

A Eurozone Hub *Background Briefing*

**Being "fit and proper" in the
Banking Union in 2017**

**ECB-SSM's supervisory guidance
on fit and proper assessments**

Being "fit and proper" in the Banking Union in 2017

The ECB-SSM's supervisory guidance on fit and proper assessments

Regulatory and supervisory policy in the EU, within the individual Member States and across the individual Eurozone jurisdictions follows global standards. This means that management bodies and key function holders of regulated financial institutions are required to be assessed as to whether they are "fit and proper". This is a prerequisite to such persons taking up the exercise of the relevant regulated and/or control function. With a range of prudential regulatory as well as conduct of business supervisory shortcomings that have emerged at individual firms as well as across the market since the worst of the 2008 financial crisis, focus on what constitutes being "fit and proper", who determines this and how, has become more and more crucial to effective supervision of regulated financial services activity.

This Eurozone Hub Background Briefing is split into two parts. Part 1 assesses the ECB-SSM's new supervisory "Guide to fit and proper assessments" (the **F&P Guide**), which launched 15 May 2017 and will apply within the Eurozone and the national competent authorities (**NCA**s) that together with the European Central Bank (**ECB**) form the Single Supervisory Mechanism (**SSM**) of the Banking Union. The F&P Guide is complemented by Decision (EU) 2017/935 of the European Central Bank on fitness and propriety assessments (**F&P Decision**)¹. Both these instruments were put to public consultation that ran from November 2016 to January 2017.

Part 2 concludes with some practical considerations for firms needing to comply with the F&P Guide and/or with the recent "Supervisory Principles on Relocation" (**SPoRs**) that were announced by the ECB-SSM as well as various European Supervisory Authorities (**ESAs**) in relation to BREXIT relocations of businesses to the EU-27 and/or the Eurozone and its Banking Union. Details on the SPoRs and the likely business impacts are discussed in further detail in our Client Alert: "The EU and the Banking Union bring out their SPoRs".

The context of these changes should also be viewed against the wider reaching changes happening across the Banking Union, and the Single Rulebook upon which it is built, as well as the further integration of the EU's Economic and Monetary Union i.e., the Eurozone. Those changes affect Banking Union supervised institutions (**BUSI**s) and non-BUSI entities engaging in regulated financial services business within or through the EU. Regardless of the SPoRs, the F&P Guide's provisions will also matter for the UK post-BREXIT. This is likely to be the case given the differences between the rules applicable across the EU, the F&P Guide's contents and the Eurozone's rules on suitability and fit and proper assessment and how this differs to the UK Regulators' own "Senior Managers and Certification Regime".

¹ See: https://www.ecb.europa.eu/ecb/legal/pdf/celex_32017d004201_en_txt.pdf

Quick Take: Key impacts from the ECB-SSM's F&P Guide:

1. fitness and propriety decisions within the Banking Union are now more centralised. This will on the one hand translate into more consistent supervisory outcomes and experiences but may take time as the new process comes into force;
2. previous applications in respect of individuals may need to be revisited and possibly resubmitted; and
3. existing management and control functions within BUSIs may need to provide greater record of evidence that they sufficiently fulfil supervisory expectations on fitness and propriety in the event of a role change or new addition affecting the overall composition of certain functions.

Background to Banking Union and why the F&P Guide matters

With the continued development of the Eurozone's Banking Union and the EU's Single Rulebook upon which it is built (see below) the need to have a single set of standards and supervisory culture in this regard is key. Completing the Single Rulebook relies very much on balancing a "jurisdiction agnostic" approach with pragmatic solutions. Harmonisation of the rules as well as the supervisory culture helps to ensure a more uniform assessment of supervised firms' compliance.

Taking a jurisdiction agnostic approach to drive harmonisation is also key to ensuring the Eurozone's 19 individual jurisdictions all apply the EU Single Rulebook in the same uniform way. Assessing the fit and proper nature of applicants that will conduct regulated and/or control functions is one area where the EU needs more harmonisation of its rules. It is an existing area where the SSM has had both the legislative and supervisory power to act and where it has now exercised that power in the form of the F&P Guide to ensure more harmonisation happens.

Background on Banking Union

In 2012, European leaders took the decision to deepen the Economic and Monetary Union i.e. the Eurozone by creating a European Banking Union with the purpose of 'breaking the vicious circle between banks and states' and addressing the weaknesses affecting the Eurozone's banking sector. Achieving this aim means that the pillars of the Banking Union seek to make European banking more:

- a. 'transparent' by consistently applying common rules and administrative standards for supervision, recovery and resolution of BUSIs through application of a Single Rulebook;
- b. 'unified' by treating national and cross-border banking activities and by removing the link between location of BUSI and sovereign; and
- c. 'safer within a stable and well-functioning financial system' by intervening early if BUSIs face problems in order to help them prevent failing or, where necessary, ensuring they undergo an efficient resolution.

Banking Union was set up initially around two pillars both of which operate on a "hub and spoke" approach with supervisory responsibility apportioned between a centralised body and the relevant NCAs:

- the Single Supervisory Mechanism (**SSM**), as Pillar I, to guarantee the consistent supervision of BUSI's prudential regulatory compliance by transferring and centralising this previously national-led supervisory remit to the SSM. This prudential regulatory regime is largely concentrated around the rules contained in the EU's Single Rulebook component that is referred to as the "CRR/CRD IV Regime"², as supplemented by SSM specific requirements. Responsibility for SSM supervision is apportioned between the ECB, as directly responsible for supervising those BUSIs (ca. 125 banking groups representing 80% of all BUSIs AUM) that within the context of SSM are categorised and designated as "**Significant Credit Institutions**" (**SCIs**) and those ca. 5,000+ legal entities within the scope of Banking Union that are categorised and designated as "**Less Significant Institutions**" (**LSIs**) and thus subject to direct NCA supervision and indirect ECB supervision. Both SCIs and LSIs remain subject to conduct of business supervision by relevant NCAs for the breadth of EU regulated activity that is not within the mandate of the SSM; and
- the Single Resolution Mechanism (**SRM**), as Pillar II, tasked with the centralised coordination and discharge of powers to ensure BUSIs comply with the rules and powers in relation to their recovery or resolution.

