

THE MUCH-ANTICIPATED REFORM OF FIT AND PROPER REQUIREMENTS FOR BANKS: THE LATEST NEWS

1. Introduction

Fit and proper requirements applicable to members of the management, administrative and supervisory bodies are currently undergoing a process of extensive reform, the outcome of which will mould a remarkably innovative set of corporate governance rules.

2. The main regulatory updates at the EU level

At the **EU regulatory level**, the adoption of the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders in banks and investment firms on the 21st of March 2018 (the "**Joint Guidelines**") and of the ECB Guide to fit and proper assessments published in May 2017 (the "**ECB Guide**"⁽¹⁾) should be recalled.

Recently, on the 31st of July 2020 EBA and ESMA published a consultation paper concerning a set of proposed amendments to the Joint Guidelines (the "**Public Consultation**") – in accordance with Art. 91(12) of EU Directive 2013/36/EU on the prudential supervision of credit institutions ("**CRD IV**"), as amended by EU Directive 2019/878 ("**CRD V**") and by Art. 9 of EU Directive 2014/65/EU ("**MiFID II**") – carried out in order to align the definitions contained in the Joint Guidelines to the new provisions introduced by the CRD V and by EU Directive 2019/2034 on the prudential supervision of investment firms ("**IFD**").

Within the scope of the Public Consultation, the following points should be highlighted:

- **board member responsible for AML regulations:** against the backdrop of the prevention of money laundering and countering terrorist financing, it is essential that senior managers take responsibility for the identification, assessment and management of AML risks. To this end, institutions are required to designate a board member as person responsible for the implementation of AML regulations. The person appointed must possess sufficient knowledge, skills and experience in this area;
- **improvements to gender diversity:** the Public Consultation stresses the need to set out measures aimed at ensuring a more gender-balanced composition of the management body. In addition, the adoption of an ad hoc diversity policy, referring to – *inter alia* – educational and professional backgrounds and to gender and age is mandated.

(1) It should be highlighted that the reform is part of the Single Supervisory Mechanism ("**SSM**"), pursuant to Regulation (EU) No. 1024/2013. Indeed, Article 4(1) (e) states that the assessment of fit and proper requirements for the persons responsible for the management of credit institutions is part of the ECB's supervisory powers on the overall governance of banks. On this basis, the ECB Guide applies "to fit and proper assessments of members of the management body, both in their management function (executives) and supervisory function (non-executives) of all institutions under the direct supervision of the ECB (significant institutions – SIs), whether credit institutions or (mixed) financial holding companies, and in the case of licensing or qualifying holdings also of less significant institutions (LSIs). On the basis of Article 6(4) of the SSM Regulation, responsibility for regular appointments in LSIs (i.e. outside the context of licensing or qualifying holdings) lies with the national competent authorities (NCAs)".

3. The main regulatory updates at the national level

At the **national regulatory level**, the Minister of Economy and Finance (“MEF”) published a consultation on the 1st of August 2017 regarding the draft implementation decree of Art. 26 of the Legislative Decree n. 385 of the 1st September 1993 (Italian Banking Act, “IBA”) (the “**Draft Decree**”) which will be adopted following a consultation with the Bank of Italy, with the aim at identifying the requirements which board members of banks must meet, the maximum number of directorships held, the grounds for the temporary suspension of a board member and its maximum duration by of a decree adopted following a consultation with the Bank of Italy. The public consultation ended on the 22nd of September 2017. As of today, the said Draft Decree has not yet been adopted and, as a result, the regulations contained in the Ministerial Decree no. 161 of the 18th of March 1998 (the “**MD 161/1998**”) continue to apply.

However, a further step towards the adoption of the Draft Decree should be highlighted.

On the 16th of October 2020, the consultative section of the State Council issued opinion no. 1604 on the Draft Decree (the “**State Council Opinion**”), which on the one hand addresses mainly terminological aspects and on the other hand provides an overall positive evaluation of the Draft Decree, describing it as “*a complete implementation of primary legislation [...] which addresses proportionally and reasonably (albeit any assessment of merit is precluded, given that it is a matter of administrative discretion) the tightening of suitability requirements of banks’ board members, which has in turn been put forward at the European level by the so-called CRD IV package*”.

As to the content of the Draft Decree, it should be underlined that it significantly tightens the suitability requirements of the senior management of banks, in line with the Joint Guidelines and the ECB Guide. Along with professional and integrity requirements, which were already provided for by Art. 26 of the IBA and MD 161/1998, the Draft Decree introduces the new criteria of fairness (2), competence (3), independence (4), on top of the criteria related to the appropriate composition of the management body (5), the maximum number of directorships held and sufficient time commitment (6).

With regards to the independence requirements, it is important to stress that, for listed banks, the above-mentioned regulations must be read in conjunction with the new Code of Corporate Governance (the “**Code**”) adopted on the 30th of January 2020 which replaces the Code of Conduct of 2018. The Code will apply from the first budget year beginning after the 31st of December 2020.

Even though the independence requirements have not been substantially amended with respect to the 2018 Code of Conduct, it is useful to highlight that Recommendation no. 7 of Art. 2 of the new

(2) The **fairness** criterion relates to past professional and personal conducts, such as convictions, administrative sanctions and disciplinary measures.

(3) The **competence** criterion relates to the adequate theoretical knowledge of, and a sufficient practical experience in, the relevant applicable fields (e.g. financial markets, financial and banking regulation).

(4) The **independence** requirement is considered not to be met when – *inter alia* – a board member of the bank is also a qualifying shareholder, or has economic or professional relations with the bank which may compromise their independence, or has been a board member of the bank for at least 9 out of the last 10 years.

(5) On the basis of the requirement that the **composition of the management body be adequate**, it is required that the composition of the management and supervisory bodies be structured in such a way as to stimulate internal dialogue, a multi-approach strategy and perspective and to effectively support the elaboration of strategies, management of activities and of risks.

(6) The criteria pertaining to the maximum **number of directorships held** and to the **sufficient time commitment** of board members are met when a given board member does not hold more than 1 executive office and 2 non-executive offices, or 4 non-executive offices. If such limits are exceeded, the body must revoke the appointment.

Newsletter

NOVEMBER 2020

Code, recommends the *ex ante* adoption of “quantitative” and “qualitative” criteria in order to assess the materiality of the relations of members of the management and/or supervisory bodies with the company in question or with other related companies.

On top of that, the new elements introduced by the Code which pertain to the other members of the management body provide that:

- the management body must comprise at least two independent directors, in addition to the president;
- in large companies with concentrated ownership, independent directors must amount to at least one third of the management body;
- in large companies with diffuse ownership, independent directors must amount to at least one half of the management body.

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The *Financial Intermediaries Regulations* Department of Legance is available to provide any clarifications, also in respect of any specific situation which may be of interest to you.

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Newsletter

NOVEMBER 2020

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