

Deutsche Börse Group Response

to EBA/CP/2016/16

“Consultation Paper: Draft Guidelines on internal governance”

issued on 28 October 2016

Eschborn, 27 January 2017

Contact: Jürgen Hillen
Telephone: +49 69 211 - 15561
Telefax: +49 69 211 - 13315
E-Mail: juergen.hillen@deutsche-boerse.com

A. Introduction

Deutsche Börse Group (DBG) welcomes the opportunity to comment on EBA consultative document 'Draft Guidelines on internal governance' issued in October 2016.

DBG operates in the area of financial markets along the complete chain of trading, clearing, settlement and custody for securities, derivatives and other financial instruments and as such is mainly active with regulated Financial Market Infrastructure providers.

Among others, Clearstream Banking S.A., Luxembourg and Clearstream Banking AG, Frankfurt/Main, who act as (I)CSD¹ as well as Eurex Clearing AG as the leading European Central Counterparty (CCP), are classified as credit institutions and therefore are within the scope of the European Capital Requirements Directive (CRD) and Capital Requirements Regulation (CRR). Clearstream subgroup is supervised on a consolidated level as a financial holding group. In addition, Eurex Repo GmbH, Eurex Bonds GmbH and 360 Treasury Systems AG which are operators of multilateral trading facilities (MTFs) and according to the wording of Article 4 paragraph 2 lit. c CRR are classified as CRR investment firms.

The document at hand contains our general comments to the guidelines on internal governance and dedicated response to selected questions raised in the consultative document in part C.

¹ (International) Central Securities Depository;

B. General comments

In general, DBG agrees to and welcomes the proposals made by EBA. We are pleased that EBA has introduced dedicated definitions within the Guidelines to provide further clarification on functions and terms used. DBG also appreciates the comprehensive update to include also current topics related to internal governance.

DBG would appreciate a further harmonisation across the different guidelines on internal governance of financial service providers currently prepared by EBA, ESMA and ECB². We therefore ask for a comprehensive rule book, e.g. a joint ESMA / EBA rule book which is also used as an anchor by the ECB. Therefore, we kindly ask the EBA, to align with ESMA and ECB in order to issue a harmonised set of guidelines on internal governance. We acknowledge in this regards that the ECB may set tighter rules for significant institutions within or in addition to the general common framework.

Related to the different internal governance rules among the Member States, we in general observe the proposal as a good approach to deal with both, 1-tier and 2-tier structures. However, we see the need for adjustments as the required responsibilities of or towards the management body in its supervisory function seems to conflict with e.g. German corporate law.

We have identified the need to cover to a broader degree and with several corrections the treatment of a 2-tier management board structure. We have already raised similar concerns in our response to the ESMA consultation for their *"Guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services provider"* as well as the ECB consultation on the *"Draft guide to fit and proper assessments"*. We have taken into account the items EBA has incorporated into the draft in this regard but we see further need for adjustments to reflect appropriately the rules as laid down in national rule, especially in Germany. We also refer to

² We refer to the guidelines currently consulted: ESMA consultation on the *"Guidelines on specific notions under MiFID II related to the management body of market operators and data reporting services provider"*, ECB consultation *"Draft guide to fit and proper assessments"* and *"Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU"* and our comments on those.

our comments to the parallel running consultation on the “*Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU*”.

Under the (German) rules reporting lines of staff are in principal always towards the executive board and direct reporting lines to the supervisory board are not foreseen by law. There are a few exemptions especially with regard to the Audit function. An extension to other functions as proposed needs therefore to be evaluated against the corporate law and the responsibilities and duties of the executive board. We deliver further details in our answers to the questions below.

While we agree in general – despite our wish for a consolidated corporate governance guideline for the financial sector – with the proposals made by EBA, we see the need for certain adjustments or clarifications. As we in general agree with the proposal, we have put our remarks in this regard into our answers to the questions below.

C. Response to selected questions raised in the consultative document

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

The draft guidelines define responsibilities and tasks for dedicated functions. Beside the management body as a whole, in its supervisory or executive function, this is true especially for the three control functions and their heads (Compliance, Internal Audit and Risk Management [including the Chief Risk Officer]). In addition, the CEO and the CFO are named. We have concerns related to the inclusion of the latter two and in particular with the CFO function in the draft guidelines. As paragraph 11 of the draft guidelines states, the usage of the two roles is not intended to introduce them but for functional aspects only.

CRD IV and its national implementation foresee a clear responsibility for the management body **in its entirety**, i.e. the board as a whole (partially being broken down to the executive or supervisory function respectively). Irrespective of this, we assume that the role of a Chairman of the Board is implemented in all EU jurisdictions. However, the function of a “*chief executive officer*” or “*CEO*” is not mandatory or at least not recognised (in full) for regulatory purposes in order to secure an “*equal rights*” approach for the management body in its executive function. Despite the fact, that Article 88 paragraph 1 lit. e CRD IV

clearly mentions the “function of the chief executive officer”, the role as such is not defined or described for regulatory purposes.

