

Composition and qualifications of credit institutions' BoD: European requirements and the principle of proportionality

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Introduction

- The principle of proportionality is well established as a general principle of EU law
- *'the lawfulness of the prohibition of an economic activity is subject to the condition that the prohibitory measures are appropriate and necessary in order to achieve the objectives legitimately pursued by the legislation in question; when there is a choice between several appropriate measures recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued'*
- It goes without saying that the principle of proportionality applies also to the banking sector and more specifically to banking regulation and supervision

Composition and qualifications of credit institutions' BoD

At the European level, the qualification and composition criteria of the banks' boards are currently laid down in art. 91 of CRD IV

Individual criteria

- fitness criteria
- properness criteria
- temporal criteria

Collective criteria

- the overall composition of the management body shall reflect an adequately broad range of experiences



Composition and qualifications of credit institutions' BoD (cont.)

- the rules laid down in the CRD IV are not maximum harmonization rules
- the criteria laid down in CRD IV are vague and need to be further specified in order to be applied to a specific banking institute
- the suitability criteria are specified in (draft) guidelines issued by the European Banking Authority (EBA) and the European Central Bank (ECB)



Guidelines issued by EBA and ECB

- The guidelines are not mandatory law provisions
- However, the guidelines are very important for the interpretation of the relevant union provisions
- In adopting such guidelines that will henceforth apply to the cases to which they relate, the competent authority, i.e. the ECB, imposes a limit on the exercise of its discretion

Analysing the principle of proportionality

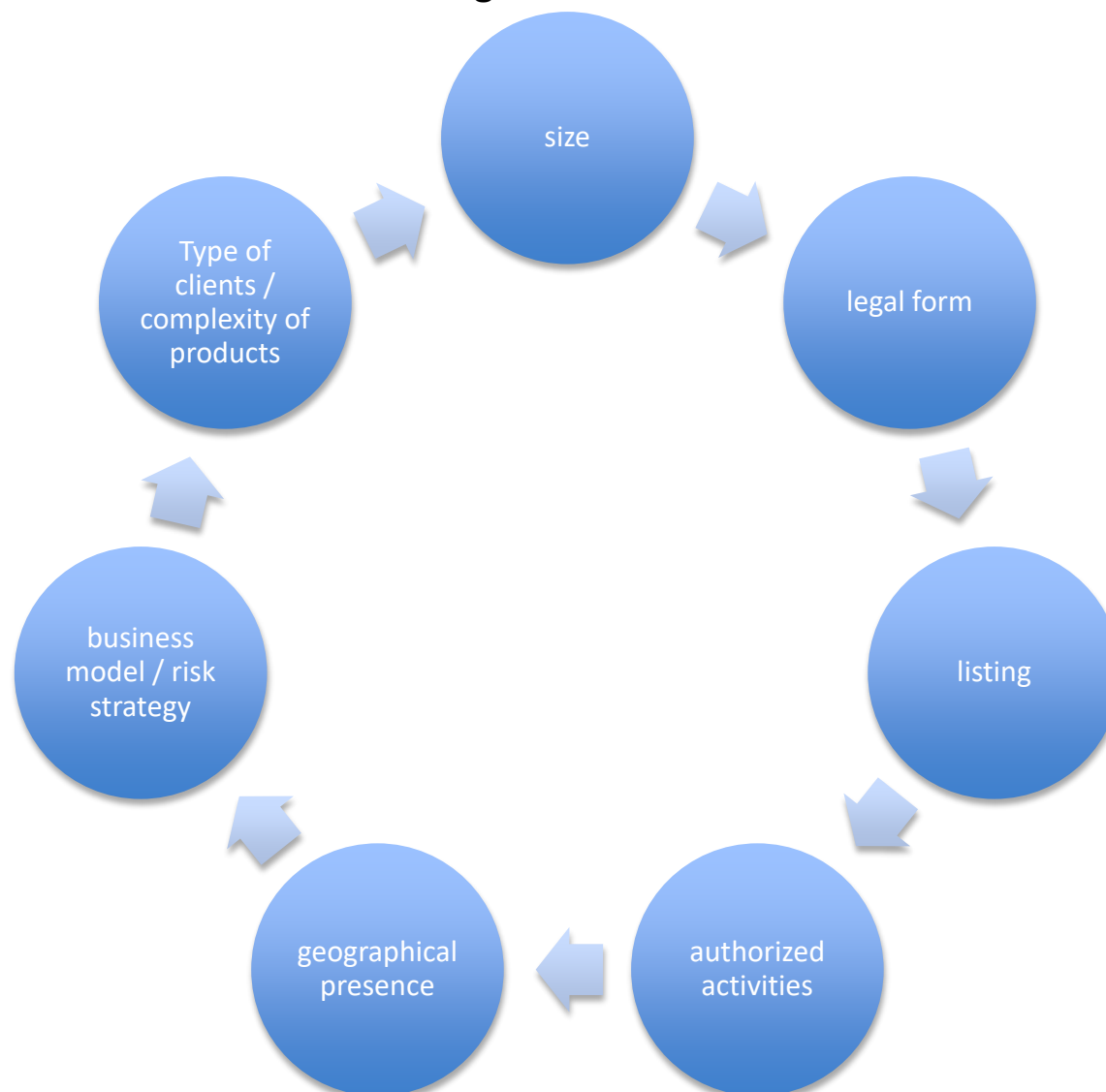


Analysing the principle of proportionality (cont.)

