



# ILA BANK DIRECTORS' GUIDE 2021

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FUNCTION	NAME	ORGANIZATION
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Vice-Chair	Michael SCHWEIGER	Loyens & Loeff Luxembourg S.à r.l.
Member	Vincent DECALF	Independent Director
Member	Hélène DUPUY	EFG Investment Luxembourg S.A.
Member	Giovanna GIARDINA	KPMG Luxembourg, SC
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Corporate resource of the ILA Bank Committee



# TABLE OF CONTENTS

## **01 INTRODUCTION**

## **02 BOARD OF DIRECTORS OF CREDIT INSTITUTIONS**

- 2.1. BOARD FRAMEWORK
- 2.2. BOARD MEMBER LIFE CYCLE

## **03 FUNDAMENTALS AND TOOLKIT FOR BOARD MEMBERS**

- 3.1. BOARD OF DIRECTORS
- 3.2. DUTIES & RESPONSIBILITIES OF LUXEMBOURG BANK DIRECTORS:  
OVER VIEW AND BEST PRACTICES
- 3.3. COMMITTEES: ORGANISATION AND REPORTING
- 3.4. BOARDS OF DIRECTORS SCOPE OF SUPERVISION – SUGGESTED  
BOARD MEETING AGENDA AND EXECUTION/IMPLEMENTATION
- 3.5. OBSERVED AREAS FOR IMPROVEMENT

# 01 INTRODUCTION

Welcome to the third edition of the ILA Bank Directors' guide!

The ILA Banking Committee's objectives are to promote proper governance principles both within and outside of the boardroom, provide guidance and share best practices amongst the Board member community, and to liaise regularly with the regulator (the CSSF) to confirm our understanding of the different regulations and their expectations.

This practical guide is intended to provide both current and future Bank Directors with guidance on how to be effective Board Members of a Luxembourg credit institution incorporated under Luxembourg law, including their branches. It also provides guidance for those responsible for Luxembourg branches of third country credit institutions, including how to meet the increasingly demanding Luxembourg legal and regulatory requirements in respect of corporate governance.

The ILA Banking Committee has decided to supplement this third edition of the guide in order to reflect the recent developments at EU and Luxembourg level relating to the mandate of a Bank board member and the implementation of a proper governance framework at the level of each institution.

The Guide contains a «fundamentals» toolkit for board members detailing the role of executive/non-executive directors, the specific role and responsibilities of the Chair of the Board of Directors and highlights common board practices which require improvement.

This guide begins with a concise overview of the Board framework and the board member mandate lifecycle. Candidates for board membership and current directors will find this concise summary of the regulatory framework to be a helpful reference. A detailed review of key issues and actions follows, highlighting what to consider during a mandate to meet the high level of professionalism expected by regulators.

Many thanks for your continuing interest in our work and feedback about this guide!



**Stanislas Chambourdon**

Chairman of the  
ILA Bank Committee



**Virginie Lagrange**

Vice-Chair of ILA

## 02 BOARD OF DIRECTORS OF CREDIT INSTITUTIONS

### 2.1 BOARD FRAMEWORK

Since November 2014, the ECB oversees all “significant” and “less significant” credit institutions in participating Member States through direct and indirect banking supervision.

The significance assessment of Credit Institutions is based on the following criteria:

- the total value of the assets;
- the importance for the economy of the country in which they are located, or the EU as a whole;
- the scale of their cross-border activities; and
- whether they have requested or received public financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF).

### CLASSIFICATION CRITERIA

- 01 Size criterion**  
Size in terms of total assets  
(Article 50-55 SSM FR)
- 02 Economic importance criterion**  
Importance for the economy of the Union or any participating Member State  
(Article 56 – 58 SSM FR)
- 03 Cross-border activities criterion**  
Its significance with regard to cross-border activities  
(Article 59 – 60 SSM FR)
- 04 Direct public financial assistance criterion**  
A request for or the receipt of direct public financial assistance from the European Stability Mechanism (ESM)  
(Article 61 – 64 SSM FR)
- 05 One of the three most significant credit institutions**  
The supervised entity is one of the three most significant credit institutions in a participating Member State  
(Article 65 – 66 SSM FR)

Less significant credit institutions in participating countries continue to be supervised by the national competent authorities (NCAs) under the overall oversight of the ECB.

The ECB can decide at any time to exercise direct supervision in order to ensure consistent application of high supervisory standards.

The regulatory framework for boards will depend on the type of institution, as for a

Significant Institution, in addition to European Regulations, Luxembourg Laws and CSSF Circulars and Regulations EBA Guidelines must also be considered. Although EBA Guidelines are not per se applicable to Less Significant institutions, we observe that the CSSF tends to consider the EBA Guidelines as representative of best practice that should be followed by Less Significant Institutions, even when not (or not yet) transposed into CSSF Circulars.

The table below highlights the main regulatory references related to governance applicable to the different types of credit institution in Luxembourg.

	Significant Institutions	Less Significant Institutions	Branches of EU Credit Institutions	Branches of Non-EU Credit Institutions
Law of 5 April 1993 on the Financial Sector as amended – Banking Law	✓	✓	✓	✓
CSSF Circular 12/552 as amended	✓	✓	X <sup>1</sup>	✓
CSSF Circular 07/325 as amended	X	X	✓	X
Regulation (EU) No 575/2013 – CRR	✓	✓	✓	✓
EBA Guidelines 2017/11 on Internal Governance	X <sup>2</sup>	✓	X <sup>2</sup>	X <sup>2</sup>
EBA Guidelines 2017/12 on suitability assessment of members of the management bodies and key function holders	X <sup>2</sup>	✓	X <sup>2</sup>	X <sup>2</sup>

1. In respect of the areas for which the CSSF retains an oversight responsibility as host authority (AML/CTF, investment services and control of obligations applicable to Luxembourg based UCI), branches of EU Credit Institutions and investment shall establish internal governance arrangements comparable to those provided for in this circular.
2. As mentioned, the CSSF tends to consider the EBA Guidelines as representative of best practice that should be followed by all credit institutions.