A legislative proposal to set up a harmonised Eurozone system of deposit guarantee schemes, as Pillar III, is still in the process of being finalised. Lastly, the pillars of Banking Union operate concurrently with the mandates of the NCAs and the multinational European Supervisory Authorities (**ESAs**), such as the European Securities and Markets Authority (**ESMA**), the European Banking Authority (**EBA**) and the European Institutional and Occupational Pensions Authority (**EIOPA**) that together make up the European System of Financial Supervision (**ESFS**).

Part 1 – the F&P Guide, its scope, its contents and how it will affect the Banking Union and NCAs

Scope of application of the F&P Guide

Since the ECB took up its SSM supervisory mandate on 4 November 2014, it has been responsible for taking supervisory "**Decisions**" on the appointment of all members of the management bodies of those BUSIs that are categorised as SCIs. A supervisory Decision is a formal legal instrument of the ECB issued within the context of SSM. The ECB has direct powers to collect information, including through interviews and the imposition of conditions, obligations or recommendations in fit and power decisions. Where the ECB exercises its SSM powers it may also do this within the context and the powers of the substantive provisions of national law implementing EU legislation.

² At the time of publication, the EU is undertaking a regulatory review of the CRR/CRD IV Regime and has communicated draft proposals known as "**CRR 2/CRD V**". Once these are in final form, the scope of the F&P Guide may need to change to accommodate the changes made by CRR 2/CRD V.

In the case of CRD IV, and in particular the suitability requirements for BUSIs and the fit and proper assessments set out in Art. 91 CRD IV, these provisions contain what EU law terms "minimum harmonisation" provisions. As CRD IV was transposed across the EU-28 Member States (soon to be EU-27 as a result of the UK leaving the EU) in different ways, with some Member States even going beyond CRD IV's provisions, differences have occurred. This results in fragmentation and conceptual differences or even gaps. Some of these differences also exist across the 19 EU Member States of the Eurozone and its Banking Union.

As the ECB component of SSM exercises its powers within the context of the EU legislation transposing i.e., embedding CRD IV into the relevant national framework, the ECB-SSM and its F&P Guide seek to drive convergence on the rules as well as the supervisory approach so as to close the gaps. It does this using a jurisdiction agnostic approach which concurrently aims to build a common supervisory culture. For BUSIs this streamlining of supervision can reduce the cost of compliance and improve the certainty of supervisory engagement with the SSM's ECB component as well as the respective NCAs.

The F&P Guide in term of its scope of application, builds upon the operative provisions of the F&P Decision, uses the terminology in CRD IV as well as the rules in specific supervisory Guidelines³ of the EBA. Besides applying to those BUSIs primarily within its remit, it also is relevant in respect of those financial entities, who for the purposes of CRD IV, are categorised as "financial holding companies" or "mixed financial holding companies" as well as entities that are categorised as "qualifying holdings". The scope of the F&P Guide is thus of relevance for those licensing decisions for which the NCAs have the operational responsibility in the decision-making process, but for which the ECB-SSM has the ultimate and definitive supervisory power to grant or revoke a license for all BUSIs.

The F&P Guide, in term of its content, supplements the provisions contained in the F&P Decision as well as the ECB's Internal Manual on Supervision. The latter is supplemented by the relevant operating procedures of those NCAs within the Banking Union as well as the high-level contents that are set out in the ECB's November 2014 public "Guide to banking supervision". The F&P Guide is clear in that it expects SCIs will take note of and comply with the:

- A. policies, practices and processes described in the F&P Guide; and
- B. harmonised application of the assessment criteria and supervisory practices that the ECB-SSM will apply according to the F&P Guide.

The F&P Guide aspires to be jurisdiction agnostic and flexibly pragmatic. This is welcome and seeks to deliver the aims it has set itself namely to:

³ Specifically:

- EBA/GL/2012/06 – the EBA Guideline on the assessment of the suitability of members of the management body and key function holders – available per: <https://www.eba.europa.eu/documents/10180/106695/EBA-GL-2012-06--Guidelines-on-the-assessment-of-the-suitability-of-persons-.pdf>;
- EBA/GL/44 – EBA Guideline on internal governance – available per https://www.eba.europa.eu/documents/10180/103861/EBA-BS-2011-116-final-EBA-Guidelines-on-Internal-Governance-%282%29_1.pdf but note the on-going review process: <https://www.eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-internal-governance-revised-> ; and
- Draft Joint European Securities and Markets Authority (ESMA) and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under CRD IV and Directive 2014/65/EU – available per the following landing page: <https://www.esma.europa.eu/press-news/esma-news/joint-esma-and-eba-guidelines-assessment-suitability-members-management-body>

1. reinforce and build the EU Single Rulebook, as it applies in the Banking Union, in the area of fitness and probity assessments and also to achieve common supervisory practices;
2. be inclusive by extending to analogous functions where relevant. Specifically, the term "management body" that has a specific meaning in certain EU legal terminology is interpreted more widely to encompass the bodies (and by extension, "key function holders") in all "...governance structures that perform management or supervisory functions". For simplicity, this is referred herein collectively and generically as the "SSM Approved Functions" or (**SSM-AFs**); and
3. be jurisdiction agnostic and flexibly pragmatic as the F&P Guide *"...does not advocate any particular governance structure and is intended to embrace all existing structures."*

