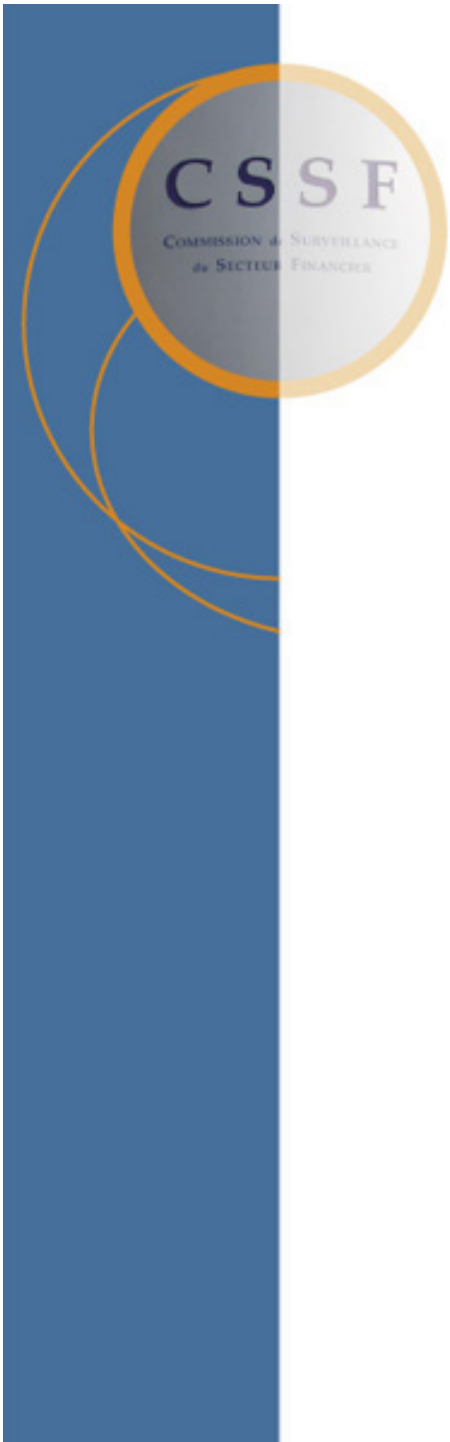


Education Day for Directors (Monday November 28, 2011)

Director' s responsibility

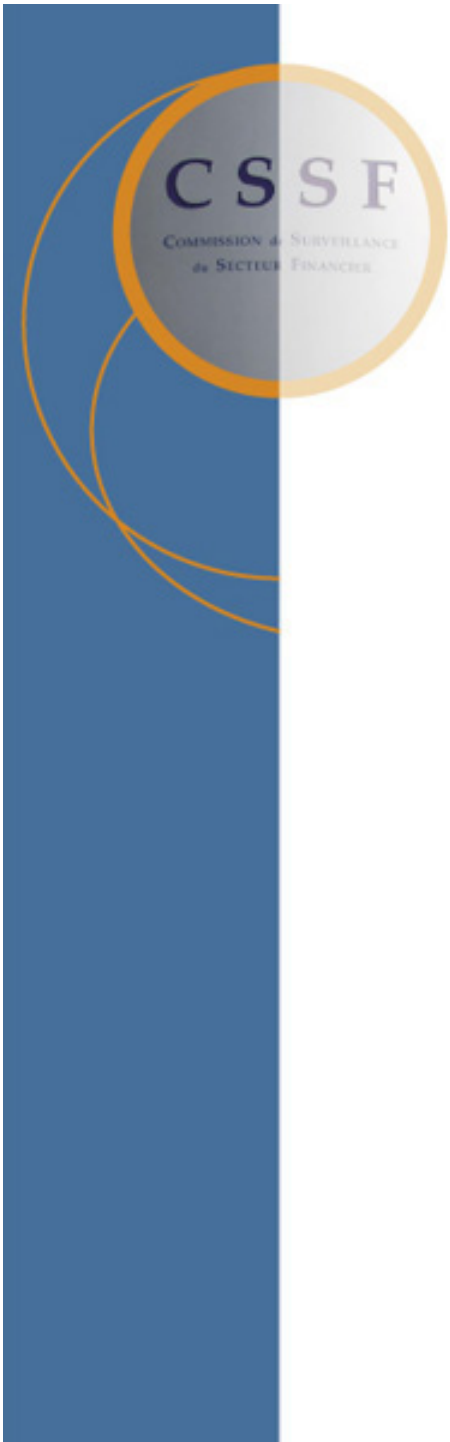
Nadia Manzari

(Deputy Head of the General Supervision Department)



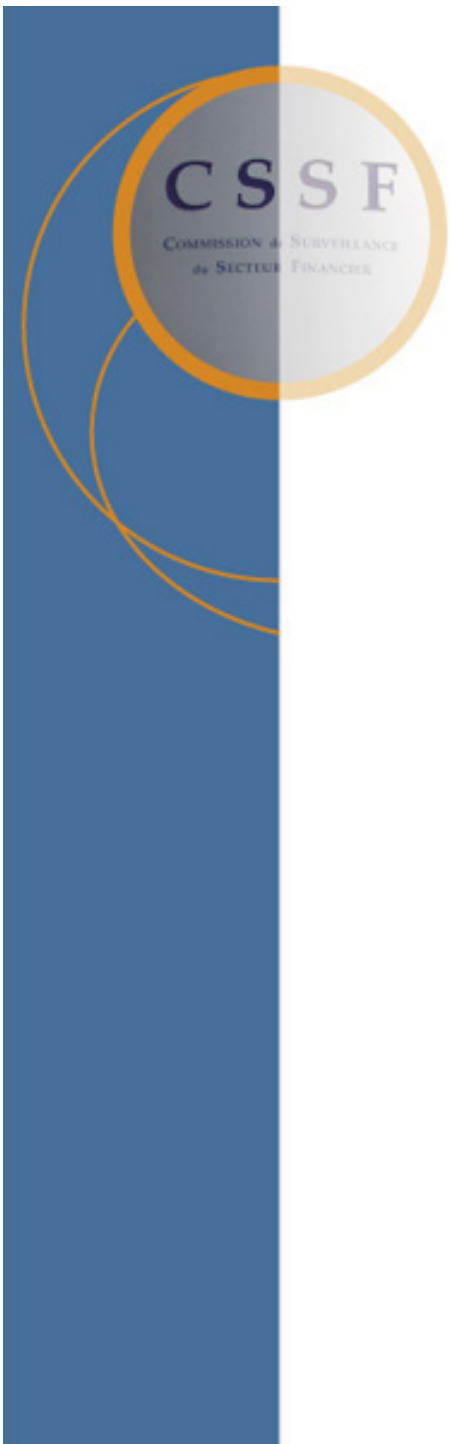
Director' s responsibility

- I. Introduction
- II. Regulatory requirements with regard to directors responsibility
 - 1. Authorization process
 - 2. Internal Governance requirements
 - 3. Key Responsibilities of the Directors
 - 4. Control
 - 5. Sanctions
- III. Future Developments