## 2.2 BOARD MEMBER LIFE CYCLE

KEY ISSUES OR ACTIONS TO CONSIDER	RESPONSIBILITY	REF. LAW OR BEST PRACTICE	RELATED BANK INTERNAL PROCEDURE (BEST PRACTICE)
<b>Accepting a director's mandate</b>			
Role and responsibilities of a Luxembourg bank director	Director	circ. 759 §11&26	Board induction policy
General duties of a Luxembourg bank director	Director	circ. 759 §11	Board induction policy
Due diligence by the prospective director on the bank and proposed Director's mandate	Director / Bank	Best practice	-- Director's individual responsibility (2)
Assessment of time availability (as part of suitability assessment)	Director / Bank	circ. 759 §20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Disclosure of external mandates	Director	circ. 759 §20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Assessment of number of mandates (as part of suitability assessment)	Bank	circ. 759 §20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Assessment of potential conflicts of interest (notably in relation to other external mandates)	Director / Bank	circ. 759 §20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Assessment of independence in respect of applicable regulatory criteria	Director / Bank	circ. 759 §20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Declaration on honour / assessment of reputation & honorability	Director / Bank	circ. 759 §18 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Due diligence by the bank incl. any other aspects of suitability assessment	Bank	circ. 759 §19&20 / EBA GL S / CSSF PP	Board membership policy (and separate suitability policy as deemed appropriate)
Regulatory (CSSF- and / or ECB) filing and approval	Director / Bank	Banking Law 05/04/1993 art7(3) / ECB GFPA / CSSF PP	Board membership policy
Establishment of a written Director mandate	Director / Bank	circ. 759 §24	Board membership policy
<b>Induction of a new director</b>			
Establishing director's skill base - induction	Director / Bank	circ. 759 §22	Board induction policy
Reminder of director's fiduciary responsibilities	Bank	Best practices	Board induction policy
<b>Overseeing the bank</b>			
Ongoing oversight of the bank's strategy	Board	circ. 759 §11&14	Board guiding principles/meetings standard agenda (1)
Ongoing oversight of the bank's risk taking	Board	circ. 759 §11&14	Board guiding principles/meetings standard agenda (1)
Ongoing oversight of the bank's internal governance	Board	circ. 759 §11&14	Board guiding principles/meetings standard agenda (1)
Periodical reminder of board detailed statutory and regulatory (fiduciary) duties	Bank	circ. 759 §11 to 17 / best practice	Board internal regulations/meetings standard agenda (1)
Dialogue with and oversight of management	Board	circ. 759 §11	Board internal regulations
Delegation to specialised (board delegated) committees	Board	circ. 759 §28	Board internal regulations
Ongoing oversight by the board of specialised (board delegated) committees	Board	circ. 759 §28 & 36	Board internal regulations
Communicating with shareholders	Board	Company Law	Board internal regulations/meetings standard agenda (1)
<b>Organising and ensuring effectiveness of the board</b>			
Role and responsibilities of the Board and	Board	circ. 759 §11	Board internal regulations (and director's mandate as appropriate)
-- Role of the chairman	Board	circ. 759 § 27	Board internal regulations (and director's mandate as appropriate)
-- Role of executive directors	Board	Best practice (1)	Board internal regulations (and director's mandate as appropriate)
-- Role of non-executive directors	Board	Best practice (1)	Board internal regulations (and director's mandate as appropriate)
Organisation and decision making	Board	circ. 759 §24 & 25	Board internal regulations
Board composition and succession planning	Board	circ. 759 §18	Board membership policy (and separate suitability policy)
Ongoing suitability assessment (individual and collective)	Board	circ. 759 §18 / EBA GL S / CSSF PP	Board membership policy (and / or separate suitability policy)
Independent director (assessment and periodical confirmation)	Director / Bank	circ. 759 § 23 / best practice	Board membership policy
Maintaining director's skill base - development	Director / Board / Bank	circ. 759 §22	Board membership policy and / or separate training and qualification policy
Ongoing assessment of director's conflicts of interest	Director / Board / Bank	circ. 759 §20	Board membership policy and / or separate conflicts of interest policy
Disclosure of new external mandates	Director	circ. 759 §20	Board membership policy (and separate suitability policy as deemed appropriate)
Preparation for meetings	Director	circ. 759 §20	Board internal regulations
Agenda of meetings incl. disclosure of potential conflicts of interest on agenda items	Director / Board / Bank	circ. 759 § 26 / best practice	Board meetings standard agenda (1)
Evaluating the performance of the board (and directors)	Board	circ. 759 § 26 / best practice	Board internal regulations and / or separate assessment policy (3)
<b>Setting up specialised (board delegated) committees (where applicable)</b>			
Terms of reference	Board	circ. 759 §35	Committee terms of reference
Composition	Board	circ. 759 §31	Committee terms of reference
Role and responsibilities	Board	circ. 759 §35	Committee terms of reference
Scope of delegation by the board	Board	circ. 759 §37	Committee terms of reference
Agenda of meetings	Committee	Best practice	Committee meetings standard agenda
Reporting to the board	Committee / Board	circ. 759 §36	Committee terms of reference / Board meetings standard agenda
<b>When should a director resign?</b>			
Assessing circumstances	Director	Best practice	-- Director's individual responsibility
Considering the risks (of staying or leaving)	Director	Best practice	-- Director's individual responsibility
Deciding objectively	Director	Best practice	-- Director's individual responsibility
<b>Making the resignation</b>			
Written formal resignation	Director	Best practice	Board membership policy
Regulatory (CSSF- and / or ECB) filing and approval	Bank	Banking Law 05/04/1993 art7 (3) / ECB GFPA	Board membership policy
<b>After resignation</b>			
Representations in the minutes of the board	Director	Best practice	-- Director's individual responsibility
Retention of personal copies by the director	Director	Best practice	-- Director's individual responsibility
Professional secrecy and fiduciary responsibilities of the departed director	Director	Corporate Law / Art. 41 Banking Law	Board membership policy
Announcement and/or publication	Bank	Corporate/Listing Laws	Board membership policy