As a result, whilst the F&P Decision is a legally binding instrument of the ECB, the F&P Guide is framed as a 'non-binding legislative instrument' that is jurisdiction agnostic in that it *"...cannot in any way substitute the relevant legal requirements stemming either from applicable EU law or applicable national law."*

However, the fact that the F&P Guide, like other ECB-SSM authored supervisory guides, are addressed either to SSM supervisors and clearly spell out how they are to approach their supervisory priorities, or are addressed to BUSIs with the need for these to adopt a "comply and explain" approach" means that in many ways, irrespective of how the provisions are framed, they can be interpreted as being rules. This is reinforced equally by statements (see 2.4 of the F&P Guide) which clarifies (emphasis bold and clarifications in square brackets):

"These policies are adopted without prejudice to national law and in compliance with the EBA Guidelines. **In the absence of contradictory binding national law, they should be adhere to by the ECB and NCAs. The NCAs have agreed, to the extent possible, to interpret and develop national law in line with these policies. The [F&P] Guide reflects the policies that have been agreed on by the Supervisory Board by the end of 2016.** They will be reviewed in the light of the ongoing development of SSM practice for fit and proper supervision and international end European regulatory developments or new interpretations of the CRD IV, authoritatively presented by, for example, the Court of Justice of the European Union."

This combination of using an ECB Decision as a legal instrument to lay down the operative framework, complemented by a 'supervisory guide' (qua rulebook) is now becoming part and parcel of SSM rulemaking and supervisory convergence efforts in the Banking Union. In this instance, unlike other thematic work areas, there is very little interaction, cross-reference or necessarily interoperability between F&P Decision and F&P Guide, so that it is apparent that the F&P Guide's workstream was perhaps quite separate to the implementation of the F&P Decision irrespective of the F&P Decision providing the structure upon which the F&P Guide operates.

It is important to equally note that the F&P Guide, is drafted in parts by non-native English speakers and non-lawyers. The intended audience equally, as with other ECB instruments, may conduct their operations in languages other than English. As a result, some of the nuances of the F&P Guide, including, in particular, when a "should" in English does not include a degree of discretion, and instead really means "must", may be lost in translation. Unlike other ECB, and as of late EU, instruments the F&P Guide has replaced most but not all references of "should" with "must" or "need to". It equally remains to be seen whether any subsequent version of the F&P

Guide will resolve this and also perhaps be more precise and detailed in certain of its requirements. The F&P Guide does contain some typos and inconsistencies.

So, whilst the F&P Guide is far reaching in its intended scope and aims, it is important to assess where boundaries of its application lie before looking at its contents.

What the F&P Decision and the F&P Guide do not apply to and why that matters

What the F&P Decision and the F&P Guide do not (currently) do is extend to apply to "regular appointments" of LSIs. This means that fit and proper assessments for appointments in situations taking place after the licensing or qualifying holding of a LSI has been approved are not covered by the F&P Guide. It remains to be seen whether this will change with an extension or mirroring of the contents of the F&P Guide. Whilst LSIs are directly supervised by NCAs within the SSM, it is important to note that LSIs can become ECB-SSM supervised if they are designated a SCI. This can occur either at the election of the ECB-SSM or if the LSIs exceeds the relevant quantitative and/or qualitative thresholds of the "significance" criteria set out in the SSM Regulation⁴ and the SSM Framework Regulation⁵.

So, whilst the F&P Guide may in its first version be limited in how it applies to LSIs, it is important to note that in order to complete the Single Rulebook within the Banking Union, a number of SSM rulemaking instruments and/or supervisory guidance have first been applied to SCIs and certain LSIs, and then subsequently been rolled out to LSIs. Separate to this "regulatory roll-out" process, there are a number of NCAs, both within or outside the Banking Union, that elect to apply or closely follow the SSM supervisory approaches and/or the regulatory requirements as they apply to SCIs and thus "mirror the provisions" to dealings with LSIs and possibly non-BUSI type regulated entities. Several NCAs within the ESFS, especially those that are responsible for areas other than the banking sector, may however have their own differing rules, interpretation of those rule and/or a different supervisory culture to the SSM generally, or the NCAs that form part of the SSM.

Consequently, a mirror of the provisions or a roll-out of the F&P Guide to all banking sector BUSIs and non-BUSI firms in Jurisdiction X may mean that a NCA that is responsible for areas other than the banking sector might still have different rules on assessing what is fit and proper. Hence if Applicant A has been approved for SSM purposes and/or possibly within a roll-out/mirror scenario by a NCA, possibly even a non-SSM NCA, there can be no assurance that when Applicant A is assessed as being fit and proper by a NCA responsible for the insurance sector, that the F&P Guide assessment will be taken into account, or if it is, as fully. Nor can there be any assurance that any provisions and documentation already submitted in support of an application will not need to be resubmitted. Equally the standard of assessment may be differ.

This therefore leads to conceptual gaps both in terms of the rules themselves, the standards applied and the sharing (let alone centralisation) of information. It remains to be seen whether these conceptual gaps will be resolved, as if left unresolved could in fact exacerbate fragmentation or at the very least unnecessarily duplicate the amount of submissions needed in support of fit and proper assessments.

