DeNederlandscheBank
EUROSYSTEEM

Q&A on supervisory board independence – Payment institutions

Payment institutions are not under a full statutory requirement to establish a supervisory board. That said, they may need to do so to fulfil the obligation to have in place a clear, balanced and adequate organisational structure as stipulated in Section 17 of the Dutch Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*). In this context, DNB refers to the Q&A on supervisory boards at payment institutions and electronic money institutions. In the Q&A below, DNB will elaborate on the legal basis for supervisory board independence at payment institutions, and set out its views on different types of independence and ways for payment institutions to ensure supervisory board independence.[1]

Question:

What are the requirements that govern supervisory board independence?

Answer:

Good and balanced institutional governance contributes to a robust and ethical financial sector. A discerning and independent supervisory board exercising its supervisory and advisory roles is instrumental in a financial services provider's governance structure. At payment institutions, supervisory board independence revolves around three types of independence: independence of mind, independence in appearance and formal independence.

Legal basis

In Section 3:17, the *Wft* stipulates that payment institutions are to structure their governance processes such that sound and ethical operational management is guaranteed. Under Section 17 of the *Bpr*, a payment institution's business practices should, in particular, ensure that the institution has in place a clear, balanced and adequate organisational structure. By exercising internal supervision of the policies pursued by management and the general course of business at an institution, a supervisory board contributes greatly to a balanced organisational structure. A supervisory board will also offer advice to management. In performing their duties, supervisory directors are required to act in the best interest of the company and its

[1] In this Q&A, the term 'supervisory board' is used to refer to the highest internal supervisory body. This Q&A also applies to non-executive directors on a one-tier board.

business (Sections 140/250, Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek – BW*)).

Pursuant to Section 3:8 of the *Wft*, the members of a payment institution's supervisory board must be fit to fulfil their supervisory role. To ensure this, DNB will perform fitness assessments based on the Policy Rule on Fitness. Part of the fitness assessment is a review of whether the person in question is capable of making their own sound, objective and independent decisions and judgements.

Types of independence

In assessing the independence of a supervisory board, DNB will consider the following three types of independence.

1: Independence of mind

All supervisory board members should be independent of mind. Acting with independence of mind is particularly important in discussions and in the decision-making process in the supervisory board. All supervisory directors should engage actively in their duties and be capable of making sound, objective and independent decisions and judgements when fulfilling their duties and responsibilities. Supervisory board members must have the courage, conviction and strength to effectively assess and challenge the management body's policies and proposed decisions without being led by group thinking.

They cannot have any conflicts of interest that would impede their ability to perform their duties independently and objectively.

2: Independence in appearance

Supervisory board members should prevent and/or manage conflicts of interest or the semblance of such conflicts. The supervisory board must have a policy in place to address and manage actual and potential conflicts of interest or the semblance of such conflicts. Dutch law stipulates that, if a supervisory director has a direct or indirect personal interest that is contrary to that of the institution, they will not take part in the supervisory board's deliberations and decision-making.

3: Formal independence

To effectively ensure sound and ethical operational management and a balanced organisational structure, a supervisory board should have a sufficient number of formally independent members.

When does a supervisory director qualify as formally independent?

Although the EBA/ESMA Guidelines on the assessment of the suitability of members of the management body and key function holders (hereinafter: "the EBA/ESMA Guidelines") do not apply to payment institutions, they do provide useful guidance

for assessing whether a supervisory board member can be considered as formally independent. For this reason, DNB will take the EBA/ESMA Guidelines as a starting point when assessing whether a payment institution's supervisory directors qualify as formally independent (notably Paragraphs 89-91). A payment institution may decide not to follow the EBA/ESMA Guidelines, explaining its reasons, if it can demonstrate why it believes a supervisory director should nevertheless be considered as formally independent.

What is a 'sufficient number' of formally independent supervisory directors?

There is no strict definition of the term 'sufficient number' that applies across the board, given that its interpretation depends on the circumstances of a case. That is why, with this Q&A, DNB seeks to provide insight into the circumstances it will consider when determining what constitutes a 'sufficient number' of formally independent supervisory board members in a specific case.

In assessing how many formally independent supervisory board members are required in a specific case to effectively ensure sound and ethical operational management and a balanced organisational structure, DNB will consider all relevant circumstances of a case, including the nature, scale, risks and complexity of the payment institution's operations. In some instances, it may be enough for payment institutions to have fewer than 50% formally independent supervisory board members for the purposes of ensuring sound and ethical operational management and a balanced organisational structure, while other payment institutions may be required to have at least 50% formally independent members on their supervisory board.

Furthermore, listed institutions are subject to the Dutch Corporate Governance Code (CGC), which stipulates in a best practice provision that a majority of their supervisory board members should be formally independent. The CGC is a form of self-regulation based on the comply-or-explain principle.

When will a payment institution have to have at least 50% formally independent supervisory directors?

Circumstances may dictate that a payment institution should have at least 50% formally independent supervisory board members to ensure sound and ethical operational management and a balanced organisational structure. To DNB, such circumstances would include situations in which the interests of the payment institution in question are, or are likely to become, incompatible with, or contradictory or subordinate to, the interests of shareholders or other stakeholders. In all these circumstances, it is particularly important that the supervisory board can exercise countervailing power. A number of examples of such circumstances have been provided below:

a) **Group structure with entities providing different services**: providing different services and/or not holding the same type of licence (e.g. payment institution/bank or payment institution/IT services provider combinations) may lead to situations where the interests of the payment institution and the parent institution are opposed or where the interests of the payment institution are, or are likely to become, subordinate to other interests within the group.

b) **Presence of director-majority shareholder or dominant shareholder**: structures with a director-majority shareholder/dominant shareholders (e.g. because of a majority interest or substantial minority interest, specific special voting rights or a particular investment strategy (e.g. short or medium-term profit maximisation)) come with a risk of the decision-making process being dominated by the majority shareholder or shareholders, as a result of which their part interest will take precedence over other part interests in the payment institution or the payment institution's own interest.

c) **Parent institution outside EEA**: if the parent institution is not located in the EEA, the risk of a conflict of interest between the parent institution and the payment institution and/or of incompatibility of a parent institution's decision with the interests that are sought to be protected by European and/or Dutch law is greater than if the parent institution were located in the EEA.

DISCLAIMER

Q&As provide further insight into DNB's policy practice by setting out its interpretation of statutory supervisory rules. Institutions are free to opt for alternative ways in which to meet the statutory and regulatory requirements provided that they apply the comply-or-explain principle. To learn more about the status of DNB's policy statements, go to the Explanatory guide to DNB's policy statements on Open Book on Supervision.