

C L I F F O R D

C H A N C E

**CRD6: NEW EU RULES FOR BANK
SENIOR MANAGERS AND GOVERNANCE**

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CRD6: NEW EU RULES FOR BANK SENIOR MANAGERS AND GOVERNANCE

The new EU Capital Requirements Directive (CRD6) will introduce a revised framework for assessing the suitability of directors and other senior managers of EU banks, including new requirements for key function holders and a new supervisory process for the prior assessment of the suitability of some appointments. It will also make other changes to the EU rules on bank governance. The new rules are expected to take effect by end-2025.

CRD6 amends the provisions of the Capital Requirements Directive (CRD) governing the authorisation and supervision of EU banks. CRD6 is being adopted in parallel with a new EU regulation (CRR3) which amends the Capital Requirements Regulation (CRR) to implement the final elements of the Basel 3 framework for the prudential regulation of banks.

When will the new rules for bank senior managers and governance take effect?

The text of CRD6 has been adopted by a **resolution** of the European Parliament. The next step is for the Council of the EU to endorse that resolution, after which the text will be revised and translated into all the EU official languages by the EU institutions' lawyer-linguists, signed by the Presidents of the Parliament and the Council and published in the Official Journal. The Directive will enter into force 20 days after publication.

Member States will be required to transpose the new requirements for bank senior managers and governance into their national legislation within 18 months of entry into force and to apply the new requirements from the day after the expiry of the transposition period, which means that the new rules are expected to come into effect by end-2025 (assuming that CRD6 is published in the Official Journal in May this year).

The European Banking Authority (EBA) will be tasked with developing draft regulatory technical standards (RTS) for adoption by the Commission specifying the information to be provided to supervisors in relation to their assessment of suitability as well as guidelines on other aspects of the new suitability framework. However, the deadline for the EBA's delivery of the draft RTS to the Commission and the issue of the guidelines is 24 months after CRD6 enters into force. As a result, the final details of the new framework may not be available until after the new rules begin to apply. The EBA will also be required to publish guidelines relating to the new ESG governance requirements by the end of the transposition period.

What are the current EU rules on assessing the suitability of bank senior managers?

Currently, there is limited EU harmonisation of the rules for assessing whether senior managers of EU banks and other entities supervised under the CRD are fit and proper

Key issues

- Revised framework for assessing suitability of management body members and key function holders
- Requirements will apply to EU banks and approved EU holding companies of EU banks
- New prior supervisory assessment process for appointments of the chair and executive members of the management body of large entities
- Changes to the specific suitability criteria that apply to members of the management body
- Supervisors no longer able to authorise an individual to act as both chair of the management body and chief executive
- New requirement to maintain statements of responsibilities and responsibilities maps for members of the management body, key function holders and other senior management
- New governance requirements for ESG risks and crypto-asset exposures
- Penalty regime extended to cover key function holders and other senior staff and to include periodic penalties
- New rules expected to apply by end-2025

to perform their functions. CRD places the primary responsibility on EU banks and their financial holding companies or mixed financial holding companies for assessing that the members of their management body are at all times of sufficiently good repute, possess sufficient knowledge, skills and experience to perform their duties and fulfil the requirements set out in the directive.

However, the CRD rules are largely principles based, do not address how and when supervisors are required to assess the suitability of members of the management body and do not provide any framework for assessing the suitability of other key function holders of an institution. The EBA and the European Securities and Markets Authority (ESMA) published **joint guidelines** in 2017 on the initial and ongoing assessment of the suitability of members of the management body and key function holders by both institutions and supervisors. The European Central Bank (ECB) has published its own **guide** (updated in 2021) to the initial and ongoing fit and proper assessments of members of the management body and key function holders of institutions directly supervised by the ECB. The ECB has exclusive competence to exercise the supervisory powers relating to key function holders conferred by national law in relation to these institutions, even though these powers are not specifically envisaged by the EU framework (see ECB **webpage** on national powers exercised by the ECB).