Related ILA publications/practical guidance

- (1) Refer to ILA Bank Directors' guide
- (2) Refer to ILA Guide for Accepting Company's Directors mandates available on <http://www.ila.lu/ILA/documents/Guidemandat2579.pdf>
- (3) Refer to ILA Board effectiveness toolkit available on <http://www.ila.lu/ILA/documents/ILABoardEvaluationtoolkitv11432.pdf>

# 03 FUNDAMENTALS AND TOOLKIT FOR BOARD MEMBERS

## 3.1 BOARD OF DIRECTORS

### 3.1.1 Composition

The composition of the board is a critical component of robust corporate governance. CSSF Circular 12/552 states that each institution should have at least one independent member in its supervisory body while significant institutions should have a sufficient number of independent members in their supervisory body based on their organization as well as the nature, size and complexity of their activities. The Circular does not stipulate how many directors should be appointed to the board, however, it requires that the composition of the board is appropriate for the size, scale, and complexity of the business. In their individual capacities, board members must have the appropriate skills, knowledge, and experience to succeed in their roles. There are also requirements with respect to personal qualities and reputation.

Collectively, the board of directors must be able to understand the risks that a bank is subject to, as well as the economic and regulatory context within which it operates.

Based on the combined requirements at both an individual and collective level, it is clear that board composition requirements will vary depending upon a number of considerations:

- Size and complexity of the business (sole or multiple business lines)
- Risk profile of the institution

- Extensive branch and subsidiary network or operating within a group context
- Number of employees and the presence of either employee representative directors and / or Luxembourg State shareholder representative directors
- Current and future challenges facing the board of directors, including succession planning
- Certain requirements or recommendations for independent directors
- An increased social, commercial, and regulatory pressure to increase diversity on boards of directors

There are limits in terms of the number of executive directors who may sit on an institution's board of directors. CSSF Circular 12/552 prohibits a majority of directors from being "executive directors". For the purposes of that calculation, executive directors include authorized managers and any other employee of the institution. However, employee representative directors are excluded when determining whether the majority threshold has been reached.

It is extremely common in Luxembourg for the bank's CEO to be a member of the board of directors.



It is also worth noting that there is a requirement that all board mandates be documented in writing. While independent directors have recently increased their efforts to document this effectively, executive directors unfortunately do not always document this with the board.

The requirements under CSSF Circular 12/552 with respect to individual and collective suitability of the board are on-going obligations, meaning this assessment must not only be made in the context of new appointments, but also on a regular basis for all board members. Given the issues highlighted above, material changes in the business or its operating environment (including risks) may result in a new composition being required. At the very least, it will trigger the need for the board of directors to review the board composition and document the outcomes.

Article 38-2 of the Banking Law applies to CRR institutions and contains additional, detailed requirements regarding board composition, including a restriction on the number of mandates which can be held simultaneously by any one individual.

## **INDEPENDENCE**

CSSF Circular 12/552 requires the Board of Directors to demonstrate adequate professional & personal skills and experience. Independence of Board members is robustly challenged and is the purpose of our further analysis.

CSSF Circular 12/552 does not, however, prevent a candidate who is not independent from being a member of the supervisory board of a credit institution. It is not necessary that all members be independent.

## **INDEPENDENCE REQUIREMENTS CSSF CIRCULAR 12/552 ARTICLES 20 & 23**

The members of the board of directors shall ensure that their personal qualities enable them to properly perform their director's mandate, with the required commitment, availability, objectivity, critical thinking and independence.

An independent director shall not have any conflict of interest which might impair his/her judgement because he/she is bound by a business, family, or other relationships with the institution, its controlling shareholder, or the management of either.

The board of directors cannot have among its members a majority of persons who take on an executive role within the institution (i.e. authorized managers or other employees of the institution, with the exception of staff representatives).

The CSSF recommends that larger institutions have one or several independent directors (within the meaning of Art. 23).

## **PRACTICAL IMPLICATIONS**

Credit institutions should implement a clear and robust process to correctly appoint directors, both dependent (including executive and non-executive) and independent, in order to ensure compliance with CSSF Circular 12/552.

## Key steps:



Independence definition & set up of an independence policy



Identify threats to independence



Implement controls that prevent conflicts of interest



Assess the independence of boards of directors on a regular basis

## DIVERSITY

The recently introduced article 38-2 (8) of the Banking Law refers to the obligation within the Capital Requirements Regulation (CRR) that regulated entities and their nomination committees should ensure that their board includes a wide range of competences and qualities. There should also be place policies encouraging diversity in board composition.

Board composition analysis has shown that bank board membership is still reserved to a limited number of (similar) profiles, and boards have had difficulties expanding membership to women, younger people or other “minorities”.

It is still very unclear whether diversity criteria will have a real impact in practice in terms of the CSSF’s actions (and sanctions) in the future. However, many Luxembourg financial actors have recognized that opening the board to non-traditional profiles is inevitable, and they have started recruiting accordingly.

## ILA RECOMMENDATION

The Luxembourg financial sector is still very traditional in many respects, and this is reflected to a large extent in the board composition of its regulated financial entities. More diversity in board composition is not only an opportunity for the Luxembourg financial market, it is a necessity. Different experiences and views being available within a board have always been important to avoid “group think”, to promote debate, thus facilitate healthy governance practices. ILA encourages its members to view diversity criteria in a positive and serious manner.