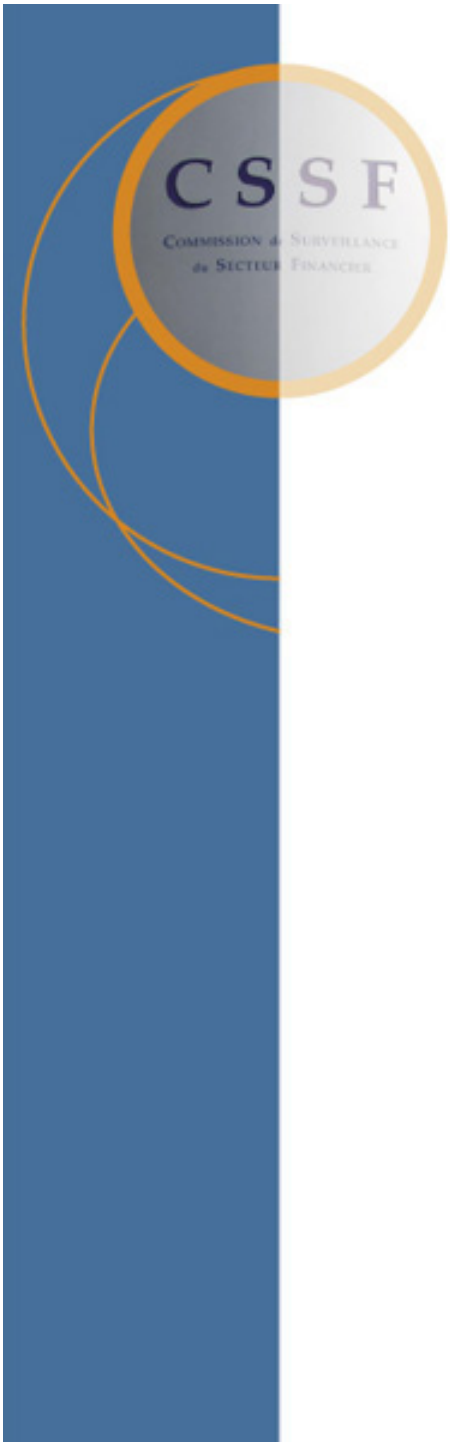
I. Introduction

- The responsibility regime of directors may be understood as one aspect of the general concept of “Internal Governance”
- The requirements relating to internal governance and directors responsibility are not new
 - embedded in Luxembourg law and regulation and they have received the increasing attention of various international bodies: BCBS, OECD, EBA, European Commission
- Financial crisis revealed weaknesses in internal governance in a number of credit institutions and investment firms which have contributed to excessive and imprudent risk-taking in the banking sector which led to the failure of individual institutions and systemic problems



Director' s responsibility

- The board, might not have understood the complexity of their business and the risks involved, and consequently failed to identify and constrain excessive risk-taking.
- Time constraints contributed to the members of the board failing to fulfil their duties
- The **risk management and internal control frameworks** were often not sufficiently integrated within institutions or groups.
- Consequence: need for enhanced internal governance rules specifically with regard to board members expertise and qualification

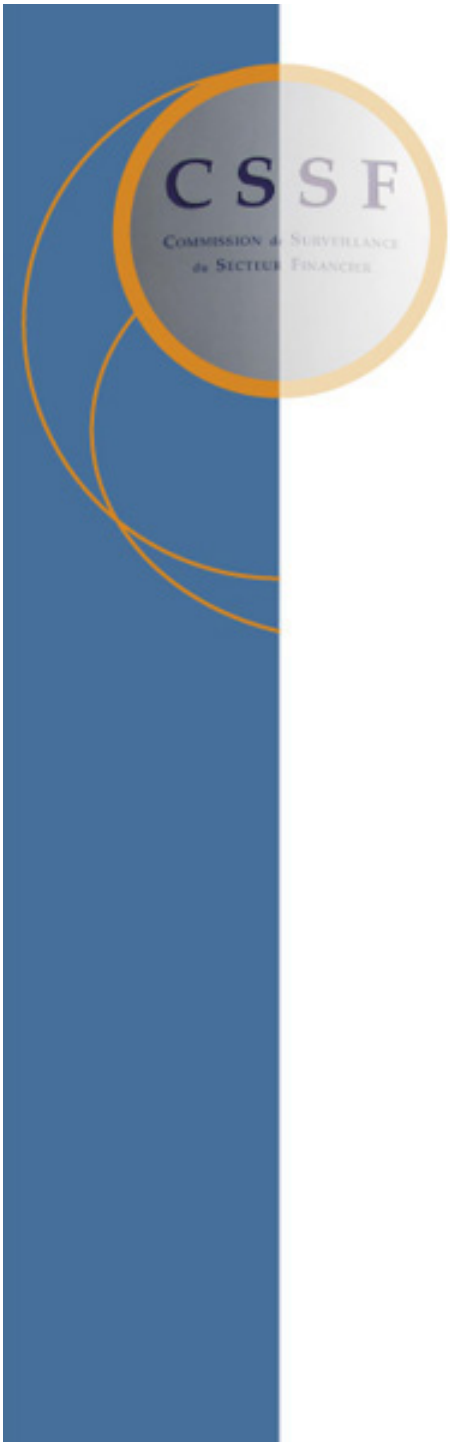


Director' s responsibility

Responsibility of the board is to ensure that:

Institutions have governance arrangements in place which are consistent with and promote sound and effective risk management :

- clear organizational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks the institution is or might be exposed to,
- adequate internal control mechanisms, including sound administration and accounting procedures,
- remuneration policies and practices consistent with sound and prudent management

