DeNederlandscheBank
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Q&A on supervisory board independence – Banks

Banks are required, under Section 3:19(1) of the Dutch Financial Supervision Act (*Wet op het financieel toezicht – Wft*), to establish a supervisory board of at least three members.[1] In this Q&A, DNB will elaborate on the legal basis for supervisory board independence, and set out its views on different types of independence and ways for banks to ensure supervisory board independence.

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 banks, 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 banks are to structure their governance processes such that sound and ethical operational management is guaranteed. Under Section 17 of the Dutch Decree on Prudential Rules for Financial Undertakings (*Besluit prudentiële regels Wft – Bpr*), a bank'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 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 bank's supervisory board must be fit to fulfil their supervisory role. The ESMA/EBA Guidelines on the assessment of the suitability of members of the management body and key function holders

[1] Under Section 3:19(2) of the *Wft*, a bank not qualifying as a private or public limited company is required to have a body in place whose duties are comparable to those of a supervisory board. This Q&A also applies to such a body.

(hereinafter: "the EBA/ESMA Guidelines") were published in 2021.[2] DNB will perform fitness assessments of would-be and incumbent supervisory directors based on these Guidelines, where relevant in combination with the Policy Rule on Fitness.[3] 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.

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[2] DNB has said to be compliant with these Guidelines. See also: Application of the Guidelines and Recommendations of the European Supervisory Authorities (dnb.nl).
[3] For the sake of completeness, it is noted in this context that fit and proper supervision is one of the tasks conferred on the ECB for which it has exclusive competence.

When does a supervisory director qualify as formally independent?

A formally independent supervisory director does not at present, or did not in the recent past, have a relationship with the institution or its management that might affect their judgement, thereby compromising their ability to make independent decisions. DNB uses the criteria of the EBA/ESMA Guidelines to assess whether a supervisory director qualifies as formally independent.

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

For the purposes of determining the required number of formally independent supervisory board members, the EBA/ESMA Guidelines distinguish between three categories of banks:

1) significant or listed banks;
2) banks that are neither significant nor listed; and
3) banking subsidiaries that are neither significant nor listed and that are wholly owned by a banking parent,[4] in particular when the subsidiary is located in the same Member State as the parent institution.

Re 1) Significant or listed banks

Significant or listed banks should have a sufficient number of formally independent supervisory directors.

Furthermore, listed banks 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.

Re 2) Banks that are neither significant nor listed

Banks that are neither significant nor listed should, as a general principle, have at least one supervisory board member who is formally independent.

Re 3) Banking subsidiaries that are neither significant nor listed and that are wholly owned by a banking parent, in particular when the subsidiary is located in the same Member State as the parent institution

By way of derogation from the rule that banks that are neither significant nor unlisted should have at least one formally independent supervisory director, the requirement of formally independent supervisory directors can be waived for banking subsidiaries that are wholly owned by a banking parent, in particular when the subsidiary is located in the same Member State as the parent institution.

[4] As defined in Article 3(1)(3) of Directive 2013/36/EU (CRD IV), also having regard to Article 3(3) of that Directive.

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

Circumstances may dictate that a bank 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 bank 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. bank/insurance, bank/clearing or bank/payment institution combinations) or the circumstance that the bank is a member of a group whose core business is not the provision of financial services may lead to situations where the interests of the bank and the parent institution are opposed or where the interests of the bank 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 bank or the bank'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 bank 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.