However, diversity is more than appointing a “minority quota” when required. It is about having the structure and mentality in place to allow relevant actors to recognize and support the potential of non-traditional profiles and personalities, factors which will help facilitate successful corporate governance. Recognizing and supporting competent profiles at an early stage related to gender, ethnicity, age, and background is key to achieving the right board appointments.

The ILA Banking Committee recommends that each credit institution implement an independence control procedure in the form of a checklist to be completed by each board of directors’ candidate. See our sample checklist below.

- Concepts used should be clearly defined in a glossary attached to the checklist and should also be tailored to the credit institution.
- Details of any non-compliance should be flagged clearly to the nomination committee in order to ensure the selection of the most appropriate candidate.
- Each board member should inform the credit institution of any modifications required for the checklist.

### 3.1.2 Independence of mind and independent members

#### INDEPENDENCE OF MIND

Independence of mind is a pattern of behavior required of all the members of the board of directors, regardless of whether or not the member is considered to be “independent” or directly linked to the organization.

Independence of mind is a characteristic which goes beyond mere independence. It means that during discussion and decision-making processes, each member of the board should be able to make his/her own sound, objective, and independent judgments and decisions; in other words, able to resist “group-think”.

In this regard, each member of the board of directors, in addition to having no conflict of interests shall possess a full set of soft skills, including authenticity, decisiveness, external awareness, strategic acumen, and stress resistance.

#### INDEPENDENT MEMBERS

Credit institutions should establish in writing their individual interpretation of independence, taking into consideration the national context as well as the size and scope of the institution’s activities.

At the board level, the proportion of independent directors relative to dependent directors should be considered and tailored to the board’s particular needs.

#### INDEPENDENCE MEASUREMENT INDICATORS AND CHECKLIST EXAMPLE<sup>3</sup>

An independent director should:

- not be an executive director of the credit institution or an associated company, and

should not have been in such a position within the previous five years;

- not be an employee of the credit institution or an associated company, and should not have been in such a position within the previous three years;
- not receive nor have received additional remuneration within the last two financial years from the credit institution or an associated company apart from a fee received as a non-executive or supervisory director;
- not be and not have represented in any way a direct or indirect shareholder with a 10% or greater holding;
- not have had a significant business relationship with the credit institution or an associated company, either directly or as a partner, shareholder, director or senior employee of a body having these relationships within the last financial year;
- within the last three years, not have had a partner or employee of the present or former external auditor of the credit institution or an associated company;
- not have a significant economic link with executive directors of the credit institution or an associated company due to positions held in other companies or bodies;
- not have served on the board or supervisory board of the credit institution as a non-executive (or supervisory) director for more than twelve years; and
- not be a close family member of an executive director or of persons in the situations referred to in the points above.

3. Source: The Ten Principles of Corporate Governance of the Luxembourg Stock Exchange (4th edition revised version Appendix D: Independence criteria (Recommendation 3.5)).

## INDEPENDENCE MEASUREMENT CHECKLIST EXAMPLE & GLOSSARY

**Director:** any member of the administrative, managerial, or supervisory bodies of a credit institution

Example: Member of the Board of Directors

**Executive director:** any member of the administrative body (unitary board) who is engaged in the daily management of the credit institution.

Example: 4-eyes of a credit institution (direction autorisée)

**Additional remuneration:** in particular, additional remuneration covers any participation in a share option or any other performance-related pay scheme;

It does not cover the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the credit institution, provided that such compensation is not contingent in any way on continued service.

Refers also to the remuneration policy in place within the institution<sup>4</sup>.

**Business relationship:** business relationships include the situation of a significant supplier of goods or services (including financial, legal, advisory or consulting services), of a significant customer of the credit institution and of organizations that receive significant contributions from the credit institution or its subsidiaries.

**Associated company<sup>5</sup>:** an undertaking shall be presumed to exercise a significant influence over another undertaking where it has 20% or more of the shareholders' or members' voting rights in that undertaking.

**Close family member<sup>6</sup>:** family members who may be expected to influence a person in their dealings with the entity include that person's:

- children and spouse/domestic partner;
- spouse or domestic partner's children; and
- dependents or dependents of that person's spouse or domestic partner.

## INDEPENDENCE MEASUREMENT/ SUGGESTED YEARLY STATEMENT<sup>7</sup>

As a Director of a credit institution, you must:

- in all circumstances, maintain independent analysis, decision, and action;
- not seek or accept any unreasonable advantages that could be perceived as compromising your independence;
- clearly express your opposition if you find that a decision of the board (or supervisory board) may harm the credit institution;
- explain your reasons for resignation in a letter to the board should you choose to resign.

4. CSSF Circular 11/505 on details relating to the application of the principle of proportionality when establishing and applying remuneration policies that are consistent with sound and effective risk management as laid down notably in Circulars CSSF 10/496 and CSSF 10/497.

5. Source: Article 103(1) of the Law of 17 June 1992 relating to the annual and consolidated accounts of credit institutions governed by the laws of Luxembourg.

6. Source: IAS 24 "Related Party Disclosures".

7. Source: derived from The Ten Principles of Corporate Governance of the Luxembourg Stock Exchange (4th edition revised version Appendix D: Independence criteria (Recommendation 3.5.)).

## INDEPENDENCE MEASUREMENT/ SUGGESTED YEARLY CONFIRMATION

As a director of a credit institution, you must confirm that throughout the fiscal year:

- in all circumstances, you maintained independence in your analysis, decision-making, and action;
- you did not seek or accept any unreasonable advantages that could be perceived as comprising your independence;
- you clearly expressed your opposition if you thought a decision by the board or supervisory board would harm the credit institution; and
- you did not have serious reservations in respect of decisions taken by the Board of Directors during the year.