⁴ Council Regulation (EU) No 1024/2013 available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R1024&from=EN>

⁵ Regulation (EU) No 468/2014 available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0468&from=EN>

In summary, the F&P Guide's scope and contents are a welcome and necessary step to facilitating a greater common supervisory culture and a new chapter in the Single Rulebook project, as it applies within the Banking Union. It thus creates a more uniform and holistic set of "jurisdiction agnostic" standards. Yet its scope as it currently is drafted and applied leaves the benefits mostly to those SCIs without much interaction or interoperability with the processes that apply in respect of LSIs, non-BUSI financial services firms in the Eurozone or those in the EU-27. Consequently, for those areas it does not cover, it leaves those areas as is. These uncovered parts are however at risk of being left behind. This could lead to fragmentation as supervisory convergence advances in the areas that are covered.

Resolving fragmentation in a wholesome manner is a prerequisite to completing Banking Union more fully and contributing to more resilient financial entities as well as the system as a whole. As Banking Union as already proved in a number of areas, having convergence and uniform application of a truly Single Rulebook can contribute to reducing the cost of compliance by having one set of rules and supervisory approach as opposed to a patchwork interspersed by conceptual gaps across jurisdictions and thematic areas.

CRD IV Internal governance

EU legislation requires that regulated financial institutions, in particular credit institutions, and thus BUSIs within the Banking Union, have robust governance arrangements, including clear organisational structures, well defined lines of responsibility, effective risk management processes, control mechanisms and remuneration policies. These arrangements are required to be proportionate to the nature, scale and complexity of the organisation. The main responsibility for internal governance lies with the "management body", which is subject to specific suitability requirements. The EBA and now the ECB-SSM have further refined the rules, at the EU level, as to what constitutes suitability of such management body and the fitness and propriety of the persons involved. It is important to note that these internal governance requirements of the CRR/CRD IV Regime, as it applies to credit institutions, and thus BUSIs within the Banking Union, may be supplemented and complemented by other internal governance requirements that exist as a matter of EU law, such as the MiFID II/MiFIR Regime, as well as at the national level. These requirements may also be supplemented by requirements that apply to specific persons, including the management, supervisory and other regulated functions exercised by individuals. In many jurisdictions, the provisions of national law and regulatory regimes are more prescriptive than the minimum and/or harmonising standards that have been prescribed at the EU level. This may remain the case despite the F&P Guide creating more uniformity.

Contents of the F&P Guide

The operative provisions of the F&P Guide can be distinguished between:

- six (6) supervisory "Principles" set out in Chapter 3 of the F&P Guide;
- the five (5) fitness and propriety assessment criteria set out in Chapter 4 of the F&P Guide;
- the supervisory assessment interview process set out in Chapter 5 of the F&P Guide;
- the supervisory assessment process set out in Chapter 6 of the F&P Guide; and

- the formal supervisory decision process set out in Chapter 7 of the F&P Guide,

each of which are explored in further detail below.

The F&P Guide concludes with a short Chapter 8, providing a reminder that, per Art. 16(2)(m) of the SSM Regulation, the ECB-SSM component has the power, at any time, to remove those members from the SSM-AFs of a SCI who breach certain supervisory threshold conditions. This power is separate to but may exercised concurrently with the other ECB's SSM powers and/or powers of the NCA within the SSM or NCAs or those of other non-Banking Union authorities.

Chapter 3 of the F&P Guide – the supervisory "Principles"

This Chapter introduces six supervisory "Principles" that act as overarching guidance for ECB-SSM and NCAs within Banking Union as well as BUSIs alike. In many ways, these supervisory "Principles" mark the first move of SSM to enshrine formal 'principles based regulation' as a support to outcomes-based and rules-based regulation contained in other SSM-specific instruments, or, in a wider setting, the other components of the Single Rulebook as applied within the Banking Union. Whilst some of these "Principles" may be familiar for certain BUSIs operating in the Banking Union and/or the wider EU as well as the UK, they do not displace those existing principles. These F&P Guide specific provisions include:

Principle	Key requirement(s) for supervisors	Key takeaways for BUSIs
Principle 1 – Primary responsibility of credit institutions	<ul style="list-style-type: none"> • ECB and NCAs decide what information must be provided including national forms if necessary⁶. • Where necessary, the ECB and NCA can ask the BUSI or the "appointee" i.e., the applicant to provide additional information in writing or orally. Failure to provide the information renders the application incomplete and no positive supervisory decision can be taken. 	<ul style="list-style-type: none"> • BUSIs are primarily responsible for selecting individuals for the SSM-AFs who comply with the fitness and propriety requirements. • BUSIs are responsible for their own due diligence assessment of the members of the SSM-AFs both prior to appointment and on an ongoing basis. • All information necessary must be provided in a timely and accurate manner to the competent authorities.
Principle 2 – Gatekeeper	<ul style="list-style-type: none"> • The ECB-SSM acts as gatekeeper to ensure that individuals who would pose a risk to the proper function of the SSM-AFs are prevented from entering in the first place or from continuing to act in that role. NB: there is nothing in the F&P Guide that explicitly suggests what would happen if there is a disagreement between the ECB-SSM and a non-Banking Union NCA in relation to that person. 	<ul style="list-style-type: none"> • Implied reference to BUSIs to remain cognisant of their existing EU and national legislative and regulatory obligations to ensure that their SSM-AFs remain fit and proper. In certain jurisdictions, early warning and self-notification/disclosure requirements apply in addition to detailed periodic certifications.
Principle 3 – Harmonisation	<ul style="list-style-type: none"> • The ECB-SSM's activity and the contents of the F&P Guide seek to ensure a higher level of harmonisation i.e., drive supervisory convergence and homogeneity. 	<ul style="list-style-type: none"> • No real operative impact for BUSIs but, as per above, conceptual gaps and supervisory fragmentation are issues that will require capture in a compliance framework.