We appreciate the EBA approach to define the CEO and CFO function as a good step. However, we disagree to the definition of the CEO and we fail to understand the definition of the CFO and the need to introduce a CFO function in the context of the proposed guideline.

A CEO role in a 2-tier structure is usually the role as chairman of the management board and as such responsible to co-ordinate the work of the management board and the dialogue with the supervisory board. According to the common responsibility of the board as a whole, he is however not “*providing steer to the manage the overall business activities*”. This in our view is too strong for the role of a CEO in a 2-tier structure. On the other hand, this may be true in a 1-tier structure. Overall, the details of the role are irrelevant for the purpose of the guideline and we propose to frame the role as follows “*means the person who is chairing the management body in its executive function or who is acting as the responsible person to co-ordinate the work of the persons who effectively direct the business of an institution.*”

The tasks described for a CFO in case not being under the responsibility of one or more dedicated members of the management body in its executive function may be under the responsibility of one or more senior managers. There is no clear definition of a “CFO” in the regulatory legislative framework to our best knowledge. Furthermore, it is unclear to us why the artificial function of one “CFO” is addressed while there is no clear role of the function defined and it is specifically stated in paragraph 11 of the draft guidelines that no need to appoint a CFO is intended to be introduced. Like for a CFO, also the function of the Chief Treasurer, the Head of the “*Human Resources Function*”, or other functional positions holders with a high likelihood to be a risk taker or key function holder could be named.³ We cannot see any reason for a dedicated treatment of a vague defined function. On top of that we also assume that the CFO function to a large degree will reside within the management body in its executive function anyway. As such, we clearly propose not to define rules on a the-

³ The CFO function is used as a reference e.g. in paragraphs 26, 44, 46, 104, 151, 152, 158, 159, 160, 164, 165, 173 and 178 of the draft guideline. As stated, we fail to understand the background to add this artificial role at these instances, while other functions are only named generically.

oretical function (as the CFO) without also clearly defining the roles and responsibilities assumed for such a function. As we currently do not see the need to define dedicated tasks, roles and responsibilities of a CFO-function, **we clearly favour to take out any reference to the CFO in the proposed guidelines.**

Having said this and in case our proposal is not followed, we fail to understand why "record-keeping" is listed as a dedicated task of the CFO and what exactly is meant by this in the given context.

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

Beside our general concern, mentioned within the "General comments", according to the aspect that the treatment of the 2-tier structure is not fully taken into account, we have some further comments. Our comments below are to a certain extent also valid within a 1-tier structure.

In a 2-tier structure the supervisory board (the management body in its supervisory function) is not responsible for day to day management and therefore in general not responsible to "ensure" certain things but rather to oversee or monitor the company and the activities of the executive board (the management body in its executive function) for validation of compliance with the identified needs. The management body in its supervisory function is therefore more in the role of a "sounding board" and consequently commonly known as the "supervisory board".

This is in particular true for ensuring the integrity of the financial information and reporting. Therefore, we see a need to avoid to some degree the term "ensure" in the context of the duties of the management body in its supervisory function. Consequently, the last sentence within paragraph 23 of the draft guideline should be rephrased like follows:

*"The management body in its supervisory function should also **monitor and oversee** the integrity of the financial information and reporting, and internal control framework, including effective and sound risk management."*

Similarly, this applies to paragraph 24 (g) and (h) of the draft guidelines where “ensure” should be replaced by the wording “*monitor and oversee*”. In the same vein also EBA should adjust the wording of paragraph 46 (d) of the draft guidelines.

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

The requirements of paragraph 34 of the draft guidelines target on “*significant*” institutions regardless of the size of the management body in its supervisory function and requirements of corporate law. E.g., the German Stock Corporation Act requires a supervisory board consisting of at least three members. There is no direct relationship between the size of the supervisory board and the “*significance*” which would lead to a mandatory higher size of the supervisory board. Moreover, under the German Stock Corporation Act committees of the supervisory board may only have members which are members of the supervisory board itself (this does not prevent external experts being guests or advisors) and the committees must be made up of at least three persons.

Consequently, in case a “*significant*” institution has a supervisory board of exactly three members and is forced to set up a committee, this would consist of all members of the supervisory board. This does not seem appropriate. As such, the guidelines should take up the possibility for significant institutions – potentially subject to approval of the competent authority – not to set up the required committees in case

(1) the size of the total board is limited **and**

- a. there would be an identity with the full management body in its supervisory function or
- b. a substantial portion of the members of the management body in its supervisory function would be required **by law** to be members of the majority or even all of the committees.

In such cases, in addition to the general requirement for the management body in its supervisory function as a whole of being responsible to deal with the matters otherwise being delegated to the committees, it should potentially be requested

to include the topics to the ordinary agenda of the regular board meetings and devote a substantial amount of time to the matters concerned.

