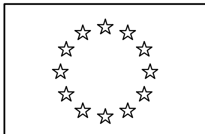

EUROPEAN COMMISSION

Brussels, 20.7.2011
SEC(2011) 953 final

COMMISSION STAFF WORKING PAPER

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate

{COM(2011) 453 final}
{SEC(2011) 952 final}

1. INTRODUCTION

In its Communication of 9 December 2010[1] the Commission has envisaged EU legislative action to approximate and reinforce sanctioning regimes in the financial.

In its Communication of 4 March 2009[2], the European Commission announced that it would (i) examine corporate governance rules and practice within financial institutions in the light of the financial crisis, and (ii) where appropriate, make recommendations or propose regulatory measures.

This Impact Assessment provides an analysis of the possible measures that may be taken in the area covered by the Capital Requirements Directive (CRD). It is a complement to the Impact Assessment for the "CRD IV" proposal.

2. PROBLEM DEFINITION

Sanctioning regimes

National sanctioning regimes currently in place for key violations of the CRD are divergent and not always appropriate to ensure effective enforcement. Certain important sanctioning powers are not available to all national authorities and sanctions are not published on a systematic basis. In some Member States the levels of administrative pecuniary sanctions (fines) are too low and thus insufficiently deterrent; and sanctions cannot be imposed on both credit institutions and individuals responsible for violations. When determining the level of sanctions to be imposed, some national authorities do not take into account criteria which are important to ensure proportionality and dissuasiveness of sanctions.

Moreover, the actual application of sanctions differs in Member States, including those with banking sectors of similar size. In some Member States, few sanctions or no sanctions at all have been applied during the last years, which could be symptomatic of a weak enforcement of EU rules.

This situation may result in a lack of compliance with the EU rules, create distortions of competition in the Internal Market and have a negative impact on financial supervision, undermining proper functioning of banking markets, which can be detrimental to the protection of deposit-holders and investors and to the confidence in the financial sector.

Corporate governance

In June 2010 the Commission published a Green Paper on corporate governance in financial institutions and remuneration policies[3] and an accompanying staff working document[4] which analysed the deficiencies in corporate governance arrangements in the financial services industry revealed by the financial crisis which contributed to excessive risk-taking.

---

1 COM (2010)716 final.

2 COM (2009) 114 final

3 COM(2010)0284 final

4 Commission staff working document - Corporate Governance in Financial Institutions: Lessons to be drawn from the current financial crisis, best practices, SEC(2010) 0669 final

Inadequate risk oversight by Boards

In many cases, Boards were either unable or reluctant to challenge executive management on their strategic business decisions. This was often the result of insufficient time commitment and inadequate technical knowledge on the Boards of credit institutions. In some cases, management dominance and insufficient diversity in Board composition undermined the objectivity of Boards.

In addition, Boards were often not sufficiently involved in the overall risk strategy and, as a result, executive management's strategic approach to risk was not monitored, excessive risk-taking incentives were established and proper systems to ensure effective risk management were not implemented. Also, Boards did not spend sufficient time discussing risk issues as risk management was regarded as a low priority compared to other subjects, such as growth strategy. Reporting on risk has not been in all situations timely and comprehensive, due in particular to a lack of direct lines of reporting of the risk management function to the Board.

Finally, in many cases, the risk management function has not been given proper weight in decision-making process.

Non-binding nature of the principles – inadequate supervisory review of corporate governance

The non-binding nature of most of the corporate governance principles contributed to the lack of effective compliance by credit institutions with these principles, leaving the implementation mostly to self regulation and external monitoring by shareholders. The shortcomings identified by the crisis, demonstrated that these mechanisms did not work in practice. In particular, in the absence of a clear corporate governance framework and a defined supervisory role, supervisory authorities were unable to adequately monitor or control the implementation of the corporate governance standards by credit institutions.

3. ANALYSIS OF SUBSIDIARITY

Convergence of national sanctioning regimes is necessary to promote dissuasiveness and create a level playing field to ensure a uniform application of the CRD and full cooperation and mutual trust between banking supervisors across the EU. Better application of the existing sanctioning powers by national authorities would not be sufficient to achieve such convergence.

A uniform and consistent approach at EU level is crucial to deal effectively with corporate governance weaknesses in credit institutions. Integrated capital markets and the inter-relatedness of the European financial sector mean that the diverging rules in Member States could result in regulatory arbitrage, which could undermine or create new obstacles to the proper functioning of the internal market.

4. OBJECTIVES

The proposal aims at ensuring proper functioning of banking markets and restoring confidence in the banking sector, through:

- Effective, proportionate and deterrent sanctions which better ensure compliance with CRD rules,

- Development of a level playing field which minimises the opportunities for regulatory arbitrage,
- Effective supervision of banking service providers,
- Effective corporate governance within credit institutions which should contribute to avoid excessive risk taking.

