framework relating to internal control procedures to be set up at the level of the central body but not at the level of the regional or local cooperative banks affiliated to such central body.

**Breach of requirements**

The requirement under paragraph 46 (b) requiring the management to inform the supervisory function on "any breaches that may have occurred" could in practice turn out as inefficient since it might lead to too many, irrelevant information. The obligation should therefore focus on "material breaches".

***Question 4:***

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

The criteria set out in Annex I, which are intended to be taken into consideration when defining governance principles, are too broad and do not allow sufficiently discretion to the institutions, so that the special features of each institution could not be appropriately taken into account. In particular, the aspects listed in Annex I under 6(c) and 6(d) are not a part of governance principles, but internal audit and evaluation processes. Therefore, such items should be deleted.

According to the paragraph 70, the management body in its supervisory function is responsible for overseeing the implementation of the internal governance policy and that it is "fully operating". EACB finds that such requirement is in too operational level to be meaningful and even possible for the management body. Therefore, it should be clarified that the management body in its supervisory function is not responsible for the operational oversight, but can rely on expert advice, such as reports produced by risk management and compliance functions as well as auditors. As regards the substance of the internal governance policy set out in Annex I it should be considered that, the weaknesses and recommendations of control functions are likely to be treated as confidential and that they can change rapidly . It would therefore be inappropriate to include this information in such a transparent document. It should be clarified what is meant by "free provision of services" in Annex 7(e).

Regarding paragraph 87c, it is not necessary or even feasible to define a policy of "acceptable and unacceptable behaviors". In our view, this would create unnecessary burden for the management. As all inappropriate behaviors cannot be defined in advance, a detailed policy would make it even more difficult to intervene in inappropriate conduct that is not included in the policy. Furthermore, we find that various guidelines issued by the relevant authorities already give sufficient guidance on this. Therefore, we suggest to delete paragraph 87c.

Paragraph 89 stipulates the requirement of a regular review of the implementation and compliance with the ethical and professional standards without further providing which department the review has to be performed. Therefore, it should be clarified that the allocation of this responsibility has to be done by the institution itself.

In paragraph 92a, "qualifying shareholder" should be defined in the Guidelines.

In paragraph 94f, EACB finds that "binding consultative advice" is not an appropriate example in this context. Such advice on transactions between related parties, could not be imposed (i.e. mandatory) to the collegial management body as a whole as a matter of corporate national laws. This recommendation has no legal basis and would not comply with corporate national laws which provide for a control of regulated agreement procedure and mitigating measures preventing any conflict of interest issues between the related parties (i.e resulting from inter alia internal compliance policies, abstention of vote mechanism, information of statutory auditors, vote in the general meeting on the basis of a specific report made by the statutory auditors).

Paragraph 94findicates that in some circumstances shareholders should approve certain transactions. Such matter depends on the corporate laws of each member states, for which reason the Guidelines should not provide further requirements. EACB suggests that this subparagraph should be deleted because the requirement of shareholder approval as well as the process associated with it depends on the applicable corporate laws of each member state in place as fully recognized, for example by recital 55 of the CRD IV.

The definition of "limits to the exposure of such transactions" (see § 94 (f)) seems unclear and it should be clarified.

Paragraph 95 sets out broad disclosure obligations regarding any identified conflicts of interests. In particular, the definition of "any conflict of interest" is too strict and goes far beyond what is necessary for establishing and maintaining robust governance arrangements. EACB suggest that disclosure obligation should only be limited to communications to the competent authority when there is a material conflict of interest that cannot be mitigated or managed otherwise.