Proportionality applies throughout the whole fit and proper process

CRD IV refers to the size, the internal organization and the nature, scale and complexity of banks' activities

EBA guidelines refer to:





Analysing the principle of proportionality (cont.)

- The criteria laid down in the draft guidelines of the EBA are appropriate for the differentiation between banks
- The market share of the bank as well as the number of employees could also be considered as differentiating criteria



Limitations of the principle of proportionality

- According to art. 91 of CRD IV it seems that the principle of proportionality cannot apply neither to the reputation requirements nor to the independence of mind.
- However, the proportionality principle could apply to these requirements. The principle of proportionality applies to all steps of the supervisory and regulatory process



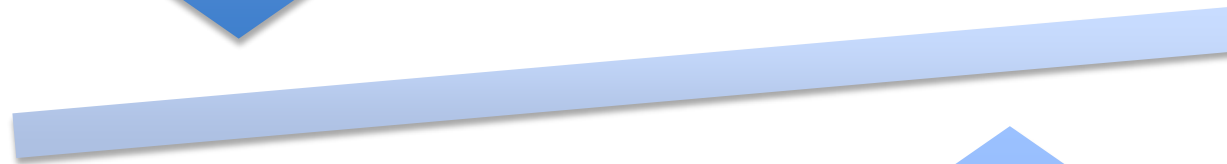
Assessment of suitability criteria according to the proportionality principle

- The more complex the activities and the characteristics of the bank are, the more qualifications will be required for the management body. This renders the evaluation process a dynamic system (bewegliches System)
- The assessment of the suitability criteria necessarily includes a degree of supervisory judgment
- The suitability and/or proportionality criteria can be contradictory.

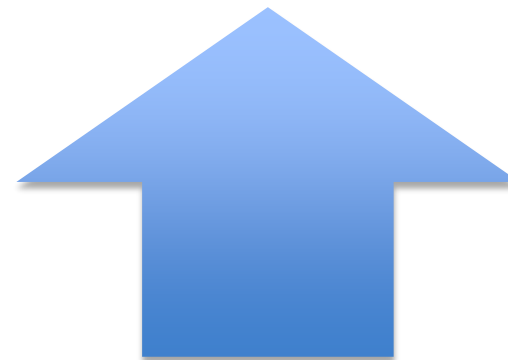
Assessment of suitability criteria according to the proportionality principle (cont.)



Neither CRD IV nor the draft guidelines offer a robust tool to weigh the different and contradictory criteria.