⁶ Available from the ECB-SSM website together with the "Fit and Proper Questionnaire" available at <https://www.bankingsupervision.europa.eu/banking/tasks/authorisation/html/index.en.html>



Principle 4 – Proportionality and case-by-case assessment	<ul style="list-style-type: none"> Fit and proper assessments shall be conducted on a proportionate manner and the application of the suitability criteria should be commensurate with relevant role of the SSM-AF as well as the size of the BUSI and its nature, scale and complexity of its activities. 	<ul style="list-style-type: none"> From a practical perspective this means that BUSIs wishing to avail of a proportionate and commensurate assessment process will need to justify and explain why this should apply and that in it applying it does not detract or reduce from the supervisory outcomes or quality of supervision.
Principle 5 – Principles of due process and fairness	<ul style="list-style-type: none"> Fit and proper assessments are confidential and the ECB has a duty to take a supervisory decision in a balanced manner based on the material information provided. 	<ul style="list-style-type: none"> BUSIs retain all the procedural guarantees introduced by the SSM Regulation, the SSM Framework Regulation including the right to appeal a supervisory decision.
Principle 6 – Interaction with ongoing supervision	A fit and proper assessment drives supervision of BUSI governance. Any supervisory decisions may drive ongoing supervision and vice versa.	BUSIs need to deal openly with supervisor.

Chapter 4 of the F&P Guide – the fitness and propriety assessment criteria

The F&P Guide’s five fitness and proprietary assessment criteria can be summarised as:

Assessment Criteria	Key requirement(s) for supervisors	How Criterion is assessed by supervisor	Key takeaways for BUSIs
Criterion 1 – Experience	<ul style="list-style-type: none"> SSM-AF Members must have sufficient knowledge, skills and experience to fulfil their functions. The test of "experience" for the purposes of the F&P Guide (currently) is used in a broad sense that extends to practical and professional experience from previous occupations as well as theoretical experience (knowledge and skills) gained through education and training. All SSM-AFs are required to have as a minimum threshold "<i>basic theoretical banking experience that allows them to understand the institution’s activities and main risks</i>". This includes minimum experience (or completion of specific 	<ul style="list-style-type: none"> Review of CVs including an assessment of previous positions and responsibilities held, length of service, number of reports, size of entity and the actual relevance for the SSM-AF. Without prejudice to national forms, a detailed CV is required to be submitted. Training plans already followed or to be implemented will be reviewed and accounted for as providing evidence of suitability or a method of curing deficiencies of the experience of a SSM-AF appointee i.e., proposed applicant. 	<ul style="list-style-type: none"> This SSM-AF Criterion, in particular what constitutes "experience" may have more stringent requirements in certain jurisdictions, including when assessed outside the context of Banking Union. BUSIs will thus most likely want to ensure the more stringent requirement is fulfilled. Proportionality applies, so that a more complex SSM-AF function will require more experience than a less complex SSM-AF. Management body SSM-AFs may require a different level of experience than those of the supervisory functions if these bodies are separate. Specific SSM-AFs such as the Chief Risk Officer, Chief Financial Officer, Compliance Officer, Chair of the Audit Committee or



	training) covering financial markets, legal and regulatory requirements, strategic planning and the implementation of the business plan, risk management, accounting and auditing, compliance and governance control assessments and financial controlling.		Chair of the Risk Committee will need to provide evidence of demonstrable specialised experience in the relevant area. These are in addition to the "detailed presumption of adequate experience requirements" set out in the F&P Guide on page 12.
Criterion 2 - Reputation	<ul style="list-style-type: none"> SSM-AF members shall at all times be of sufficiently good repute "...to ensure the sound and prudent management of the supervised entity". 	<ul style="list-style-type: none"> Satisfied as being of "good repute" if there is no evidence to suggest otherwise and no reason to have reasonable doubt about the good repute. This includes assessing the nature of (pending) criminal or administrative legal proceedings. 	<ul style="list-style-type: none"> There is no proportionality test available.
Criterion 3 – Conflicts of interest and independence of mind	<ul style="list-style-type: none"> SSM-AF members "should" (this probably means "must") be able to make sound, objective and independent decisions – and thus free of conflicts of interest. An inability to resolve a material conflict of interest means the SSM-AF appointee cannot be considered suitable. Table 1 of the F&P Guide (page 17) sets out a non-exhaustive list of potential conflicts of interest that are presumed to be material and would be assessed on a case-by-case basis where they exist. In summary, this includes any of the following between the SSM-AF appointee and the BUSI and members of its group: <ul style="list-style-type: none"> current close-personal 	<ul style="list-style-type: none"> The competent authorities will assess the materiality of the conflict of interest and the adequacy of measures adopted by the BUSI. If there are residual concerns, then a supervisory "condition" may be imposed in respect of the individual SSM-AF application. Possible conditions include (1) recusal from meetings or decision-making; (2) resignation of a certain position; (3) specific internal monitoring by BUSI; (4) specific reporting to authorities; (5) cooling-off period; (6) obligation of BUSI to publish details of conflict; (7) imposition of "at arm's length" conditions; and/or (8) specific approvals by the whole 	<ul style="list-style-type: none"> BUSIs and the SSM-AF appointee must inform the competent authority of all conflicts of interest and BUSIs must provide a "Conflict of Interest Statement" explaining how that conflict is being prevented, mitigated or managed. BUSIs "should" (this probably means "must") governance policies in place for identifying, mitigating, managing and preventing conflicts of interest, whether actual, potential or perceived. Conflicts are to be split between those that are material and which require taking specific actions and those that are not material. The F&P Guide is however not fully clear as to what should happen if there is a conflict between a national law/regulatory requirement and/or