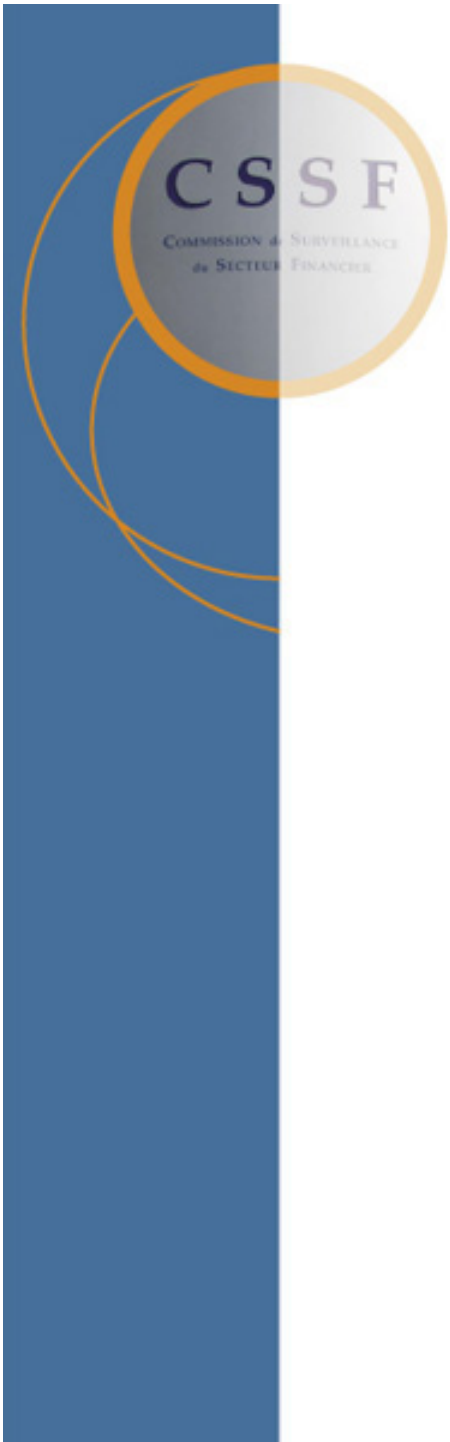


Director' s responsibility

II. Regulatory requirements with regard to directors responsibility

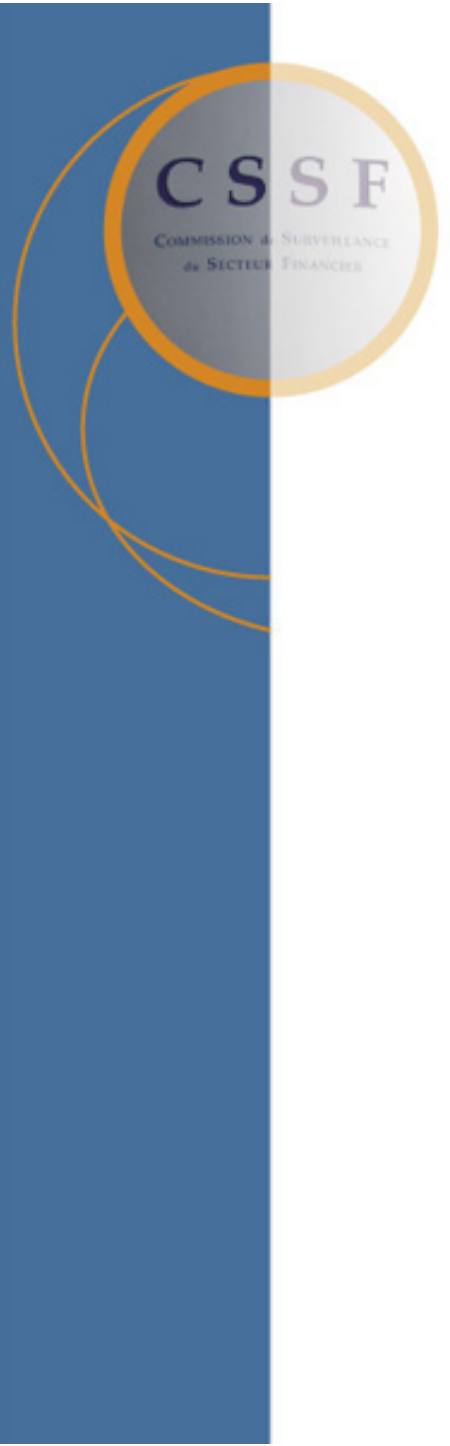
1. Authorization process

- The law of 5 April 1993 on the financial sector contains provisions relating to the professional standing of the members of the bodies performing administrative, management and supervisory functions as condition precedent to the authorization of institutions:
 - article 7 → credit institutions
 - article 19 → investment firms



Director' s responsibility

- Professional standing is also verified by the CSSF during the authorization procedure of other supervised entities such as:
 - Undertakings for collective investments (article 129 (5) of the law of 17 December 2010 relating to undertakings for collective investment)
 - Payment and E-money institutions (articles 8 i) and 24-4 i) of the law of 10 November on payment services