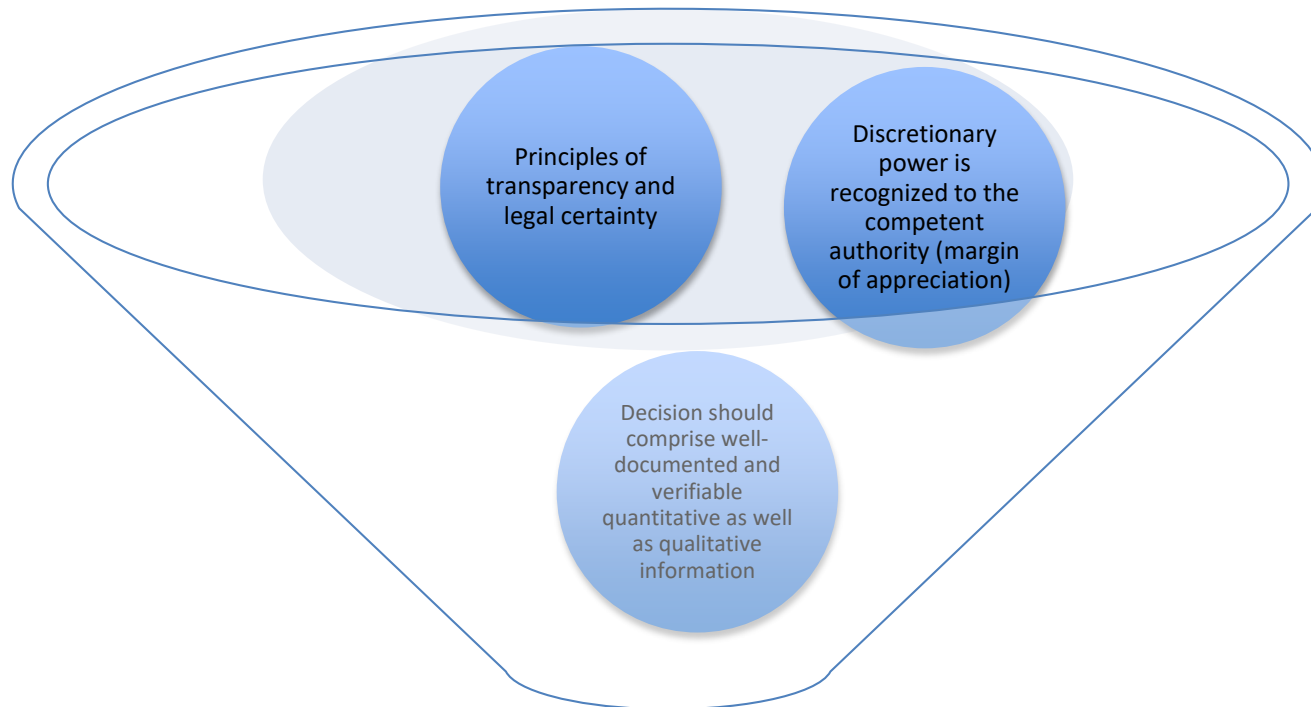


The ECB declares that its decision will be taken in a balanced way, weighing up the factors that speak in favour and against the appointee



Assessment of suitability criteria according to the proportionality principle (cont.)

→ appropriate evaluation cannot be the result of a simple arithmetical calculation



Procedural aspects of the principle of proportionality

(a) Conditional approval

(b) Informal assessment

(c) burden of proof

(d) Judicial review





Conditional decisions of appointment

- The power to take conditional decisions is not directly conferred to the ECB. However, such a power is inherent and derives from the competences of the ECB.
- The issue of a decision on fit and proper cases subject to conditions is tightly associated with the principle of proportionality
- Nonetheless, (a) the conditions should be based on the assessment criteria laid down in the relevant national and European provisions (principle of legality) and (b) the conditions should be clear, precise and appropriate
- The conditions can be either precedent or subsequent



Informal assessment

- Informal procedures are a quite common phenomenon
- In the webpage of the ECB it is explicitly stated that: ‘And more than in any other field of supervision, we can often reach our objectives in an informal way. Banks quite regularly decide to withdraw candidates if it becomes clear that concerns cannot be remedied’
- This practice seems to be in line with the principle of proportionality. However, the candidate is deprived of his or her fundamental rights

The burden of proof

- We have to distinguish between the burden of persuasion and the burden of producing evidence
- The applicant / supervised entity is obliged to provide to the competent authority all information necessary for the fit and proper assessment (*First Financial Advisers Limited v Financial Services Authority*, Financial Services and Markets Tribunals, June 21, 2012).
- The same rationale applies also in relation to the burden of persuasion (*Deakin & Ors v Financial Services Authority*, Financial Services and Markets Tribunals, February 08, 2005)
- Another issue tightly interrelated with the burden of proof is the evidential threshold which is necessary to establish a finding of unfitness (standard of proof)

Judicial review

- Decisions taken by the ECB in relation to fit and proper cases can be challenged either before the Administrative Board of Review (ABoR) or before the competent court.
- The ABoR review is not limited to infringement of an essential procedural requirement. It also includes the substantive conformity of the contested decision, but it should respect “the margin of discretion left to the ECB to decide on the opportunity to take those decisions”
- A request for a review of an ECB decision by the ABoR does not affect the right to bring proceedings before the General Court / Court of Justice of the EU and is no legal requirement for an action

Judicial review (cont.)

- The judicial review seems to be limited. According to the settled case law, when the concept of proportionality is examined, *'the legality of a measure adopted [...] can be affected only if the measure is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue [...]*
- However, the Court must *'establish whether the evidence relied on is factually accurate, reliable and consistent[,] whether that evidence contains all the information which must be taken into account in order to assess a complex situation and whether it is capable of substantiating the conclusions drawn from it'*

Conclusion

- The election of members of the management body is a fundamental right of the shareholders, of the legal person, i.e. the bank, and the (natural) persons to be appointed. On the contrary, the smooth functioning of the market and the stability of the financial system requires a broad regulatory intervention
- The means to find an equilibrium between these contradictory interests is the principle of proportionality
- The European legislator acknowledges the importance of the principle of proportionality in the banking sector and provides for special provisions. It remains to be seen how the ECB as well as the European Court will interpret and apply the relevant provisions
- In any case, for the uniform application of the suitability criteria, a further convergence of the fit and proper assessment process would be necessary



**KEEP
CALM
AND BE A
FIT AND PROPER
PERSON**