## ILA RECOMMENDATION

In addition to the independence checklist, the ILA Banking Committee recommends the signing of an independence confirmation statement on a yearly basis addressed to the Chair of the Board. See our example above. This statement could be useful in the context of the yearly Board self-assessment required by CSSF Circular 12/552.



## PRACTICAL EXAMPLES OF HOW TO CLASSIFY INDEPENDENT/DEPENDENT<sup>8</sup> DIRECTORS

EXTERNAL DIRECTOR <sup>9</sup>	QUALIFICATION
Group CEO of Parent Bank; Executive Director of an affiliate of the institution	DEPENDENT
Head of Private Banking department; Representative/Personal delegate	DEPENDENT
Director awarded with a success-fee related to the implementation of an efficient tax restructuring scheme at Group level	DEPENDENT
Representative of a company having a participation (less than 10%) in the capital of the institution	INDEPENDENT
A Director who did not have, during the financial year, any material business relationship/remuneration/function with the institution (e.g. as an advisor, or any employee of the firm which might have maintained the relationship) BUT did have such a relationship three years ago	INDEPENDENT
A Director who did not have, during the last financial year, a material business relationship with the institution (e.g. as an advisor, or any employee the firm which has maintained the relationship)	DEPENDENT
Former employee of the institution (more than three years ago)	INDEPENDENT
Former employee of the institution (less than three years ago)	DEPENDENT
Audit manager involved in the audit of an entity fully integrated in the consolidated financial statements of the institution during the last two years	DEPENDENT
Significant sponsor of the Golf Club for which one of the authorized directors of the institution is the President	INDEPENDENT
Daughter (or any member of the family) of the previous CEO of an associated company of the institution	DEPENDENT
Former minister of the Grand Duchy appointed as board member of the Luxembourgish subsidiary of a foreign bank	INDEPENDENT
Known member of the same political party as the President of the board of the institution	INDEPENDENT
Two friends, both members of the same board	INDEPENDENT
Advisor of an important client of the institution and of another company, both the client and the Company having been previously, but are no longer, members of the board of the institution	BECOME INDEPENDENT

8. Examples mentioned above are ILA's view only and should be tailored to concrete facts and circumstances.

9. "External" Director means in the context above a Director being not part of the authorized Management of the credit institution.

### 3.1.3 Conflicts of interest

In order to ensure independence of mind, all board members shall avoid any conflict of interest.

In case of actual or potential conflicts of interest board members shall inform the board of directors and abstain from voting on the matter where he/she has a conflict of interest.

Any abstention due to a conflict of interest shall be indicated in the minutes of the board meeting.

In order to limit potential conflicts of interest a member could be exposed to, members of the board should limit the number of directorships in other companies.

The mere fact of being a shareholder, owner or member of a credit institution, having private accounts, loans or using other services of the institution or any entity of the Group does not constitute per se a conflict of interest.

### 3.1.4 Executive/Non-Executive Directors<sup>10</sup>

#### **THE IMPACT OF THE STATUS OF A DIRECTOR OF A CREDIT INSTITUTION (IN LIGHT OF CURRENT LUXEMBOURG LAW AND CSSF CIRCULAR 12/552)**

Luxembourg laws and regulations typically do not differentiate between the status of board members. A director representing the Luxembourg state, or another public body is the only (statutory) exception.<sup>11</sup> There is therefore no legal differentiation in Luxembourg between an executive director who is an employee of the entity, a non-executive director who is not, and an independent director who is a non-executive director with no link to the entity that could entail a conflict of interest. The lack of differentiation or legal status of the different director statutes under Luxembourg law has traditionally made such differentiation void of any consequences and therefore not very important in practice.

With CSSF Circular 12/552, as amended (the Circular), the Law of 23 July 2015 (as implemented in the Banking Law), and the increased European harmonization of corporate governance, the situation has changed, and is likely to change even more dramatically in the next few years. We will briefly cover those areas where the director's status may have an impact now and in the future.

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10. This section was previously published in AGEFI in March 2014, in the ILA newsletter of January 2015 and has been slightly updated for the purposes of the present guide.

11. Law dated 25 July 1990, as amended concerning the status of a director representing the state or a public body in a Luxembourg public limited liability company.

## EXECUTIVE VERSUS NON-EXECUTIVE DIRECTORS

Given that there is no legal distinction between the status of executive and non-executive directors, both have the same legal duties, responsibilities and potential liabilities. This is, for instance, regularly evidenced by the fines imposed by the CSSF for regulatory violations, which are generally imposed identically across the board with no differentiation for status.

This lack of distinction is somewhat problematic in practice as both groups of directors do not have the same access to information or involvement in the business, yet they have to show the same commitment to the entity they serve and have a good understanding of its structure and business. Also, it is evident that non-executive directors should feel less pressured by internal politics than executive directors. This is because non-executives are not financially dependent on the entity being overseen by the board on which they sit.

Finally, their underlying purposes differ. The additional cost of having (remunerated) non-executives on the board is usually linked to the expectation of bringing more independence and impartiality than could be expected from an executive director. Non-executives also have more liberty to act upon their convictions. They also can bring specific experience and knowledge that may not be found internally. As well, they may have personal qualities that will increase the ability of the board to make constructive discussions and challenges to decisions.

Historically, non-executive directors were often seen mostly as honorary directors, because they were trusted advisers, well-known in the industry or had an extensive network. It

was less of a factor that their profile in terms of competence and personality added to the board and encouraged active and productive discussions. With the “fit and proper” test applying to bank directors individually<sup>12</sup> and the diversity and “collective fitness” requirements applying to the bank board collectively,<sup>13</sup> we are now witnessing a clear willingness by the legislator and the CSSF – following a European trend – to break with past practice.