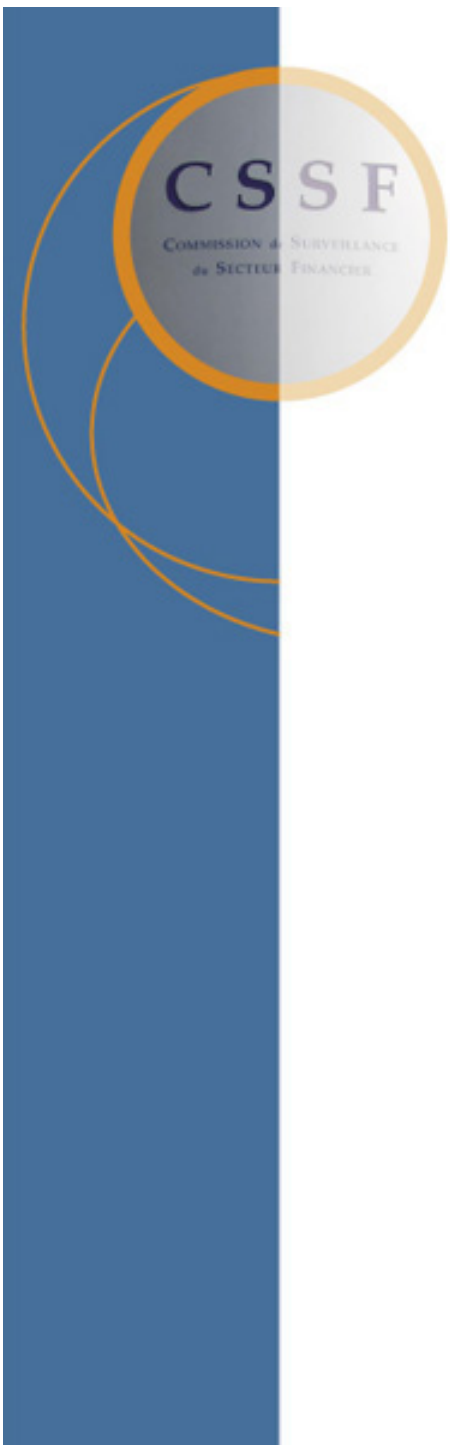
CSSF

COMMISSION de SURVEILLANCE
de SECTEUR FINANCIER

Director's responsibility

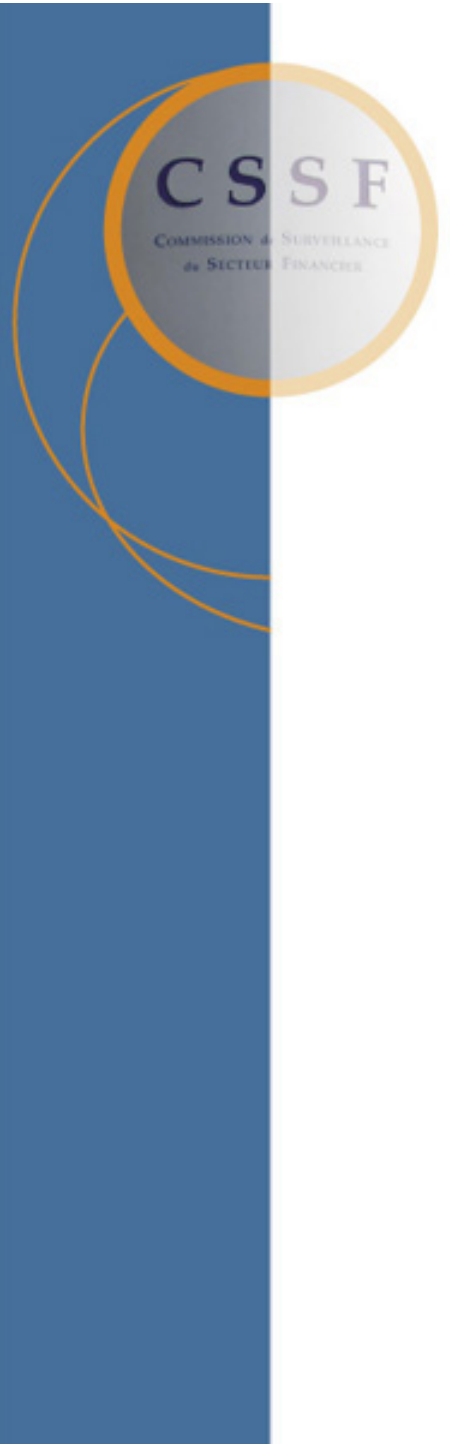
2. Governance requirements

- Internal governance for institutions in Luxembourg is also covered by the law on the financial sector:
 - article 5 (1a) and (3) → credit institutions,
 - article 17 (1a) → investment firms,
- Moreover, a number of internal governance provisions have been implemented into Luxembourg law by way of CSSF circulars:



Director' s responsibility

- Circular CSSF 07/301 specifying the object, the scope and the implementation of the internal capital adequacy assessment process (ICAAP) for credit institutions and investment firms, sets the rules of the role and the responsibility of the board of directors and the authorized management with regard to the implementation of an ICAAP
- Circular CSSF 95/120 (central administration), Circular CSSF 96/126 (administrative and accounting organization), Circular CSSF 98/143 (internal audit), Circular CSSF 04/155 (compliance function), Circulars CSSF 10/496, 10/497 and 11/505 (remuneration policies) codify the internal governance requirements as set out under article 5 /17 of the law on the financial sector



CSSF

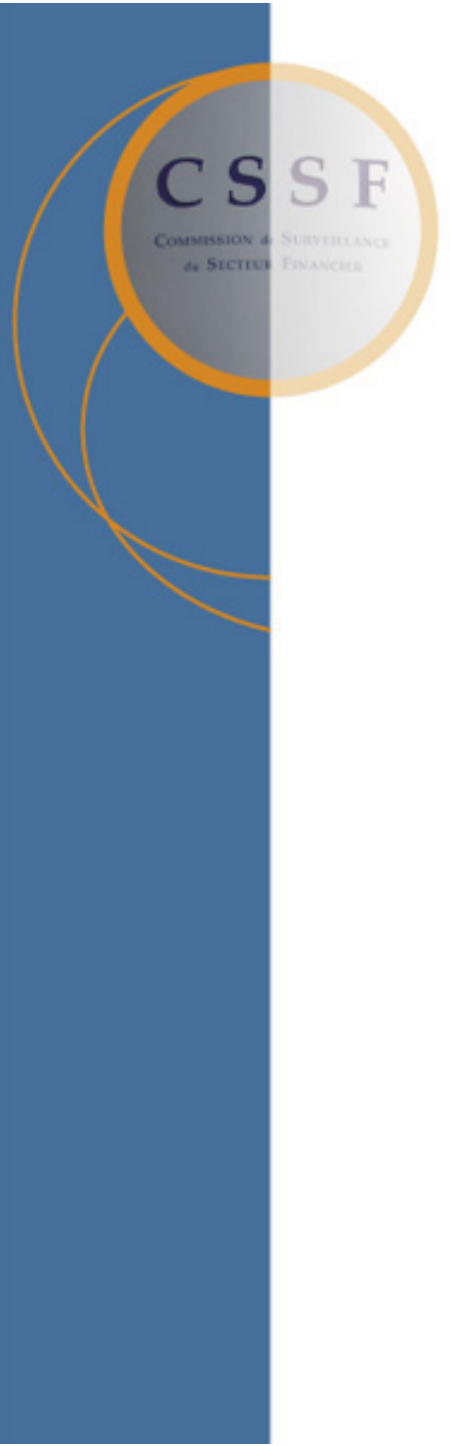
COMMISSION DE SURVEILLANCE
du SECTEUR FINANCIER

Director's responsibility

- Circular CSSF 11/506 on the principles of a sound stress testing program provides in its chapter IV. for the stress test to be considered as mandatory risk management practice and to be integrated in the internal governance of the institutions
- Regarding the risk management rules applying to undertakings for collective investments and their management companies, Circular CSSF 11/512 and CSSF Regulation N° 10-04 are covering certain aspects of internal governance applying to the persons responsible of risk management

3. Key Responsibilities of the Directors

- setting and overseeing:
 - the overall business strategy of the institution within the applicable legal and regulatory framework taking into account the institution's long-term financial interests and solvency;
 - the overall risk strategy and policy of the institution, including its risk tolerance and its risk management framework;
 - the amounts, types and distribution of both internal capital and own funds adequate to cover the risks of the institution;
 - a robust and transparent organizational structure with effective communication and reporting channels;