***Question 5:***

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

***EACB welcomes introducing more detailed description on the applicability of proportionality principle. EACB suggests that the Guidelines would make a clear distinction between the central institutions and other affiliated (local/regional) institutions. This is the core element of the governance arrangements of co-operative banking groups. In addition, EBA should develop more guidance on the proportional application of the Guidelines into subsidiary entities. EACB finds that such aspects are core matters in applying the proportionality principle. Furthermore, adding such factors would help both the institutions and competent authorities applying the Guidelines in practice. Finally, we believe that also the principle of subsidiarity should be stressed to ensure that national company laws, especially regarding cooperatives, are respected.***

EACB very much regrets that, unlike the Basel Committee's Corporate Governance Principles for Banks (July 2015), the draft Guidelines does not explicitly address the application of the Guidelines to different group structures (see Principle 5 of the BCBS publication). Especially the levels of the affiliated local bank/subsidiaries and the parent/central institution have to be seen in different light. The preference should be given to a strong governance of the entire group. One reason for this is that there are group policies that have to be implemented and complied with at the level of subsidiaries and other affiliated institutions. Emphasis on independence at local bank/subsidiary level would be contrary to a strong group governance.

Tasks and responsibilities of all aspects of operating as a financial institution (including banking business, governance, risk management and risk monitoring) are allocated between the local/regional banks and the central institution (and its subsidiaries) in co-operative banking groups. Central institutions play a significant role in the core functions of all associated member banks, such as risk and liquidity management, internal audit, product management and development, and ICT. Many banking groups have established a joint liability system (statutory or contractual) or the banking groups are responsible for maintaining deposit protection funds.

Therefore, taking into consideration the roles of each member bank and the central institution, the focus should be put in the central institutions that are mainly responsible for steering the banking group, whereas the individual member institutions should not be subject to excess administrative burden. Such view should be clearly addressed in the Guidelines as it is a crucial factor in the application of the principle of proportionality. Proportionality in this sense should be applied both for the suitability requirements and the assessment process itself.

Co-operative banking groups that comprise consolidations for the prudential purposes should be seen as a single institution also from the suitability assessment perspective. In particular, banking groups that follow the Article 10 of the CRR are one example of this category. Such banking groups have gone through significant structural reforms in order to take benefit from the prudential consolidation. These reasonable expectations to be treated as a single institution should be protected.

In order to better address the key functionalities of co-operative banking groups and networks, EACB proposes including the following criteria to the proportionality assessment:

- Co-operative banking groups that comprise consolidations for the prudential purposes should be seen as a single institutions also from the suitability assessment perspective. In particular, banking groups that follow the Article 10 of the CRR are one example of this category. These cases the suitability assessment obligations should primarily apply in the central institution/parent entity level.
- The more centralized the business operations, risk management and internal audit, the lighter requirements should apply in the local/regional/sunsidiary level, taken into consideration, among other things, the following factors:
- Products offered and to what extent the institution is responsible of the product development and management or whether such functions are centralized in the group-level.
- Whether significant risk management or audit functions are organized in the prudential consolidation level.
- Whether there is an institutional protection scheme (cross-guarantee) or an equivalent system in place.
- Whether the subject of the assessment is a member/nominee to the management body in its supervisory function or management function.

In addition, EACB suggests that EBA Guidelines take better into account the other fundamental EU subsidiarity principle which should be complied with in the internal governance arrangements.

In areas in which the European Union does not have exclusive competence, the principle of subsidiarity seeks to protect the capacity of the Member States to take decisions and to take action and only authorises intervention by the EU when the objectives of an action cannot be satisfactorily achieved by the Member States by reason of the scale and effects of the proposed action. The purpose of including a reference to such subsidiarity principle in the CRD IV is also to ensure that powers are exercised as close to the citizen as possible.

***Question 6:***

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

**General remarks**

In line with earlier remarks, we would like to see a clarification in paragraph 113 that proportionality criteria will be applied to groups and IPS in such a way that the requirements for an internal control framework are developed at group level and individual institutions simply adhere to those requirements.

As a general comment, the draft Guidelines do not provide clear guidance on how the three lines of defense model (risk management function, compliance function and internal audit function) would be applied. Our view is that, in particular, there is a lack of distinction between the second line and the third line of defense. In Chapter 12 (Internal control framework) more emphasis should be given to the responsibilities of the first line / the management body to 'set' the control framework as stated in 19c. The text now might suggest the reader this task can be outsourced to the internal control functions.