This new turn also means that it is no longer sufficient for experts appointed to a board to merely advise other board members. They have to be conscious of their role as separate and individual board members who should act and make decisions using their knowledge, skills and independent thinking, just as is expected of other directors.

Non-executive directors are specifically expected to allocate sufficient time to being able to conduct their mandates effectively. A minimum time commitment is often also mentioned in a director’s engagement letter (if one is signed). The time commitment is however only indicative, as directors are expected to dedicate sufficient time to be able to effectively fulfill their mandate. Such a mandate implies that they shall have read and understood the information contained in the board pack and have acquired sufficient knowledge to fully understand the core information provided therein.

One other difference that could impact the treatment of different groups of directors is remuneration. Executive directors are usually not remunerated for sitting on the board, whereas non-executive directors typically would be. Under Luxembourg law, a mandate holder (such as a director) who is not remunerated for

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12. The assessment of the suitability of members of management and key function holders is, as referenced by the Circular, required for all banks.

13. The Circular also requires that a bank board cannot have a majority of executive directors.



his/her mandate could argue they have lower responsibility<sup>14</sup>. This could theoretically have an impact on an executive's behavior. This argument is, however, weak and the director's executive remuneration is likely to be taken into account. In practice however, this is rarely taken into consideration, as the main responsibility risk for bank directors is not related to being sued by the bank or a third party, but to being fined or otherwise sanctioned by the CSSF. In the latter case, remuneration would not make a difference as non-compliance is usually a "strict liability", which would result in an (administrative) sanction being applied by the CSSF.

## NON-EXECUTIVE VERSUS INDEPENDENT DIRECTORS

The independent director concept has long been associated with that of non-executives in the Luxembourg market. Experts acting as non-executive directors often considered themselves to be "independent" directors even though they usually had business connections with the entity in which they were acting as directors.

The Circular sheds some clarity on the independent director concept: an independent director is a *"director who does not have any conflict of interest which might impair his/her judgment because s/he is bound by a business, family or other relationship with the institution,*

*its controlling shareholder or the management of either"*.<sup>15</sup> The Circular also notes that the Chair of the board is in charge (and must therefore directly or indirectly promote, as far as possible) of proposing the election of independent directors.

The appointment of independent directors is encouraged by the Circular, and their "market share" is likely to increase with time. For now, they benefit from recommendations<sup>16</sup> as opposed to quotas, but this is expected to change in the near future. Other non-executives will remain relevant to a diversified and healthy bank board and will continue to benefit from the "no executives majority" rule.

## EMPLOYEE REPRESENTATIVE DIRECTORS

Employee representative directors are executive directors,<sup>17</sup> and they are subject (in the absence of statutes or court cases to the contrary) to the same standards of care and expectations in terms of skills and competence as other bank directors. This will mean in practice that they may have to attend training to meet the high expectations of bank directorship roles<sup>18</sup>. They are also subject to the same duty of confidentiality as any other bank director. Moreover, because of their unique position, they will often need to clarify with the board what information (and when) they may or may not disclose to their fellow employees.

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14. Article 1992 of the Civil Code, "Le mandataire répond non seulement du dol, mais encore des fautes qu'il commet dans sa gestion. Néanmoins, la responsabilité relative aux fautes est appliquée moins rigoureusement à celui dont le mandat est gratuit qu'à celui qui reçoit un salaire." It is however unclear under Luxembourg law whether an executive director will be considered to be without remuneration since he/she will be remunerated by the entity as an employee and, as such, receive a salary.
  15. Article 31 of the Circular. See also, for guidance on criteria applied to define independence, "The Ten Principles of Corporate Governance of the Luxembourg Stock Exchange" (4th edition, Appendix D – Independence criteria) and the practical checklists and examples set out in this guide.
  16. In article 31 of the Circular, the CSSF recommends larger institutions should have one or several independent directors. The Bank Committee of ILA recommends having at least 2 independent directors to ensure that the independent directors are not isolated, and thus are less comfortable expressing challenging views.
  17. While these directors have no management role, in the absence of clarity given by the CSSF in this respect, it is to be assumed that at least for regulatory purposes, employee representative directors will be considered to be executive directors.
  18. It is unfortunate that employee representative directors rarely attend external directorship training courses. It is sometimes forgotten that their status of employee-elected director does not change the fact that they have to act in the interest of the bank. In this they must meet the same expectations in terms of understanding of the bank structure, its business and strategies, even if the "fit and proper test" is applied to them with a different perspective.

## STATE AND PUBLIC BODY REPRESENTATIVE DIRECTORS

A non-executive director representing the Luxembourg state, or a Luxembourg public body has, unlike other directors, a very particular status. According to the law dated 25 July 1990, as amended, such a director is not liable for his/her actions taken during the directorship mandate, but it is the state or public body that is liable. Such directors must report to the state or public entity and take voting instructions (which are however rarely given in practice). This obviously means that these directors do not have the same pressure as other non-executive directors when it comes to their investment of effort in the director mandate, nor when acting in the best interest of the bank, at least not vis-à-vis the bank. They will, at least from a legal and political perspective, have more of an interest in fulfilling the expectations that the state or public body will have attached to their mandate.

All bank directors (except state and public body representatives) are subject to the same legal duties, responsibilities and potential liabilities, but their status differences matter elsewhere. Certain directors are receiving growing regulatory recognition and may be imposed on a larger number of banks in the near future. This will have a cost impact in the form of their remuneration.

In Luxembourg, a larger and more diversified choice of non-executive directors, coupled with more transparency requirements, are slowly pushing down some forms of remuneration, as well as reducing the number of mandates per director. At the same time, regulatory sanctions are being increased and are becoming more common. Bank board membership is now rarely an honorary position, yet it is still an appealing opportunity for many. It remains to be seen how the bank directorship situation will evolve in Luxembourg, but it can be expected that the

changes will be greater than initially anticipated. It can be hoped that such market evolution will encourage changes to corporate governance expected by the Luxembourg legislator, the CSSF, and the regulators of the European Union.