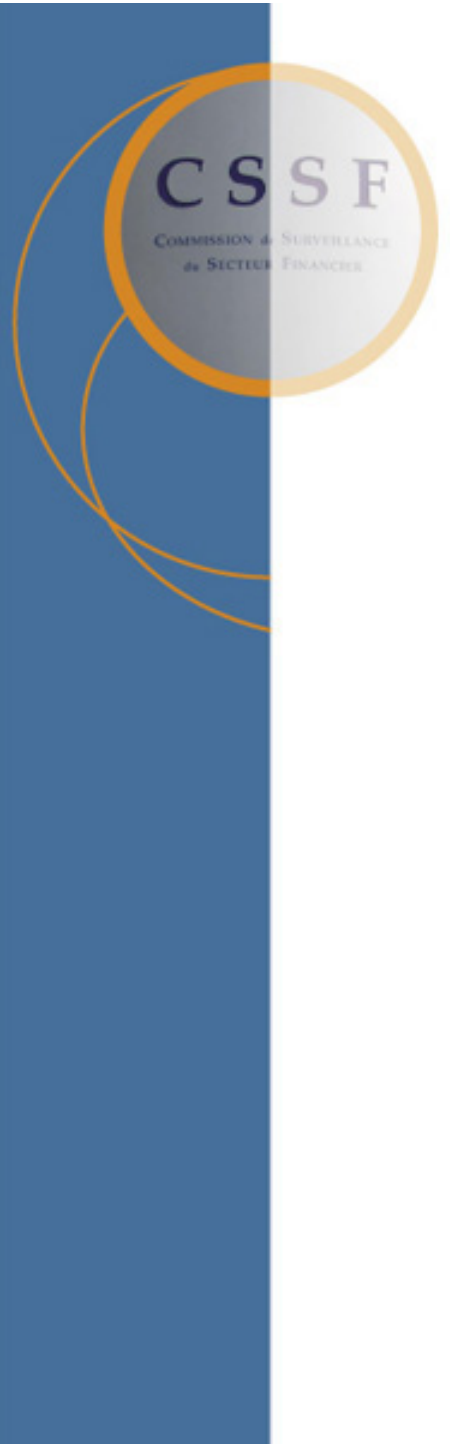


CSSF

COMMISSION de SURVEILLANCE
de SECTEUR FINANCIER

Director' s responsibility

- a policy on the nomination and succession of individuals with key functions in the institution;
- a remuneration framework that is in line with the risk strategies of the institution;
- the governance principles and corporate values of the institution: code of conduct
- an adequate and effective internal control framework, that includes well-functioning Risk Control, Compliance and Internal Audit functions as well as an appropriate financial reporting and accounting framework.



CSSF

COMMISSION de SURVEILLANCE
de SECTEUR FINANCIER


Director' s responsibility

- The board should also regularly review and adjust these policies and strategies.
- Article 7 § 4 FSL: obligation to notify any changes to the CSSF
- The board is responsible for appropriate communication with supervisory authorities.

4. Control

Ongoing Supervision

- Article 53 (2) → powers of the CSSF
- Desk based approach (ICAAP, CRA) and on-site inspections with regard to corporate/internal governance
- The aim is to verify the respect and implementation of the internal governance requirements at the level of:
 - conflict of interest, whistle blowing,
 - outsourcing,
 - compliance,
 - organization and allocation of responsibilities,
 - internal audit processes...