This requires:

- The reinforcement and approximation of the legal framework concerning sanctions and the mechanisms facilitating detection of violations and
- Strengthening corporate governance framework:

– increasing the effectiveness of risk oversight by Boards;

– improving the status of the risk management function; and

– ensuring effective monitoring by supervisors of risk governance.

5. POLICY OPTIONS, IMPACT ANALYSIS AND COMPARISON

5.1. Options on sanctioning regimes

5.1.1. Options concerning appropriate administrative sanctions

Options
1: no EU action
2. Uniform rules on types and level of administrative sanctions
3. Minimum common rules on types of administrative sanctions
4. Minimum common rules on levels (minimum and maximum) of administrative fines
5. Minimum common rules on maximum level of administrative fines
6. Uniform rules on factors to be taken into account in the application of sanctions
7. Minimum common rules on factors to be taken into account in the application of sanctions

Option 1 would preserve the problems identified: although the European Banking Authority could promote further convergence of national regimes, this action would hardly be effective without an EU framework in place.

Options 2 and 6 would eliminate any divergence in types, level of sanctions and criteria for their application, and therefore would be the most effective in terms of ensuring level playing field and facilitating cross-border supervision. Options 3, 4, 5 and 7 would be less effective but would permit to adapt sanctions to the specificities of the different national legal systems. Option 4 would be more effective than option 5 in reducing divergences in the levels of fines and ensure deterrence but Option 5 will better ensure proportionality.

Options 2, 3 and 4 would be similarly effective in ensuring deterrence. However, Option 3 would allow for the provision of additional types of sanctions, which can increase dissuasiveness in some Member States. Option 5 will be less effective in ensuring that sufficiently high fines are actually applied but could better ensure they are proportionate. Options 6 and 7 can be considered equally effective to the extent they include the same factors but Option 7 could better ensure appropriateness of sanctions actually applied, as it would not prevent competent authorities from taking into account other factors.

Options 2 and 7 are the less efficient in terms of changes required in national legislations and Option 5 is more efficient than Option 4.

5.1.2. Options concerning the personal scope of administrative sanctions

Options
1: no EU action
2. General obligation to provide for the application of administrative sanctions to both individuals and credit institutions
3. Minimum common rules on the application of administrative sanctions to individuals and/or credit institutions

Option 3 would be more effective than option 2 in ensuring level playing field and better cross-border supervision, but the difference on the dissuasive effect of those options is considered to be minor. Option 3 is much less efficient than option 2, as it would require more changes in national legislations and may oblige Member States to adapt their general liability regimes.

5.1.3. Options concerning the publication of sanctions

Options
1. Do nothing
2. publication of sanctions as general rule
3. publication of sanctions decided by competent authorities

Option 2 would be much more effective than option 3 in increasing deterrence of sanctions. Option 3 is slightly more efficient than option 2.

5.1.4. Options concerning the actual application of sanctions

Options
1: no EU action
2. Internal whistle blowing procedure in credit institutions
3. Member States to set up systems for the promotion and protection of whistleblowers
4. Detailed EU requirements for whistle blowing programmes

Options 2, 3 and 4 are all effective in pursuing the objective of better detection of violations leading to a higher level of enforcement in all Member States. Option 4 is considered slightly more effective in this regard. All three options have impacts on fundamental rights (respect

for private and family life, protection of personal data, presumption of innocence and right of defence) but they can be mitigated and, given the importance of the objectives to be achieved, their impact is necessary and proportionate.

Options 2 and 3 are equally efficient in terms changes required in national legislation. Option 4 is considered to be inefficient as it would require more radical changes, probably also in Member States which already provide for whistleblowing mechanisms. Compliance costs could also be higher than those required by Options 2 and 3 as Member States will have less flexibility.

5.2. Options on corporate governance

Options
1. no EU action
2. Improve the implementation of the existing EU framework
3. Enhance and develop the Capital Requirements Directive framework

Option 3 will be the most effective to achieve the underlying objective compared to Options 1 and 2. Option 1 will keep the regulatory framework open-ended and continue to generate lack of compliance and legal uncertainty. Option 2 relies on market discipline and better monitoring of the implementation of existing principles by supervisors. However, supervisors will have no clearer legal framework within which to exercise their supervisory oversight and self-regulation has shown its limits.

Option 3 goes beyond the existing framework on corporate governance and would involve the development of additional and enhanced provisions. It will contain measures to increase the effectiveness of risk oversight by Boards, improve the standing and independence of the risk management function and ensure efficient monitoring of risk governance by supervisors. These new requirements will create a set of minimum standards providing credit institutions and supervisors with clear benchmarks within which to develop and assess corporate governance structures.