	<p>relationships, current legal proceedings, conduct of significant business;</p> <ul style="list-style-type: none"> ○ the current or holding of any of the following over the past two years within the BUSI, its group or its competitors, a "senior staff position", commercial relationship, commercial interest; ○ a current substantial financial interest in or obligation (incl. loans, investments and shareholdings) to the BUSI its group, its clients and competitors; and/or ○ a current or the following over the past two years: the SSM-AF appointee or a close personal relation holds a position of high political influence. 	<p>management body for a certain situation to continue.</p>	<p>professional requirement in relation to the affected person or BUSI. The anticipation is that the more stringent rules should take precedence and that any BUSI conflicts of interest policy has a detailed and holistic framework and hierarchy of precedence.</p> <ul style="list-style-type: none"> • The supervisory condition number 8 may not be permissible or capable of compliance in certain jurisdictions as it might conflict with individual company law directorship and/or professional duties. • The presumed material conflicts of interest are exceptionally wide-reaching. Certain standards are conceptually different in the F&P Guide than in law i.e., "high political influence" v "politically exposed person".
<p>Criterion 4 – Time commitment</p>	<ul style="list-style-type: none"> • All SSM-AF members must be able to commit sufficient time to performing their functions in the institution. 	<ul style="list-style-type: none"> • Assessment of the number of directorships held, the size and complexity of the entities and the activities of where other directorships are held and the place or jurisdiction in which they are located. • Additional 	<ul style="list-style-type: none"> • The number of directorships which be held by a member of the management body of a "significant institution" for purposes of CRD IV, which can be both a LSI and/or SCI for SSM purposes, is limited to one executive directorship and two non-



		<p>assessment of professional or personal commitments and circumstances.</p> <ul style="list-style-type: none"> • BUSIs will need to deliver a specification of the time commitment required for a role, a full list of mandates and expected time commitments and a self-declaration by the SSM-AF appointee that they have sufficient time to dedicate to all the mandates. 	<p>executive directorships or four non-executive directorships subject to exemptions for directorships within same group, same qualifying holding or institutional protection scheme. Another exemption applies for directorships in non-profit sports or cultural associations, charities, churches (presumably this extends to other organisations of worship) chambers of commerce/trade unions/professional associations and private discretionary investment vehicles of the management body.</p>
<p>Criterion 5 - Collective suitability</p>	<ul style="list-style-type: none"> • BUSIs must have SSM-AFs that evidence collective suitability. • The F&P Decision also requires that a management body evidence "sufficient diversity" (undefined term). 	<ul style="list-style-type: none"> • The BUSI must provide the following information that will be assessed: <ul style="list-style-type: none"> ○ A description of the composition of the SSM-AF; ○ A short reasoned statement on how the SSM-AF appointee contributes to the collective suitability needs; and ○ where it exists, a result of the periodic self-assessment of the collective suitability. 	<ul style="list-style-type: none"> • The BUSI has primary responsibility in identifying the gaps in the SSM-AFs and its collective suitability and SCIs must report this to the Joint Supervisory Team.

Chapter 5 of the F&P Guide – supervisory interviews

One of the ECB-SSM's primary tools for gathering and/or validating information is the use of supervisory interviews. These are conducted by an interview panel of at least two and no more than three supervisory staff of sufficient seniority interviewing the SSM-AF appointee. The



interview panel is required to be free of conflicts of interest (actual or perceived) and free from bias. Supervisory interviews must be scheduled with sufficient advance notice in writing of date, time and place of the requested interview and equally the language in which the interview is to be conducted. To the extent the BUSI has agreed to receive supervisory Decisions in English, the interviews will then be conducted in English.

The F&P Guide is clear that reviews of any new appointment of CEOs and Chairperson positions (or equivalents) at standalone BUSIs and/or at the top level of a BUSI group will be conducted, including interviews, in order to fulfil the ECB-SSM's supervisory tasks in this area. It should however be noted that an ECB-SSM led interview does not preclude interviews being led by Banking Union NCAs and/or other EU and national authorities.

The interview process is split between what is an "informative interview" i.e., fact-gathering and any follow-up "specific interviews". Unlike the rules of certain national authorities the F&P Guide is not clear whether those individuals that have been invited to an interview may, if circumstances dictate, make use of their legal rights to be accompanied by legal counsel.

It should also be noted that whilst ECB-SSM rules dictate that any recordings of the interview are to be held as confidential and in accordance with the ECB's data handling procedures, unlike other authorities, it is unclear whether the SSM-AF appointee has a right to review or correct the notes or recordings prior to these being used for a Decision. The rights to legal representation, rights to access files and the right to a "statement of reasons" are only available after receipt of a communicated Decision.

Chapter 6 of the F&P Guide – the supervisory assessment process

The F&P Guide is clear that a fit and proper assessment can be triggered by any of the following occurring or being planned:

1. a new appointment, a change of role or a renewal;
2. new facts or any other issue arise; or
3. in the context of a licensing or qualifying holding procedure.

Resignations do not require a supervisory Decision, except where there are concerns that the Assessment Criterion 5 (Collective suitability) may no longer be satisfied. In such instances, a supervisory-led exit interview may be conducted. As with the above, the absence of an ECB-SSM-led interview or administrative/operative process will not preclude the operation of such process by any other regulator or supervisor exercising its own competent jurisdiction.

The stakeholder decision tree involves a SCI lodging a request for an assessment, using national notification forms, where available, with the relevant NCAs who in turn inform the ECB-SSM. The NCA and the ECB-SSM together collect the necessary and carry-out the assessment. Following the assessment, a draft supervisory Decision is prepared by the ECB-SSM, in conjunction with the NCA, and then submitted to the ECB-SSM's Supervisory Board who will approve the supervisory Decision that is then communicated formally to the BUSI and the SSM-AF appointee by the ECB's Governing Council. This process is however subject to the election of a Decision being delegated, in accordance with the terms of the F&P Decision to certain SSM heads of unit, who exercise delegated authority to approve certain supervisory Decisions, as described below.