The term "accountable to" has been used several times when describing the hierarchical level of the Heads of internal control functions. EACB suggests a further specification of the scope of use, especially the difference between internal Audit and other control functions.

**Specific remarks**

Paragraph 115 a.: We find that it is not appropriate to recommend an obligation to ensure effective and efficient operations to the internal control function. Please also see below our remark regarding para. 161.

Paragraph 116 should be adjusted in order not to impose too operational and burdensome duties for the management bodies regarding establishing and monitoring the adequacy and effectiveness of the internal control framework, processes and mechanisms. Any duplication of formalities, additional documentation and authorization at the level of the management body of each individual institution should be avoided if such internal control policy has been put in place at the level of the central level.

Paragraph 121: "vis-à-vis the business and vis-à-vis each other" should be added in the last sentence, to make the content clearer for the institutions.

Paragraph 122: this distinction does not make sense in a one-tier structure with a single collegial management body which includes only elected directors.

EACB welcomes the distinction between the Compliance function and the Risk Management function. However, this distinction is not always clear and/or appropriate throughout the text, in particular in the following aspects:

- Paragraphs 143 and 144: The primary responsibility of ensuring compliance with a significant change policy on processes and specifically (IT-)systems seems to be better suited with Risk Management, as more of the risks associated with processes and (IT-)systems will be operational risks rather than compliance risks. For products and services, we do believe that the responsibility should lie with Compliance function, in coordination with the new product approval framework.
- The second sentence of paragraph 144 should be amended as follows: "They should, on annual basis, check…"
- Paragraph 148: The power to require that changes to existing products go through the formal NPAP process is now assigned solely to Risk Management while the compliance function is primarily (in collaboration with) responsible for ensuring internal compliance with the NPAP process.

Paragraph 144: Word "ensure" should be replaced by "monitor".

Paragraph 145 is too categorical as it requires written opinion from the head of compliance. EACB suggests that also other documentation from the compliance function would be sufficient in this sense. This should include a systematic prior assessment and approval by the compliance function, including a written opinion from the head of compliance or a person duly authorized by the head of compliance for new products or significant changes to existing products. If the compliance function should approve each product and changes to products before the launch, this is conflicting with the roles of the first and second line, with the first line being responsible and the second line challenging and advising. We would suggest to amend this sentence change to exclude the word 'approval' and replace it with 'written opinion'. Therefore, the wording in the second sentence of paragraph 145 should be changed as follows: "This should include a systematic prior assessment and a written opinion by the compliance…" This proposed amendment aims at reducing any unnecessary burden which could result from the currently chosen wording. Finally, EACB does not consider the term "approval" appropriate term in this context, as compliance function does not make decisions on business matters. Moreover, the impression should be avoided that the compliance and risk function can only raise objections on issues which are in their (exclusive) remit.

Paragraph 143 sets requirements for the new product approval policy (NPAP) and also for material changes to processes and systems. EACB has the impression that the following paragraphs 144ss do not always differentiate consistently between both requirements, so that it is unclear whether the requirements set in the individual paragraphs relate solely to the NPAP or to the NPAP and changes to processes and systems. Only paragraphs 146 and 147 expressly refer to the NPAP. Paragraphs 144 and 145, in contrast, merely refer in general terms to policies. Paragraph 148, on the other hand, refers to "significant changes to existing products, processes and systems", although it is unclear whether, in addition to the NPAP ("significant changes to existing products"), "material changes to processes and systems" within the

meaning of paragraph 143 (material changes of processes are relevant. We therefore suggest to better clarify and/separate the requirements for the NPAP and changes to processes and systems in the guidelines.