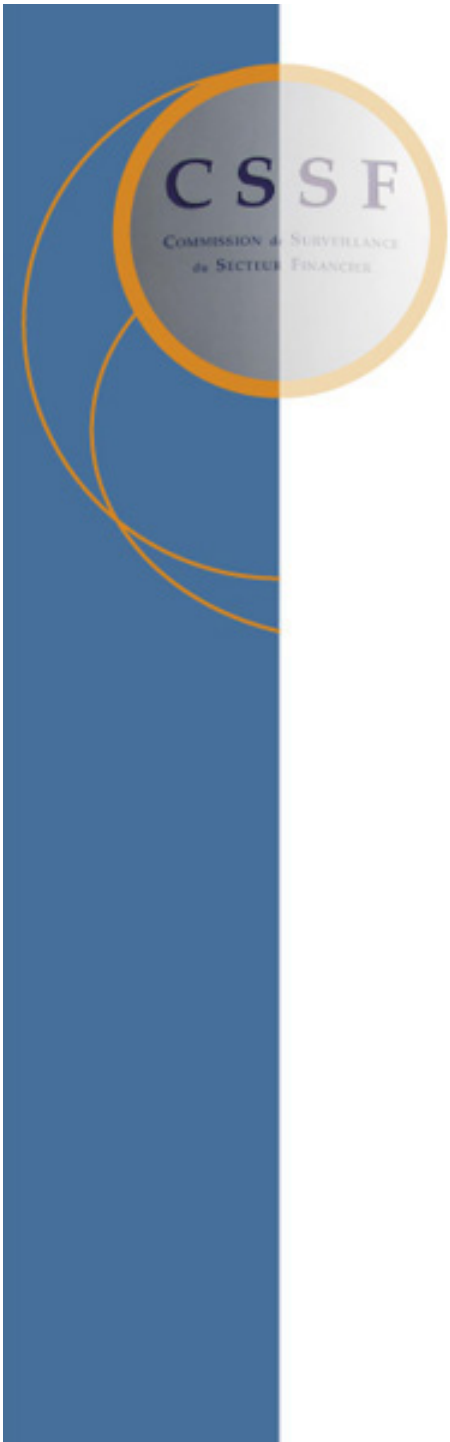
CSSF

COMMISSION DE SURVEILLANCE
du SECTEUR FINANCIER

Director's responsibility

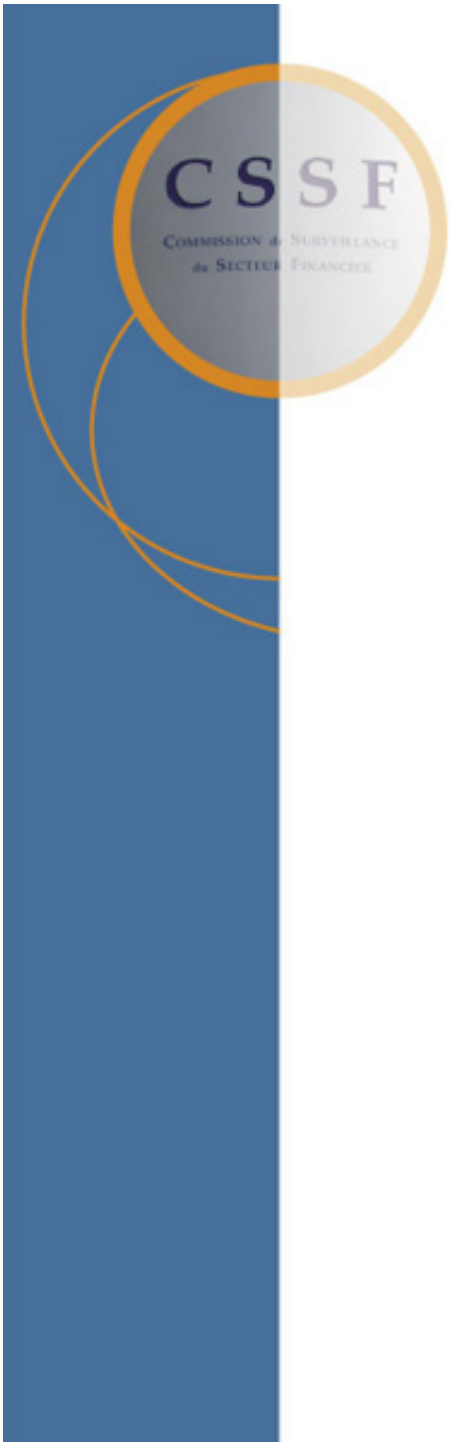
5. Sanctions

- Articles 6 (17) and 63 of the law on the financial sector: the CSSF may impose various administrative sanctions such as
 - warnings,
 - reprimands,
 - administrative fines,
 - temporary or definitive prohibitions,
 - coercive fines, and
 - disclosure to the public of any of these sanctions



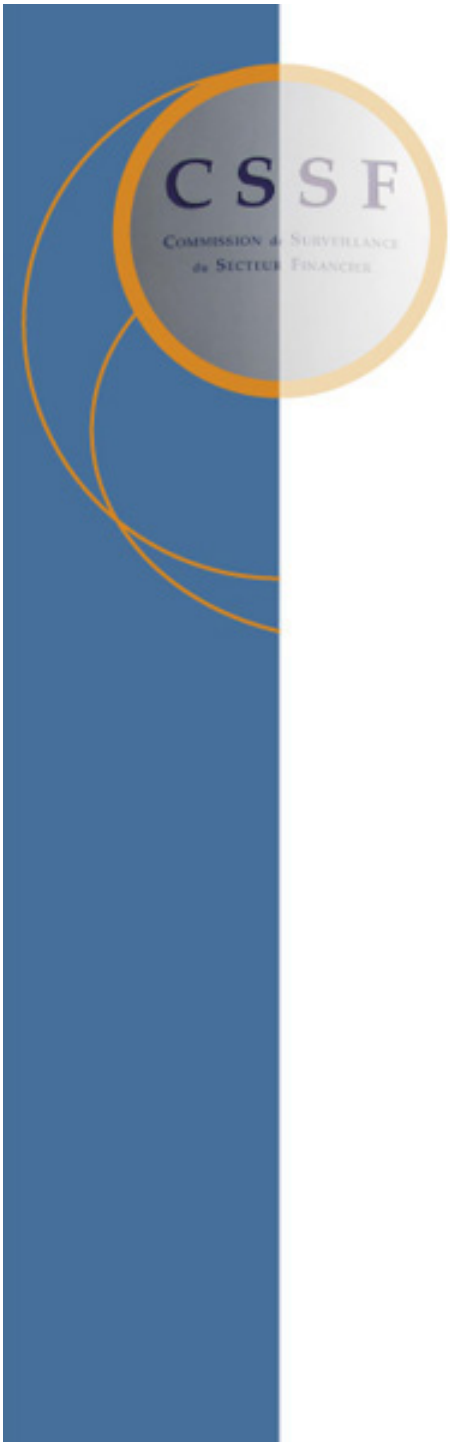
Director's responsibility

- The CSSF may also impose an administrative fine on the persons responsible for the administration or management of payment institutions and electronic money institutions (article 46 of the Law of 10 November 2009 on payment institutions)
- Besides, such fines may be imposed by the CSSF to the directors or members of the management board, managers and officers of undertakings for collective investments, of management companies, depositaries as well as of any other undertaking contributing towards the business activity of the UCI



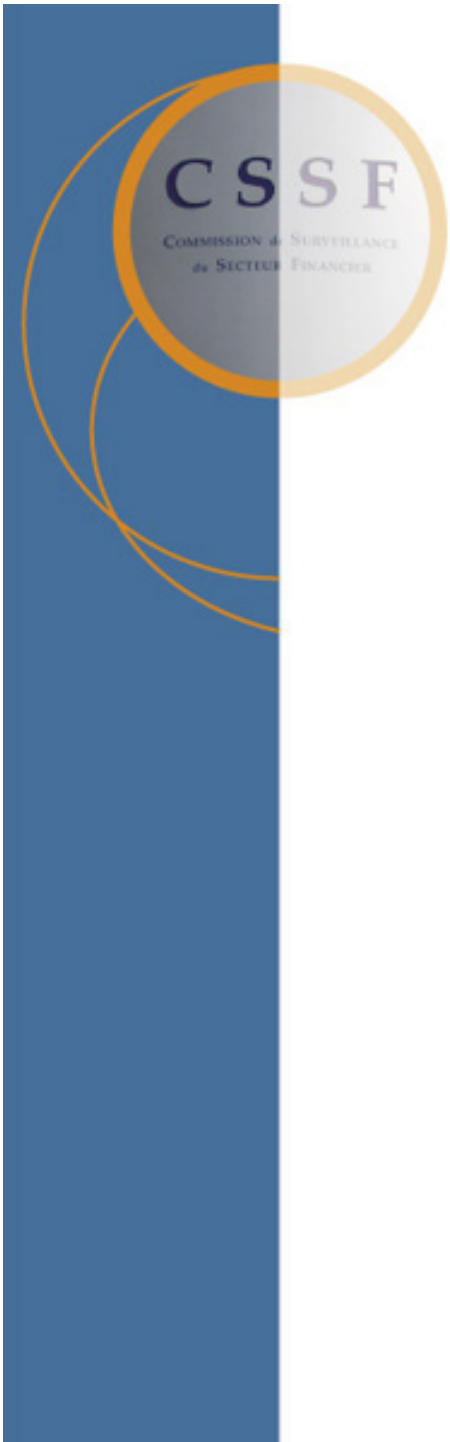
III. Future developments

- EBA Guidelines on Internal Governance dated September 26, 2011
- To be incorporated within the supervisory procedures by 31 March 2012
- The new Guidelines are divided into 6 chapters:
 - Corporate structure and organization
 - Management body (Board)
 - Risk management
 - Internal Control
 - Information systems and business continuity
 - Transparency