However, differences in national laws still mean that banks across the EU are subject to significantly different rules, even within the Banking Union. The Commission was also concerned that while, in the majority of Member States, supervisors assess the suitability of members of the management body prior to appointment, supervisors in other Member States assess suitability of appointees only a significant period of time after their appointment. The Commission was also concerned that some supervisors do not properly identify key function holders and therefore do not carry out an assessment of their suitability to perform their duties, while others do it in a variety of ways.

Some Member States already maintain or are introducing rules that are similar to (and in some cases, broader than) the requirements laid down by CRD6. However, the new EU rules are likely to cause all Member States to re-evaluate how they regulate these issues.

What is the new EU framework for suitability assessment?

CRD6 amends CRD to create a revised framework for the assessment of the suitability of senior managers, which will cover members of the management body (both in its supervisory and management function) and key function holders of EU banks and financial holding companies and mixed financial holding companies of EU banks approved under CRD (entities).

Broadly in line with the EBA and ESMA guidelines, 'key function holders' will be defined as persons who have significant influence over the direction of a bank, including the heads of internal control functions (risk management, internal audit and compliance) and the chief financial officer, where they are not members of the management body. CRD6 also adds a new definition of the 'management body in its management

function' covering the management body acting in its role of directing an institution and including the persons who effectively direct the business of the institution (alongside the existing definition of the 'management body in its supervisory function' covering the management body acting in its role of overseeing and monitoring management decision-making).

Additional rules will apply to certain parent, subsidiary and stand-alone entities that are large institutions, holding companies of large institutions and central bodies that supervise large institutions (large entities). For these purposes, institutions are large institutions if they are classified as globally systemically important institutions (G-SIIs) or other systemically important institutions (O-SIIs), they are one of the three largest institutions in their Member State or they are entities whose individual or consolidated assets are €30 billion or more.

The revised framework will have the following common elements in relation to members of the management body and key function holders:

- entities will have the primary responsibility for assessing whether members of the management body and key function holders are at all times of sufficiently good repute, act with honesty, integrity and independence of mind and possess sufficient knowledge, skills and experience to perform their duties (CRD will continue to require institutions to assess members of the management body against additional specific criteria discussed below);
- the absence of a criminal conviction or of ongoing prosecutions for a criminal offence will not itself be sufficient to fulfil the requirement to be of good repute and to act with honesty and integrity;
- entities must assess the suitability of members of the management body and key function holders, taking into account supervisory expectations, before they take up their position and periodically, as laid down in applicable laws and regulations, guidelines and internal suitability policies;
- if nominated or current members of the management body or key function holders do not meet the suitability criteria, entities must not make the appointment, remove them from their position or take additional measures to ensure that the suitability criteria are met in a timely manner;
- entities must ensure that they keep up-to-date information about the suitability of the members of the management body and key function holders and communicate that information to their supervisors on request; and
- supervisors must be able to require entities to take additional measures to ensure the suitability of members of the management body and key function holders.

The revised framework will also impose the following additional requirements in relation to members of the management body of all entities and in relation to the heads of internal control functions and the chief financial officer of large entities:

- supervisors must assess that members of the management body and those key function holders meet the suitability criteria at all times and reassess the suitability of members of the management body and those key function holders on becoming

aware of new information affecting their suitability (and for members of the management body, when they have reasonable grounds to suspect money laundering or terrorist financing is being committed or attempted or an increased risk of money laundering or terrorist financing);

- those entities must inform their supervisors without delay of any new information that may affect the suitability of members of the management body or those key function holders (and supervisors may request additional information or documentation, including interviews or hearings, in relation to members of the management body);
- supervisors must be able to prevent members of the management body and those key function holders taking up their position and to remove them from their position where they assess the person to be unsuitable; and
- supervisors may request the anti-money laundering and counter-terrorist financing authorities to consult with them on their review of appointments (and may also request access to the central anti-money laundering and counter-terrorist financing database being set up under the new EU regulation establishing an EU authority for anti-money laundering and countering the financing of terrorism).