The implementation of a committee consisting by national law of all members of the management body in its supervisory function should not be mandatory irrespective of the significance of the institution.

The wording of paragraph 47 of the draft guidelines creates some doubts whether or not the tasks listed are really in scope of the management body in its supervisory function or are not only in the responsibility of the management body in its executive function. In order to avoid possible misinterpretations, we propose to rephrase the introductory part of paragraph 47 as follows:

“Where established, the risk committee should, within the scope of the management body in its supervisory function.”

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

We agree in principle to the proposal on the internal governance policy as laid out in chapter 7 of the draft guidelines. However, in our view paragraph 73 of the draft guidelines is too prescriptive in requiring a periodical review by the management body in **its supervisory function** of the design, implementation and effectiveness of the governance policy taking into account the recommendation from the relevant internal committees or the internal audit function. Therefore, DBG asks to delete this requirement.

Moreover, policies are only **general guidelines**, which set up the framework for any implementation measure. Hence, the outsourcing policy can only set risk considerations and overall risk appetite and other general risk guidelines. The policy cannot consider the impact of any given (**specific**) outsourcing on the risk of the company. As such, in our view, the first sentence of paragraph 107 is going beyond the content of a policy. Therefore, we propose to rephrase the sentence as follows:

“The outsourcing policy should set the appropriate guidelines for the consideration of the impact of outsourcing on an institutions’ business and the risks it faces (such as operational, reputational and concentration risk).”

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

No specific comment.

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

The head of the internal audit function in general is accountable to the management body. However, according to national law this may be either the management body in its executive or in its non-executive function. The mandatory accountability to the management body in its supervisory function as proposed in paragraph 122 of the draft guidelines therefore cannot be accepted. At least it should be put under a condition like "as far as allowed under national law". Similarly, we have doubts that the direct access of the RMF to the management body in its supervisory functions and to the committees as outlined in paragraph 150 of the draft guidelines is compatible with national law in all cases and especially in a 2-tier structure. Again, at least a reference to the limitations of national law should be made. The same holds true related to the communication of the management body in its supervisory function and the head of the risk management function as requested by paragraph 174 of the draft guidelines and related to the Compliance Officer or Head of Compliance in paragraph 175 of the draft guidelines.

We strongly disagree to the magnitude of the proposed rights of the head of risk management in regards to challenging decisions taken by the management body as proposed in paragraph 173 of the draft guidelines. The management body in its executive function is ultimately responsible for the management of the company and it is liable towards shareholders and competent authorities. As such, a veto right of a senior manager not being part of the management body or a single member of the management body in its executive function does not seem to be appropriate. Especially with regard to situations where the Chief Risk Officer is not part of the management body this is most likely in conflict with national law. We even doubt that a dedicated veto in this regard for a CRO being part of the management body is a suitable approach. The EBA may consider other approaches to strengthen the role of the CRO in this regard, e.g. the possibility to require an adequate involvement of the management board in its supervisory function in such case. However, EBA should keep in mind that especially with

regards to risk decisions there may be not much time to extend the decision process on the timeline and as such, any additional step considered should be carefully weighted out against the additional risk it creates as such and should also be made under the caveat that this is allowed under national law. **As this is a very strong change, we furthermore express our concerns that such strong change can be introduced by an EBA guideline but rather recommend to make this a level 1 consideration and take it out of the guidelines.**

Finally, the requirement in paragraph 178 of the draft guidelines seems to be too prescriptive. In our view, it is in general and especially in most 2-tier structures not the management body in its supervisory function who should oversee the implementation of a well-documented compliance policy, which should be communicated to all staff. This is more a day-to-day business and as such rather under the responsibility of the management board in its executive function.

Q7. Are the guidelines within Title V regarding transparency of the organization of the institution appropriate and sufficiently clear?

We consider the listed topics of the publication of the annually description of the legal structure and governance and organisational structure of the group of institutions within paragraph 202 of the draft guidelines as overshooting. Especially the required overview on outsourcing seems to be excessive. In general, we see the risk with the exhaustive list of items to be published to disclose key elements of business success with the risk of disclosing items which would in general be deemed as business secrecy and therefore disagree to the disclosures on outsourcing (point d), and also in essence on close links (point e). Furthermore, the requirement under point a) to disclose an overview of the organisation also seems to be burdensome and not really adding value. Finally, there are already disclosure requirements under the accounting framework and the disclosure requirements should only be requested in case it goes beyond what is needed to be published with the annual accounts anyway.

Q8. 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?

No specific comment.

Deutsche Börse Group Response to EBA Consultation Paper on
'Draft Guidelines on internal governance'

We are at your disposal to discuss the issues raised and proposals made if deemed useful.

Yours faithfully,

Jürgen Hillen
Executive Director

Marisa Ranft
Regulatory Specialist