5.3. Preferred policy options and instruments

The most appropriate to achieve the objectives of the proposal is a combination of the following mutually reinforcing options:

Options on sanctioning regimes

- Minimum common rules on the type of administrative sanctions to be available to competent authorities
- Minimum common rules on maximum level of pecuniary administrative sanctions
- List of key factors to be taken into account when determining the administrative sanctions
- Obligation to provide for the application of administrative sanctions to both individuals and credit institutions

- Publication of sanctions as a general rule
- Internal whistle blowing procedure in credit institutions
- Require Member States to set up systems for the protection of whistleblowers

Options on corporate governance

Improve time commitment of Board members	Require credit institutions to disclose the number of mandates of Board members
	Require Board members to spend sufficient time to exercise their duties
	Limit the maximum number of mandates a Board member may hold at the same time
Improve expertise of Board members	Require disclosure of the recruitment policy and the actual expertise and skills of Board members
	Specify criteria that Board members must possess individually and collectively with regard to appropriate skills and expertise Require that Board members should receive appropriate induction and continuous training
	Mandatory Nomination Committee
Counterbalance management dominance	Prohibit cumulating mandates of Chairman and Chief Executive Officer in the same credit institution
Improve diversity in Boards' composition	Require disclose of internal policy on diversity Benchmarking different practices at national and European level
	Require diversity as one of the criteria of Boards' composition Require credit institutions to establish a diversity policy
Improve ownership by Boards of risk strategy	Require a declaration on the adequacy of risk management systems Require a risk statement stating credit institution's approach to risk
Improve priority given by Boards to risk issues	Require disclosure of policy and practice with regard to discussion and analysis of risk issues during Board meetings
	Require that Boards devote sufficient time to risk issues
	Mandatory Risk committee at Board level
Improve the information flows to Boards on risk	Require disclosure of policy and practice with regard to the information flow on risk to the Board
	Require Boards to determine the content, format and frequency of risk information it should receive Require that risk management function can report directly to the Board
Improve the standing and the authority of the risk management function	Require disclosure of the standing and authority of risk management function Require an independent Risk management function Require an independent Chief Risk Officer Require Chief Risk Officer has an appropriate status and authority Require that removal of the Chief Risk Officer is subject to prior approval by the Board
Ensure efficient monitoring of risk governance by supervisors	Require that corporate governance is part of supervisory review Require that the suitability of Board members is subject to specific supervisory review Require supervisors to review agendas and supporting documents for meetings of the Board

5.3.1. Impacts of the preferred options: sanctioning regime

The options on sanctioning regimes are expected to facilitate detection of violations ant to empower competent authorities to apply appropriate sanctions. This is expected to ensure better enforcement of the CRD obligations by credit institutions, which would benefit all **stakeholders**.

These options will not create **administrative burdens** on financial institutions, or non-financial companies, including SMEs, except a limited administrative burden on credit institutions deriving from the obligation to provide for internal whistle-blowing systems.

A positive **social impact** is expected**,** as the protection of deposit-holders and investors will be reinforced and employees of credit institutions who act as whistle blowers will benefit from better protection.

These options are in line with the common objectives of major jurisdictions within the G20 Group to strengthen the regulation and supervision of the financial and are expected to have positive impact on the EU's global **competitiveness**.

5.3.2. Impacts of the preferred options: corporate governance

The preferred policy options improving corporate governance will help avoid excessive risk-taking by credit institutions and lower the risk of failure. It would contribute to the resilience of the banking sector and improve investor confidence Therefore, the impact on credit institutions and all **stakeholders** (depositors, shareholders, creditors) should be positive.

At a macroeconomic level, sound risk governance system of credit institutions would contribute to avoid future crises, increase confidence in the banking system and the efficiency of credit institutions’ funding mechanisms, which accelerates **economic growth**.

The introduction of measures on diversity in Boards' composition is likely to have a positive impact on the **gender policy** of the EU, breaching glass ceilings and helping women to access leadership positions in companies and could have a positive impact on women employment.

The preferred option could entail additional **administrative burden** for credit institutions and supervisors. However, these costs should be limited and proportionate to the overall objective. To reduce potential regulatory burden, the principle of proportionality should apply that takes into account the size and the complexity of the activities of credit institutions.

6. MONITORING AND EVALUATION

The Commission as guardian of the Treaty will monitor how the Member States implement the changes to the Capital Requirements Directive. The consequences of the application of the legislative measures regarding sanctioning regime will be evaluated on the basis of the following main indicators:

- Number of violations detected and the number of sanctions applied;
- Practice of the national competent authorities in the application of sanctions.

As regards corporate governance, the delivery of the expected benefits of new provisions may take time to be realised and the degree of realisation of these benefits will depend on how credit institutions implement the new requirements. The Commission will be monitoring the application of the relevant provisions of the Capital Requirements Directive through EBA and an extensive and continuous dialogue with all major stakeholders, including market participants (credit institutions, investors). It may also use of the findings of studies carried out by stakeholders.