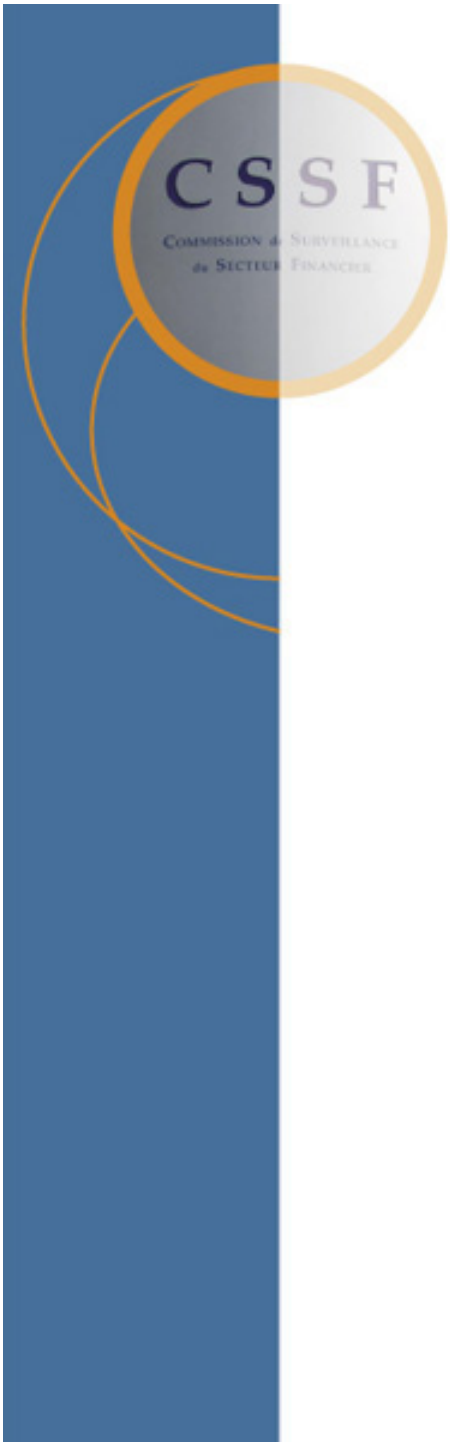
Management body (Board):

- The new EBA Guidelines refer to the functioning and composition of the board as well as the qualification, appointment and succession of its members
- Members of the board shall be and remain qualified, including through training,
- They shall have a clear understanding of the institutions governance arrangements and their role in them
- The members of the board, both individually and collectively, should have the necessary expertise, experience, competencies, understanding and personal qualities, including professionalism and personal integrity, to properly carry out their duties



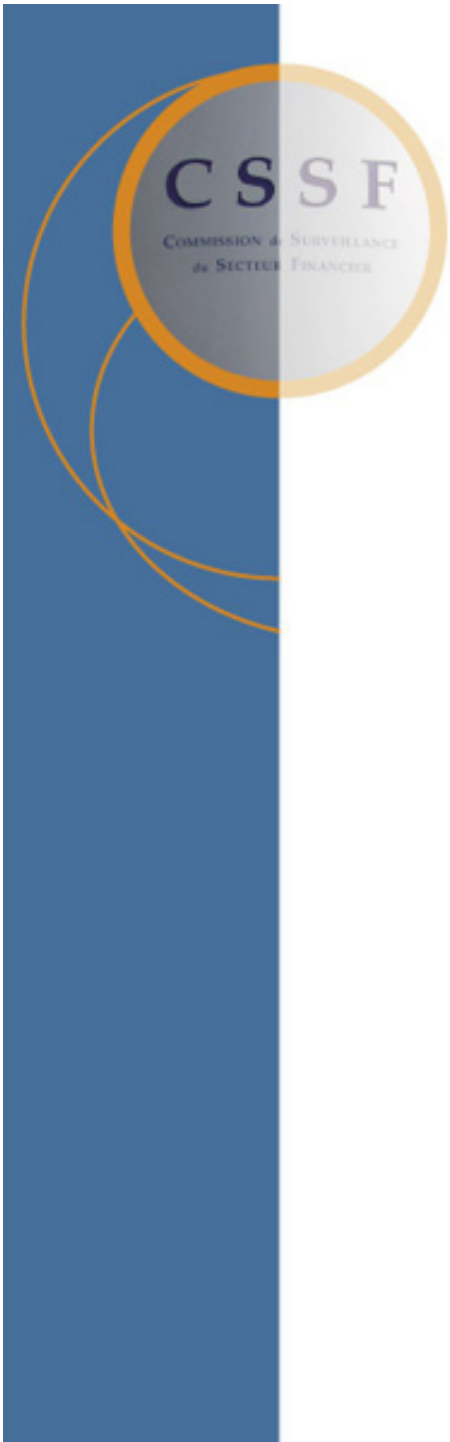
Director' s responsibility

- Members of the board should have an up-to-date understanding of the business of the institution. This includes appropriate understanding of those areas for which they are not directly responsible but are collectively accountable
- Collectively, they should have a full understanding of the nature of the business and its associated risks and have adequate expertise and experience relevant to each of the material activities the institution intends to pursue in order to enable effective governance and oversight
- Institutions should have a sound process in place to ensure that the board members, individually and collectively, have sufficient qualifications



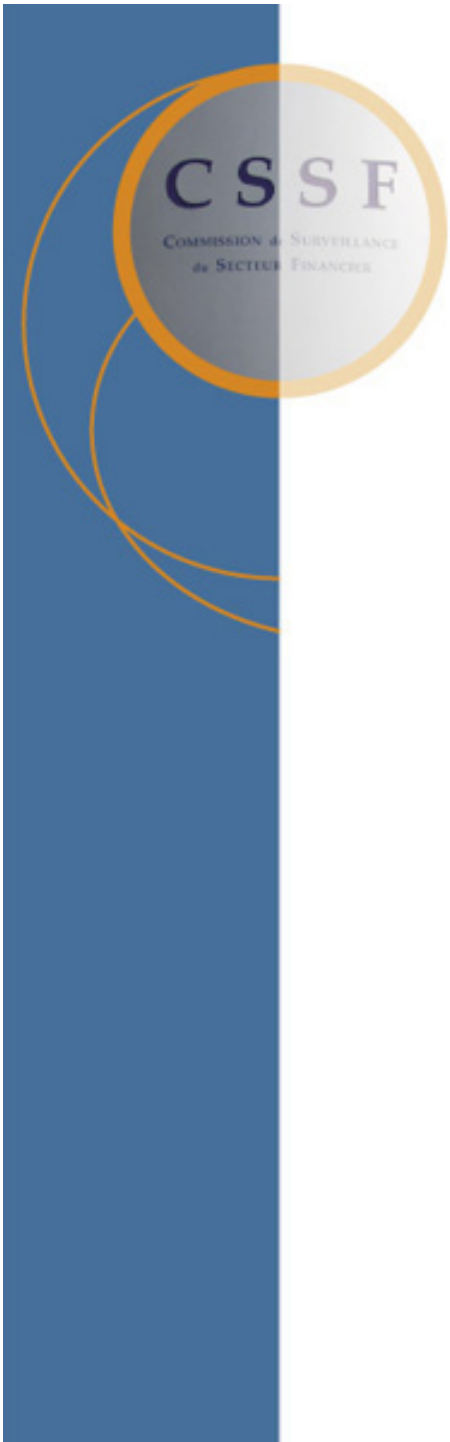
Director' s responsibility

- Lifelong learning: Members of the board should acquire, maintain and deepen their knowledge and skills to fulfil their responsibilities.
- Individually tailored training programmes which might cover the following areas:
 - the institution's risk management tools and models, new developments, changes within the organisation, complex products, new products or markets and mergers
- Sufficient time and resources should be dedicated to training