The RTS to be drafted by the EBA will specify the details of the suitability questionnaire, curriculum vitae and internal suitability assessment which will have to be submitted to supervisors in relation to appointments of members of the management body of large entities and the heads of internal control functions and the chief financial officer of large entities, but, as already mentioned, these may not have been adopted by the time the new rules begin to apply. Member States will be required to develop appropriate standards for entities that are not large entities.

CRD6 does not set a maximum period within which supervisors must complete their suitability assessments. However, supervisors will be required to consider setting a maximum period (which may be extended where appropriate) for concluding their assessments of members of the management body of large entities and the heads of internal control functions and the chief financial officer of large entities.

What is the new prior supervisory assessment process?

Large entities will have to provide their supervisor with a suitability application in advance of the appointment of a member of the management body in its management function or the chair of the management body in its supervisory function. This application must be submitted without undue delay, and as soon as there is a clear intention to make the appointment, and at least 30 days before the intended appointee takes up the position.

The application will have to be accompanied by a suitability questionnaire and a curriculum vitae, the institution's internal suitability assessment, criminal records (as soon as available), any other documents required under national law or by the supervisor and an indication of the date of the appointment and the date on which the intended appointee's duties will effectively start.

Supervisors may require intended appointees to delay taking up their position where the documents provided do not provide sufficient information for the supervisor to

conduct the suitability assessment. Where supervisors have concerns as to whether an intended appointee meets the suitability criteria, they must engage in an enhanced dialogue with the entity to address the identified concerns with a view to ensuring that the appointee is or become suitable by the time of the appointment. The EBA will be tasked with issuing guidelines on this process.

What are the changes to the specific suitability criteria that apply to members of the management body?

CRD6 makes some changes to the specific criteria that must be met by members of the management body of entities. CRD will continue to require that:

- members of the management body must commit sufficient time to perform their functions;
- each member of the management body acts with honesty, integrity and independence of mind to effectively assess and challenge the decisions of the senior management where necessary and to effectively oversee and monitor management decision-making (being a member of the management body of a bank permanently affiliated to a central body does not in itself constitute an obstacle to acting with independence of mind);
- the management body possesses adequate collective knowledge, skills and experience to be able to understand the institution's activities, but CRD6 will extend this to require an understanding of the associated risks (not just the main risks as currently provided) to which the institution is exposed and specifically to require an understanding of the impacts the institution creates in the short, medium and long term, taking into account environmental, social and governance (ESG) factors;
- the overall composition of the management body is sufficiently diversified to reflect an adequately broad range of experience;
- members of the management body of an entity that is significant in terms of its size, internal organisation and the nature, the scope and the complexity of its activities do not hold more than one executive directorship with two non-executive directorships or, as an alternative, four non-executive directorships (although supervisors may authorise an additional non-executive directorship);
- institutions devote adequate human and financial resources to the induction and training of members of their management body but CRD6 will specify that the training must include training on ESG risks and impacts and on risks related to information and communications technology; and
- Member States or competent authorities require entities and their respective nomination committees (where established) to engage a broad set of qualities and competences when recruiting members to the management body and for that purpose to put in place a policy promoting diversity on the management body, but CRD6 will specifically provide that the entity must also proportionally promote diversity and gender balance in the management body.

CRD6 will end the ability of supervisors to authorise the chair of the management body in its supervisory function simultaneously to act as the chief executive officer.

What is the relationship with other provisions on appointments of members of the management body?

CRD6 states that its provisions on the appointment of the members of the management body and of key function holders are without prejudice to provisions of national law on the representation of employees in the management body or on the appointment of members of the management body in its supervisory function by regional or local elected bodies or the appointments where the management body does not have any competence in the process of selecting and appointing its members. However, in the latter case, it will require Member States to ensure that there are appropriate safeguards in place to ensure the suitability of these members of the management body.