EACB has concerns on proportionality and/or the distinction between first and second line of defense roles. According to the paragraph 143, the management body should consider if approved products and changes require changes within the risk strategy, risk appetite and corresponding limits. This sentence is not clear, as it seems to imply that the management body should assess individual products. For a large bank, given the large number of products, this does not seem proportional. Probably the intention is that the management board should take changes in the product range into consideration when re-assessing the risk strategy, risk appetite and corresponding limits. That proposals for new products and product changes should fit within risk appetite, strategy and limits is standard part of product approval process.

EACB believes that the scenario analysis required in paragraph 143, especially the wording "under a variety of scenarios" goes too far and should be deleted. Given the large number of scenario analyses already required, the additional analyses called for here – now even for fictive positions – would impose an unreasonable extra burden while delivering only limited added value.

In paragraph 161 is stated that the risk management function should ensure that all risks are identified, assessed, measured, monitored, managed, mitigated and properly reported. In other parts of the document 'ensure' is most often to be read as 'to make something certain to happen'. But the RMF cannot guarantee all risks are known. They can only ensure the risk framework to be concise and effective.

In paragraph 173, the term "management body" should be replaced by "senior management" to the extent that, according to article 76(5). of the CRD IV, a report could be made directly from the risk management function to the management body in its supervisory function independently from the senior management.

Regarding paragraph 179, the role of the compliance function is described inaccurately. The role of the compliance function is not to act as the management body's advisor regarding laws, rules, regulations and standards. Any legal advice corresponds to the mandate of the legal department exclusively. Therefore, the wording should be changed in order to properly reflect the role of the compliance function, which is to ensure that operations and internal procedures of a group comply with laws, regulations, professional standards and internal standards applicable to its activities as well as report to the management body on its observations.

Article 76 5. of CRD IV only provides an obligation of direct reporting by the head of the risk management function, for which reason such obligation should not expressly be extended to the internal audit function, nor the compliance function (paragraphs 122 and 175)but such arrangements should be left to the discretion of each institution. Such supervisory requirements should not go beyond the level 1 legislation and should be therefore deleted in the said paragraph 122 and 175 of the guidelines. Moreover, the demand for the internal audit function being accountable to the management body in its supervisory function exceed the level 1 text, where independence is solely guaranteed by a sufficient level of reporting line or an adequate function separation by different means. Thus paragraph 122 should be amended correspondingly.

Regarding paragraph 124, Article 76(5) of CRD IV requires a management body approval only in terms of removal of the head of risk management function. Due to the lack of appropriate

level 1 legislation, such requirement should not be extended to the head of the internal audit function, nor the head of compliance.

The paragraph [124] should not limit such power to designate and revoke the head of internal control function to the supervisory function. In some governance structures, senior management (and also the heads of risk management and internal audit functions) is appointed by the management function.

Paragraph 124 should also take into account that all institutions do not have a head of internal control functions, but these duties are distributed in different roles. This is common practice in smaller institutions. Therefore, paragraph 124 should not apply in these circumstances according to the proportionality principle. Furthermore, CRD IV focuses on the one hand on assigning procedure for all internal control functions, on the other hand limits the conditions of withdrawal but only to the head of risk an permanent control. As a consequence, the actual demand goes far beyond the level 1 text and should be limited to the original proposal.

Remarks regarding compliance function (175-182)

- EACB is not in favour to the limitation of combinations of the compliance function with other units. Unlike in the current EBA guidelines, there is no longer any mention of the fact that, where smaller and less complex institutions are involved, the compliance function can be combined with the risk management function or other supporting functions (e.g. human resources or legal division) or assisted by the latter. Instead, this paragraph merely says that, taking into account the proportionality criteria the compliance function may be combined with the RMF or the legal division or assisted by the RMF. Such a restriction on would in fact not meet the reality in smaller institutions, which only dispose of a small number of staff members. We consider the current German practice whereby only the IAF, being outside the internal control system, is excluded from the compliance function along with market trading units is appropriate in our view. We did not hear of any problems that would require a change of current practice.