### 3.1.5 Are you a good chair? Specificities of role and responsibilities

#### GENERAL ROLE

The legal requirements applicable specifically to the chair of the board of directors (“the Chair”) are limited in Luxembourg.

As per article 444-3 of the Law of 10th August 1915 on commercial companies, as amended, the appointment of a chair amongst the members of the board of directors, the management board and the supervisory board is only mandatory for “sociétés européennes.”

The bylaws generally define any reserved rights or duties for the Chair.

In practice, the chair leads the board, sets its agenda and ensures there is an effective working group at the head of the Bank. He/she should promote a culture of openness and debate and is responsible for effective communication with shareholders. He/she ensures that all board members receive accurate, timely and clear information.

#### CHAIR OF THE BOARD OF DIRECTORS OF A LUXEMBOURG BANK

It is recommended (best practice) that his/her role is defined in the Board’s Internal Regulations.

In addition to his/her general role, being chair of a board of directors of a bank also implies the following in accordance with the Circular CSSF 12/552, as amended;

- The chair of the board of directors is in charge of ensuring a balanced composition of the board of directors, namely in terms of diversity, of promoting within the board of directors a culture of informed and contradictory discussion, and to propose the election of independent directors.
- The mandate of authorized manager and chair of the board of directors cannot be combined as per article 38-1(e) of the Banking Law.
- More specifically in the organization chart of the bank, the key internal control functions have direct access to the board of directors and to its chair.

### KEY ROLE IN THE BOARD EFFECTIVENESS

As defined in the EBA Guidelines on internal Governance,<sup>19</sup> the role of chair of the board is to lead the board and facilitate the efficient flow of information within the board and between the board and the committees thereof.

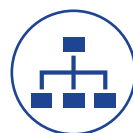
The Chair sets the board's meeting agendas and ensures that strategic issues are discussed with priority, and that decisions are taken on a sound and well-informed basis. To this end, the chair should ensure that documents and information are received well before the meeting. They should also promote open and critical discussions, ensuring that dissenting views can be expressed and discussed within the decision-making process.

### EXAMPLES OF THE DETAILED ROLE AND RESPONSIBILITIES OF THE CHAIR OF A LUXEMBOURG BANK

The Chair of the board represents the bank and its corporate governance with its principal audience. We have therefore identified the following key skills and behaviours that a "good" Chair should demonstrate:



**Leadership.** The Chair provides leadership to the board and arranges for it to review and monitor the aims, strategy, policy and directions of the Bank and the achievement of its objectives.



**Reporting to the Board.** The Chair reports to the board on matters arising when undertaking his/her functions and responsibilities under his/her mandate and, if necessary, makes recommendations to the board for its approval of these matters.



**Communication.** The Chair communicates with the board to keep it up to-date on major developments. The aim is to avoid surprises by ensuring timely discussion of potential developments, and to have the board provided with sufficient knowledge to permit it to make major decisions in a considered manner. He/she oversees the distribution of information to directors. He/she facilitates communication between and among the directors and management.

19. EBA/GL/2017/11



### **Convening board meetings in an appropriate manner.**

**Timeline:** The Chair establishes the annual schedule of the board and consults with all directors concerning board agendas and information provided to the board.

**Agenda:** The Chair sets the agenda for each board meeting in collaboration with the Authorized Management. He/she ensures that each board meeting agenda includes appropriate strategic issues and any other matters requiring approval of, or consideration by, the board.

**Attendance:** He/she shall draw up an attendance list.

**Decisions:** He/she remains attentive to the potential for conflicts of interest that may influence the vote. He/she may decide to invite external/internal experts or management to participate in the discussions.

**Minutes:** He/she ensures that minutes of meetings reflect the opinions expressed during the meetings.



### **Bank's strategic planning and business model sustainability.**

The Chair coordinates periodic board input, reviews management's strategic plans for the bank, and ensures that the sustainability of the bank's business model is evaluated periodically.



### **Director Appointments and Nominations.**

The Chair coordinates (or provides input to) the Corporate Governance or Nomination / Remuneration Committee (if any) on its recommendations to the Board for approval of:

- (i) candidates for nomination or appointment to the board; and
- (ii) members and chairs of board committees (if any).



### **Director Development.**

(In consultation with the Corporate Governance or Nomination / Remuneration Committee, if any), the Chair leads the bank's director development program.



**Succession.** In consultation with the Corporate Governance or Nomination / Remuneration Committee, if any, the Chair leads the board's review of the succession plan for the board, the Authorized Management, and other key senior executives.



**Board self-assessment.** The Chair coordinates the board's self-assessment and evaluation processes. He/she acts on the results of board evaluations.



**Relationship with Authorized Management.** The Chair provides support and advice to the Authorized Management. He/she keeps in regular contact with the Authorized Management between the board meetings in order to be regularly informed about all important business developments and strategic issues of the bank.



**Assessment of Authorized Management.** In consultation with the Corporate Governance or Nomination/ Remuneration Committee, if any, the Chair leads the development of appropriate objectives for the Authorized Management and monitoring of performance against those objectives (periodical evaluation).



**Communication with Shareholders.** As necessary, in conjunction with the board and the Authorized Management, the Chair reviews the effectiveness of the bank's shareholder communications plan.



**Reporting to the Regulator.** It is expected that the Chair reports directly to the CSSF in times of stress (crisis management) acting as the voice of the board of directors.