The amendments will also make clear that the assessment requirements do not apply to special managers or temporary administrators appointed under the Bank Recovery and Resolution Directive.

Member States will still have to ensure that members of the management body of financial holding companies and mixed financial holding companies not subject to the new rules (because they are not approved under CRD) are of good repute and have sufficient knowledge, skills and experience to perform their duties. The holding company will continue to have the primary responsibility for assessing the suitability of the members of their management body.

What is the new requirement for statements of responsibilities?

There will be a new requirement for banks to draw up, maintain and update individual statements setting out the roles and duties of each member of the management body in its management function, each key function holder and each other member of senior management and a mapping of duties, including details of reporting lines and lines of responsibility. These statements will also have to cover the roles and duties of the persons who are part of the bank's governance arrangements required by CRD. Banks will have to provide the statements of responsibilities to their supervisor on request.

What are the changes to bank governance of ESG risks?

Banks will be required to ensure that their internal capital adequacy assessment process explicitly takes into account the short, medium and long term for the coverage of ESG risks (as defined by CRR3) and that their processes for identifying, managing, monitoring and reporting of risks include ESG risks in the short, medium and long term.

CRD6 also amends the requirements for management bodies to approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks to which banks are or might be exposed. CRD6 will specify that these strategies and policies must also cover the risks relating to ESG factors in the short, medium and long term and that the review must take place at least every two

years. Management bodies will be required to develop and monitor the implementation of specific plans, quantifiable targets and processes to monitor and address the financial risks arising in the short, medium and long-term from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member State, EU and, where relevant, non-EU regulatory objectives and legislation relating to ESG factors.

As already mentioned, CRD6 will require that a bank's management body possesses adequate collective knowledge, skills and experience to be able to understand the impacts the bank creates in the short, medium and long term, taking into account ESG factors and training of members of the management body must include training on ESG risks and impacts.

Banks will be specifically required to ensure that their remuneration policies and practices take into account their risk appetite in terms of ESG risks. The risk committee will also be specifically required to examine whether incentives provided by the remuneration system take account of risks resulting from the impact of ESG factors.

Supervisors will be required to ensure that banks have, as part of their governance arrangements and risk management framework required, robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of ESG risks over the short, medium and long term. These must be proportionate to the bank's business model and activities and must consider a short, medium and a long-term horizon of, where appropriate, at least ten years. Banks will be required to test their resilience to long-term negative impacts of ESG factors under a range of baseline and adverse scenarios.

Supervisors will be required to assess and monitor banks' practices and the EBA will be required to issue guidelines on methodologies, planning, assessment criteria and scenario setting within 18 months of entry into force of CRD6.

Supervisors carrying out their periodic supervisory review and evaluation of banks will be required to assess the bank's governance and risk management processes for dealing with ESG risks and the bank's exposures to ESG risks, taking into account their business models and their plans to monitor and address ESG risks. Supervisors will also be required to assess banks' ESG plans and targets as well as the progress made towards addressing the ESG risks arising from the process of adjustment towards climate neutrality by 2050 and whether banks have put in place appropriate policies and operational actions related to the targets and milestones defined in the plans.

Member States will be obliged to ensure that supervisors have powers to require banks to reduce the risks arising in the short, medium and long term from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member State, EU or non-EU legal and regulatory objectives, through adjustments to their business strategies, governance and risk management.

What are the changes to bank governance of crypto-asset exposures?

Supervisors will be required to ensure that:

- banks conduct and report on ex-ante assessments of any proposed crypto-asset exposures and the adequacy of existing processes and procedures to manage counterparty risks;
- banks' monitoring of concentration risks considers, for crypto-assets without an identifiable issuer, concentration risk in terms of exposure to crypto-assets with similar features;
- banks' policies and processes for evaluating and managing exposures to operational risk cover direct and indirect exposures to crypto-assets and crypto-asset service providers; and
- their supervisory review and evaluation process includes an assessment of banks' governance and risk management processes for exposures to crypto-assets and the provision of services related to crypto-assets, including banks' policies and procedures for identifying risks.