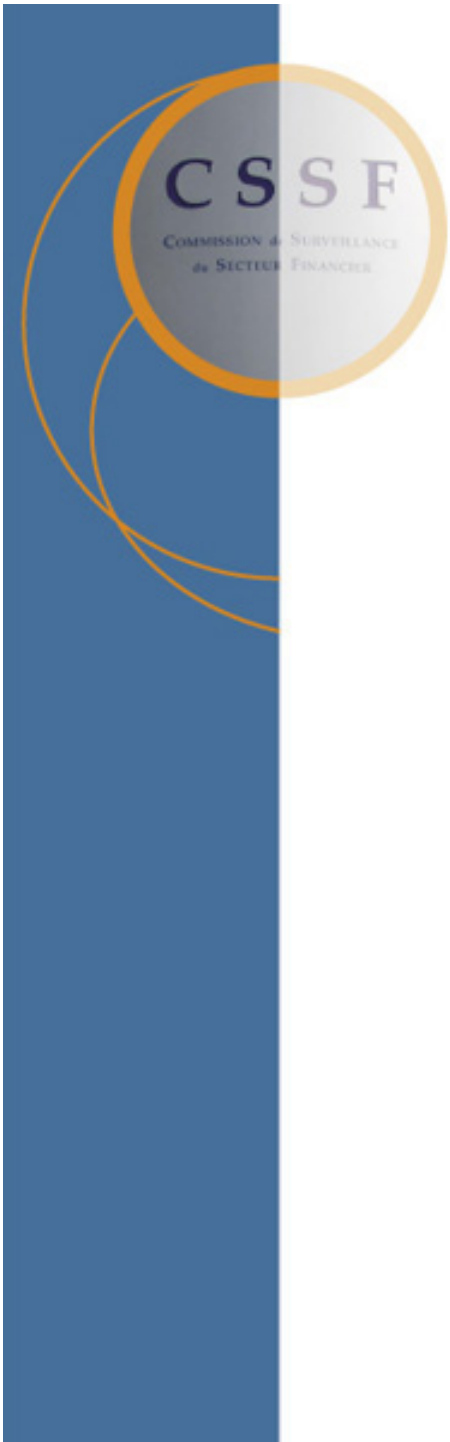
Director' s responsibility

- Setting up specialized committees consisting of members of the board:
 - an audit committee, a risk committee, a remuneration committee, a nomination or human resources committee and/or a governance/ethics or compliance committee
 - an optimal mix of expertise, competencies and experience that, in combination, allows the board to fully understand, objectively evaluate and bring fresh thinking to the relevant issues
 - **BUT: delegation to such committees does not implicate collective discharge of the duties and responsibilities of the management body**



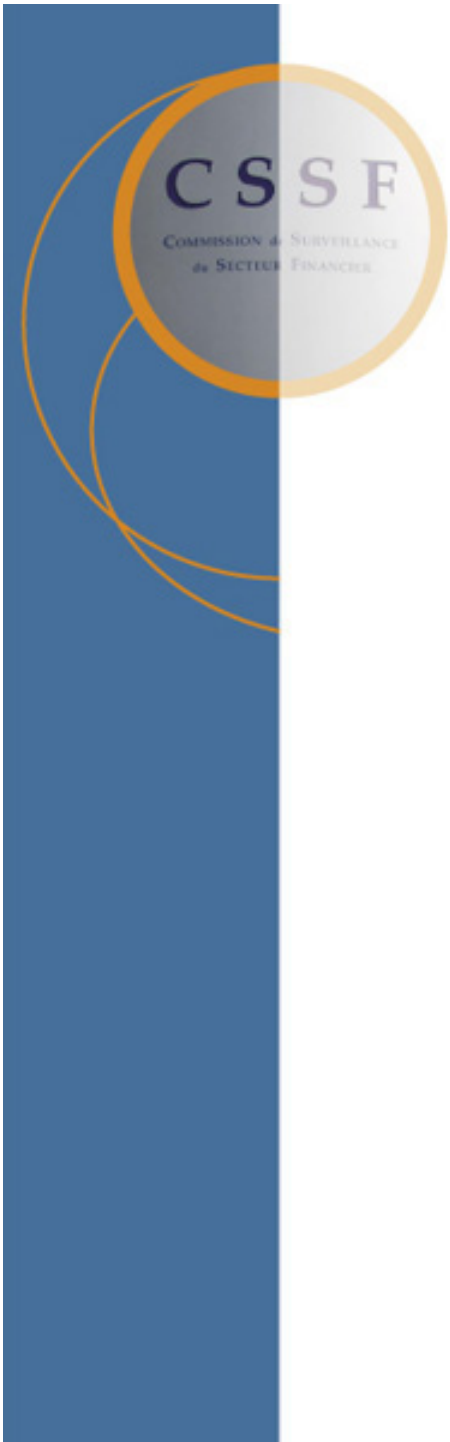
2. CRD IV Proposal

- Directive proposal on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms
- The overarching goal of CRD IV Proposal is to ensure that the effectiveness of risk governance in European credit institutions and investment firms is strengthened.
- The measures envisaged should help avoid excessive risk-taking by individual credit institutions and ultimately the accumulation of excessive risk in the financial system by
 - 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.



Director' s responsibility


- Articles 86 (governance arrangements) and 87 (management body) of the CRD IV Proposal contain new requirements in terms of governance:
- All members of the board of any institution shall at all times be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties
- Institutions shall devote adequate human and financial resources to the induction and training of members of the board
- Institutions shall take into account diversity as one of the criteria for selection of members of the management body



Director' s responsibility

- In particular, institutions shall put in place a policy promoting gender, age, geographical, educational and professional diversity on the management body

Conclusion: Qualification and sufficient expertise of the board members is essential for an institution to identify and address the risks an institution is exposed to in time!



CSSF

COMMISSION de SURVEILLANCE
de SECTEUR FINANCIER

Thank You

Disclaimer:

The views expressed in this presentation are those of the presenter only. Official positions of the CSSF on Governance in the financial sector are determined only after extensive due process and deliberation.