Chapter 7 of the F&P Guide – the supervisory Decision process

Supervisory Decisions form the basis of how the ECB-SSM formally communicates a supervisory outcome to the relevant BUSI, or in the case of fit and proper assessments, the SSM-AF appointee. In the case of the F&P Guide, the following types of supervisory Decisions can be approved and communicated to the BUSI and, in "exceptional circumstances", to the SSM-AF appointee:

- **negative Decision;**
- **positive Decision;**
- **positive Decision with a supervisory "Recommendation".** These non-binding instruments of the ECB may set out supervisory expectations to be fulfilled including the taking or refraining from taking action in relation to a certain issue;
- **positive Decision with a supervisory "Condition".** This is a more formal instrument and may only be imposed where a negative Decision could be adopted but the shortcoming is easily remediable, the Condition is well defined and can be fulfilled in a short time frame, or the content of the Condition can be grounded on the basis of the Assessment Criteria established in applicable national law. The F&P Guide is clear that the most common Conditions include (but are not necessarily limited to):
 - a. an undertaking to follow specific training;
 - b. divestiture of an external directorship or function; or
 - c. a probationary period. The BUSI is required to notify the ECB (and presumably a host of other regulators/supervisors – although the F&P Guide omits this) once the Condition has been satisfied;
- **positive Decision with an obligation.** This includes an obligation upon the recipient of the Decision to take a specific action relating to the fitness and propriety that apply to the BUSI as a whole but not the SSM-AF appointee. According to the F&P Guide the most common "obligations" include:
 - a. reporting on pending legal proceedings;
 - b. improvements to written conflicts of interest policies; or
 - c. improvements to collective suitability.

Positive and negative supervisory Decisions can include references to related ongoing supervisory workstreams. In each instance, the following principles and redress options, as set-out in the SSM Framework Regulation apply following the communication of a Decision and allow the BUSI and the SSM-AF:

- appellant rights subject to thee having sufficient standing i.e., is only available to concerned parties. Once standing is proven the party has the right to be heard both in terms of the ECB-SSM's Administrative Board of Review or to challenge a Decision directly with the Court of Justice of the European Union;
- appellant parties have the right to legal representation, the right of access to the ECB file and the right to receive a "statement of reasons"; and

- the ECB-SSM shall take into account all relevant circumstances and may hear witnesses and experts if it deems necessary. The ECM-SSM may also take evidence.

What the F&P Guide does not do is clarify the rights of the appellant(s) to redress via the NCAs and/or the relevant dispute resolution venues.

The F&P Decision's powers to authorise heads of unit to exercise delegated authority in relation to supervisory Decisions on fitness and propriety

Given the sheer volume of Decisions, which will only increase as a result of BREXIT, certain Decisions are able to be delegated to heads of unit within the ECB-SSM. The F&P Decision, specifically Art. 3 thereof, sets out the instances where a fitness and propriety Decision may be delegated to the relevant heads of work unit, as described in Decision (EU) 2017/936. The types of Decisions that may be delegated were those that are neither complex, controversial or in relation to SSM-AFs at entities not at the top level of a group or an entity which represents the bulk of assets. This allows for a more streamlined administrative process.

Consequently, Art. 3 of the F&P Decision sets out which fitness and propriety Decisions may not be delegated and thus which must go through the ordinary approval process i.e., via the Supervisory Board and Governing Council. The scope of this process could change over time depending on how the SSM copes with the volume of administrative processes. At present Art. 3 of the F&P Decision sets out that these non-delegable Decisions in relation to fitness and propriety include where the assessment is in relation:

- to a supervised entity at the highest level of consolidation within the Banking Union Member State of a supervised group;
- the credit institution with the largest total value of assets in a significant supervised group;
- a SCI that is not part of a significant supervised group;
- to a person applying for a SSM-AF who does not fulfil the fit and proper requirements – i.e. a negative Decision;
- to a person applying for a SSM-AF in which a positive Decision contains conditions – unless such conditions are necessary to cure the fit and proper requirements and have been agreed in writing;
- the person applying for the SSM-AF is currently subject to "criminal proceedings before a court of law or been convicted of a criminal offence at first or final instance" – presumably this also applies to courts of appeal as if not this would be a gap and thus possibly an oversight;
- the person applying for the SSM-AF is currently subject to a financial services or regulatory investigation, an enforcement action or an administrative sanction is currently being carried out, pending or imposed upon that person;
- a draft delegated Decision and the NCA has not submitted this 20 working days prior to the expiry of the deadline for the adoption of a fit and proper Decision under applicable law; or

- a Decision has insufficient information or the complexity of the assessment requires that the fit and proposer Decision be adopted under the ECB-SSM's existing "non-objection procedure" and thus goes through the ordinary procedure.

For those fitness and propriety Decisions that may be delegated, the provisions of Decision (EU) 2017/936 of the European Central Bank⁷ apply. This was published on the ECB website on 1 June 2017 and complements the general delegation power in Art. 2 of the F&P Decision. In short, this Decision 2017/936 clarifies the heads of work units to whom this decision-making delegated to. The authority is delegated to the relevant Deputy Director General of ECB Directorate General Microprudential Supervision IV (at time of writing, Francois-Louis Michaud and Giuseppe Siani), or in the case of absence, the Head of the Authorisation Division (at the time of writing, Sofia Maria Toscano Rico) jointly together with one of the heads of the relevant Director Generals of the relevant Directorate General of Microprudential Supervision that is tasked with the supervision of the relevant SCI or the group.