- The requirement for institutions to have a well-documented compliance policy that should be communicated to all staff stems – like the implementation of a compliance monitoring programme called for in paragraph 180 should not be applied to small institutions the same way as it is done in large banks. Under proportionality aspects iit should be enough for smaller banks to have special standards or policies are adopted for the most relevant areas of compliance, e.g. securities trading, money laundering or data protection, and are regularly communicated to staff. A specific compliance policy focusing on general legal risks (paragraph 179) which has to be communicated to all staff would, on the other hand, seem disproportionate particularly for smaller institutions. It should be sufficient in this respect that the compliance function executes a regular analysis and a report of the most relevant risks and involves the units concerned where necessary.

Remarks concerning 15.3 Internal Audit function (IAF) (para. 183 et. seq.):

- In terms of the qualification of the IAF and its resources, in particular the monitoring tools and risk analysis methods are in adequacy with its size, locations and the nature, scale and complexity of the risks associated with the institution's model and business activities and risk culture and risk appetite. This recommendation is not clear. There should be guidance of

the EBA when this will be the case. The EBA should provide further key figures when the IAF complies with this requirement.

- The terminology used in the paragraph 185 does not reflect the Basel Committee's Corporate Governance Principles of Banks ("Internal Audit Function in Banks") and also not following the IIA standards. EACB proposes the following amendment, which would better reflect the BCBS principles (in particular Principle 1): "An effective internal audit function provides independent assurance to the board of directors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes, thereby helping the board and senior management protect their organization and its reputation. The IAF should ensure that each entity within the group fall within the scope of the IAF."

Paragraph 178 states the management body in its supervisory function should oversee the implementation of a well-documented compliance policy which should be communicated to all staff. EACB finds that such requirement is in too operational level to be meaningful and even possible for the management body.

Paragraphs 187 and 188 should be amended to better reflect the BCBS "Internal Audit function in banks"-paper, principle 6 and 7. Such principles give a better coverage of the Internal Audit scope.

***Question 7:***

***Are the guidelines in Title V regarding transparency of the organization of the institution appropriate and sufficiently clear?***

[N/A]

***Question 8:***

***Are the findings and conclusions of the impact assessments appropriate; please provide to the extent possible an estimate of the cost to implement the Guidelines differentiating of one-off and ongoing costs?***

First of all, the time spent by the various staff (legal, compliance, internal audit, risk management, representation before regulators and supervisory authorities) in the institutions for the review of (and the response to) the draft guidelines on internal governance is very signficant. The one-off costs resulting from the review, the meetings and the proposed amendments to the guidelines in the institutions should not be underestimated but is hardly quantifiable within the period of consultation of 3 months: the costs borne by each institution would mean to make the sum of the percentage of the monthly salary of each employee dedicated for this task in each group (irrespective of the costs of any external consultant if any).

In the second place, as a result of the number of policies, procedures, framework, business conduct, form of approval files to the supervisors that institutions would have to adopt, review,

amend and complete, it is obvious that the implementation of the guidelines will involve additional, recurring and sustainable costs and also a material administrative workload (at the level of the managers of the local cooperative banks and the central body).

Nevertheless, the said on-going costs cannot be measurable or assessed in advance prior to the final guidelines that would need to be implemented by the institutions.

Finally, another material impact could derive from the scope of the Guidelines within a EU banking group. The Guidelines are not supposed to be applied with the same level of constraints within a consolidated group: at the level of the central body and at the level of the affiliated cooperative banks and their subsidiaries especially if the latter are not subject to CRD IV on an individual basis. Proportionality principle should be fully taken into cosideration by EBA in the preparation of such guidelines in respect of the said entities which is not the case by now.

The Guidelines on internal governance should not be an obstacle to the development of cooperative banks and their subsidiaries as a result of an excessive formalism burden and administrative reporting. Otherwise, the ultimate impact of these guidelines would be to fragilise the situation of the cooperative banks in favour of non EU banking groups which would benefit from a competitive advantage over EU banking groups since they would be in a position to focus on their clients without the same number of policies, procedures and administrative burden and reporting to apply.

**Contact:**

The EACB trusts that its comments will be taken into account.

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