Member States will be obliged to ensure that supervisors have powers to require banks to undertake stress testing or scenario analysis to assess risks arising from crypto-asset exposures and from the provision of crypto-assets related services.

What are the other changes to governance rules?

The heads of the internal control functions will be required to be independent senior managers with distinct responsibility for the risk management, compliance and internal audit functions (and must not be removed without the approval of the management body in its supervisory function). Other senior managers will only be able to perform these roles in limited circumstances and banks will not be able to combine the internal audit function with any other business line or control function.

CRD6 will specifically require that the internal audit function performs an independent review of the effective implementation of the bank's risk strategy and that the compliance function assesses and mitigates compliance risk and ensures that the bank's risk strategy takes into account compliance risk and that compliance risk is adequately taken into account in all material risk management decisions.

The internal control functions will be required to have direct access to the management body in its supervisory function and to be able to exercise that access independently from the members of the management body in its management function and from senior management to raise concerns and warn the management body in its supervisory function.

What are the changes to the penalty regime for senior managers?

CRD6 amends the CRD provisions on administrative penalties and other administrative measures that may be imposed where EU banks, financial holding companies and mixed financial holding companies contravene national provisions transposing CRD,

CRR or supervisory decisions based on CRD or CRR. It will require Member States to ensure that administrative penalties and other administrative measures can be applied to senior management, key function holders and staff whose professional activities have a material impact on a bank's risk profile, in addition to members of the management body and other natural persons who are responsible for the breach.

For breaches of specified provisions, the penalties for individuals will now include daily periodic penalties of up to at least €50,000 until the breach is remedied (for up to six months) and the supervisor must be able to publicly censure individuals, order individuals to cease the conduct and desist from repeating the conduct and impose temporary bans on members of the management body or individuals responsible for a breach from exercising functions in any EU bank. These are in addition to the existing powers to impose penalties on individuals of up to at least €5 million and twice the profits gained or losses avoided.

Will the new rules apply to large investment firms?

An EU entity will be treated as an EU bank for the purposes of the new rules if it is classified as a credit institution under CRR. This will mean that some EU investment firms will be subject to the new rules, even though they do not take deposits, where they meet the size and other criteria under the extended definition of 'credit institution' in CRR (as amended by CRR3).

What should EU banks do now?

Banks should review the existing requirements relating to senior managers and governance in the Member States in which their institutions are established to establish the extent to which the implementation of CRD6 will result in practical changes. In some cases, existing national requirements may already meet or even go beyond the new rules in CRD6, meaning that there will be little practical change unless the Member State decides to align the national requirements with less stringent requirements in the Directive. In other cases, the existing national regime may not address all the requirements introduced by CRD6, meaning that the Member State will need to bring its requirements into line with those in CRD6.

However, banks in many Member States will need to make changes to their policies and procedures, such as the new requirements to maintain responsibility statements and responsibility maps for members of the management body, key function holders and other senior management and the new framework for suitability assessments. They will also need to consider whether they need to change their employment and remuneration documentation to comply with the new requirements and how to engage with affected members of their management body and affected staff, including those based outside the EU.

Large entities will also need to monitor their plans for appointments of a new chair or new executive members of the management body as the date approaches on which Member States bring the new prior assessment process into force as the new requirements may affect the timing of when appointments can take effect. The introduction of these requirements may also have an impact on pending M&A transactions or reorganisations where the transaction will result in changes to the management body.

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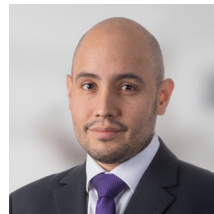
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