New ECB Decisions on streamlining process for adopting supervisory Decisions on "significance"

The ECB-SSM's bid to streamline administrative procedures has also extended to those that relate to supervisory Decisions on significance of a BUSI i.e., its categorisation as a LSI or SCI. These delegation mechanics are set out in Decision (EU) 2017/937 of the European Central Bank⁸, which nominates specific heads of ECB-SSM business units to adopt delegated supervisory Decisions⁹ instead of the ECB's governing bodies. This was published on the ECB website on 1 June 2017. This only applies to determining "significance" and the supervisory Decisions for those entities:

- that classify or cease to classify a SCIs as included within a "significant supervised group";
- that cease to classify a BUSI as a SCI; or
- that are SCIs and alter their name.

Part 2 - practical considerations for firms needing to comply with the F&P Guide and/or with the recent "SPoRs"?

So, what does all of this mean in practice? Firstly, it means that BUSIs and those wishing to, due to BREXIT or otherwise, establish themselves in the Banking Union will need to be patient as the more intensive supervisory scrutiny is likely to mean that administrative timelines for review and approvals potentially take longer. This is the case despite the SSM's best efforts in streamlining its administrative provisions as of late, including the internal simplification of the approval process for non-material or less complex supervisory Decisions.

⁷ See: http://www.ecb.europa.eu/ecb/legal/pdf/celex_32017d0016_en_txt.pdf

⁸ See: http://www.ecb.europa.eu/ecb/legal/pdf/celex_32017d0017_en_txt.pdf

⁹ Permitted by ECB Decision (EU) 2017/933 (ECB/2016/40).

Secondly, in terms of qualitative and quantitative issues the advent of the F&P Guide and the on-going development of the SPoRs will likely yield the following for BUSIs and those wishing to establish in the Eurozone and its Banking Union:

1. a more harmonised approach, as the F&P Guide seeks to establish a common supervisory approach in the area of fitness and propriety assessments, whilst at the same time finding its supervisory tone in implementing and administering what is a new component of the Single Rulebook, certainly as it applies in the Banking Union. Concurrently, the EBA's rules in this area, which apply across the whole of the EU, have yet to be fully finalised. As with other ECB-SSM driven rules, it remains to be seen how quickly a regulatory roll-out and/or mirroring of provisions is likely to be driven forward across the whole of the Banking Union and breadth of BUSIs;
2. with BREXIT, the volume of fitness and propriety assessments are likely to increase. The increased scrutiny that is expected, and as communicated by the SPoRs may contribute to longer lead times, when compared to the processing times of certain NCAs that some market participants may be used to;
3. despite the immense benefits of having uniformity and greater certainty in the rules offered in the F&P Guide, some of its provisions may not close the breadth of conceptual gaps that exist amongst the 19 Eurozone Member States, or do so as fully. Consequently, the residual gaps could cause further fragmentation. This means that SSM-AFs, firms and their advisers, will need to remain cognisant of the gaps and competing provisions as well as contradictions whilst the regime moves from standardisation increasingly to a uniform regime. The identification, mitigation and management of conflicts of interest, an area that the F&P Guide is comparably prescriptive and presumptive on, will require specific attention to make sure it can actually be complied with and that processing times are not unduly delayed; and
4. in a wider sense, the terms and framework of the F&P Guide, how it interoperates with the wider ESFS as well as the supervisory engagements of firms with NCAs will also mean taking a periodic look and possibly taking rectifying measures to ensure that Banking Union specific compliance and internal policies and processes are fully fit for purposes. This means ensuring that written policies and procedures are not only designed with a view to interoperate and be compatible with non-Banking Union and non-EU regulatory regimes but are actually embedded within the relevant BUSI and its group. Specifically, the interaction with the rules of the UK regulators and specifically the Senior Managers & Certification Regime is likely to be crucial.

Conclusion and next steps

These are certainly not insurmountable challenges; however, they will require more active horizon scanning of regulatory and supervisory developments at the following levels: the ECB-SSM, Banking Union and non-Banking Union levels of the ESFS. It will also require an on-going evaluation of changes in depth and breadth of conceptual gaps might affect business and strategy priorities. Whilst the F&P Guide cements the fitness and propriety regime in a concrete uniform manner within the Banking Union, it does present a number of opportunities, which might make the cost of compliance more efficient.

With the ESAs and the Banking Union's SSM and SRM likely to further intensify their supervisory scrutiny of BUSI's internal governance arrangements they will probably use fitness and propriety assessments as an on-going tool to check compliance. Firms will thus need to take a more strategic view in an area that has historically been less invasive and where prudential supervisors have been less proactive. All of this comes on top of NCAs efforts in this and other conduct of business workstreams and thus requires firms and their advisers to take a joined-up view balancing jurisdiction-specific requirements with a Single Rulebook that is becoming more uniform.

Should you wish to continue the conversation on the subjects raised herein, please do get in touch with any of our Eurozone Hub key contacts below.

For further information, please contact:



Michael Huertas, LL.M., MBA
Counsel
Solicitor (England & Wales and
Ireland) Registered European
Lawyer - Frankfurt
+49 69 2 99 08 376
michael.huertas@bakermckenzie.com



Sandra Wittinghofer
Partner
Rechtsanwältin and Solicitor
(England & Wales)
+49 69 2 99 08 275
sandra.wittinghofer@bakermckenzie.com



Dr. Manuel Lorenz, LL.M.
Partner
Rechtsanwalt and Solicitor
(England & Wales)
+49 69 2 99 08 506
manuel.lorenz@bakermckenzie.com