### 3.1.6 The individual suitability of Board's members

Article 6 and Article 19 of the Banking Law extend the powers of the CSSF in the context of its assessment of the prudent management of a credit institution which is subject to a potential acquisition. This is also relevant for investment firms, which have submitted a request for a license. The Banking Law refers not only to the honorability of potential directors, but expressly covers the requirements of knowledge and competence. This is in line with the “fit and proper test” profile that board members and members of the executive committee (referred to as the management in this paper and to “organe de direction” in the Banking Law) must have in order to meet European standards. This is also in line with the regulatory requirements of the CSSF Circular 12/552 (as amended) and, for Significant Institutions, the EBA and ESMA joint Guidelines on the assessment of the suitability of members of the management body and key function holders.

The Guidelines provide detailed criteria for assessing the suitability of the members of the management body. To this end they indicate that institutions should record in writing the roles, duties and required capabilities of each

position within the management body, as well as the expected time commitment.

When assessing the individual suitability of board members, institutions and (where relevant) competent authorities should consider not only their knowledge, skills, experience, good repute, honesty and integrity, but also their independence of mind and time commitment. Special attention is given to behavioural skills. Each board member should possess ‘independence of mind’ which goes beyond the concept of legal and financial independence. Independence of mind is a pattern of behaviour required of each member of the management body, regardless of whether or not the member is considered as “being independent”. All members of the management body, in particular during the discussions and decision-making process, should be able to make their own sound, objective and independent judgments and decisions, being able to resist “group-think”. Soft skills of board members including authenticity, decisiveness, external awareness, strategic acumen and stress resistance are key to ensuring proper management of a Bank, and so these qualities should therefore be assessed. This can be a very challenging exercise.

#### ILA RECOMMENDATION

We recommend that before accepting a mandate, candidates for board membership in regulated entities should conduct due diligence of the entity and of its profile, among other considerations, in light of the entity’s activities, financial health and current management composition. Candidates should also consider the time and procedure that the CSSF approval process will require. The ILA Working Group on directors’ mandates has published a guide in this respect (Guide for accepting company director mandates), which is accessible to ILA members via the ILA website (<http://www.ila.lu/ILA/documents/Guidemandat2579.pdf>).

We also recommend that candidates attend the necessary and relevant training, no matter their experience or profile. Given the substantial changes to the regulatory sphere in Luxembourg and CSSF practice in this respect, all directors

of regulated entities should understand the need to not only be aware of these changes, but also to maintain at all times sophisticated knowledge of all areas affecting the activities of the organization.

ILA would also like to emphasize that boards also need good generalists and others with a transversal view of an entity’s activities. Whether they are independent directors or other non-executives they may be less subject to internal and/or political pressure in terms of governance and judgment.

A board with highly specialized members is not necessarily a guaranteed way of ensuring compliance with a range of requirements. Boards as a whole must understand the activities and the risks involved, while also keeping a comprehensive overview and an ability to support key people to ensure this is done.



### 3.1.7 The collective suitability of Board of Directors

Article 38-1 and Article 38-2 (1) of the Banking Law feature the collective fitness test. The board of directors of a regulated entity must reflect:



a variety of experiences, and



collectively, have the necessary knowledge, experience and competence to properly comprehend the activities of and the main risks incurred by, the regulated entity.

This means in practice that managing the changes in a regulated entity's board composition have become a complex matter. The profiles of the members of the board of directors must not only reflect the activities of the entity and the risks involved, but also ensure variety and a global knowledge and view of the entity across the board. Apart from the necessity of having industry experts on the board, this triggers, in our view, the need for each board member to have a certain global understanding of all relevant activities and risks. This might be in areas with which he/she is not necessarily already familiar. This can be challenging, and is an area where non-executive (including independent) directors may have an important role to play.

#### ILA RECOMMENDATION

New obligations in terms of board composition are rather general in nature, which in our view means that some board practices will need to be reviewed.

The use of explanatory and brief executive summaries will need to become more common practice. This will avoid having board members who are not experts in certain areas being unable to assess certain risks if they become drowned in detail or lengthy analysis.

Some company secretaries, board chairs and chairs of specialized committees have started to work on processes which would enable board members to receive more comprehensive board materials and the use of executive summaries and key points analysis, in addition to the usual board packs is becoming more and more

common. ILA welcomes this progress and we hope that this best practice will be applied more extensively in future.

In their joint Guidelines on the assessment of the suitability of members of the management body and key function holders, EBA and ESMA recommend a periodic re-assessment. This would be at least annually for significant institutions and every two years for non-significant institutions.

In this respect, in order to enhance the collective suitability of boards, ad-hoc technical training sessions may be offered by the banks to their directors, in conjunction with board meetings. ILA strongly recommends directors attend such training, even if it is not compulsory, to gain or reinforce knowledge on the proposed subjects. Also see section 4.1.9 for director training obligations.

### 3.1.8 Time commitment

CSSF Circular 12/552, Paragraph 20 states:

“The members of the supervisory body make sure that their mandate is and remains compatible with any other positions, mandates and interests they may have, in particular in terms of conflicts of interest and availability. They shall inform the supervisory body of the mandates they have outside the institution”.

Furthermore, the ECB in their “Guide to fit and proper assessments” (May 2018) made the following statement:

All members of the management body must be able to commit sufficient time to performing their functions. The time a director can dedicate to his or her functions can be affected by several factors, such as the number of directorships held; the size and the situation of the entities where the directorships are held and the nature, scale and complexity of the activities; the place or country where the entities are based; and other professional or personal commitments and circumstances (e.g. a court case in which the appointee is involved). In addition to an assessment of the number of “directorships” (quantitative assessment), an assessment of qualitative aspects is conducted.

In summary, we can conclude that directors in a bank must commit to be sufficiently available to meet the demands of a board mandate role.

Also, Independent Non-Executive Directors (INEDs) need more time to effectively carry out their mandates than executive directors who are already familiar with subjects brought to board level.

Obviously, the complexity of the bank’s operations has an impact on the time needing to be spent by the director. Here are some questions that might help to evaluate the time commitment:

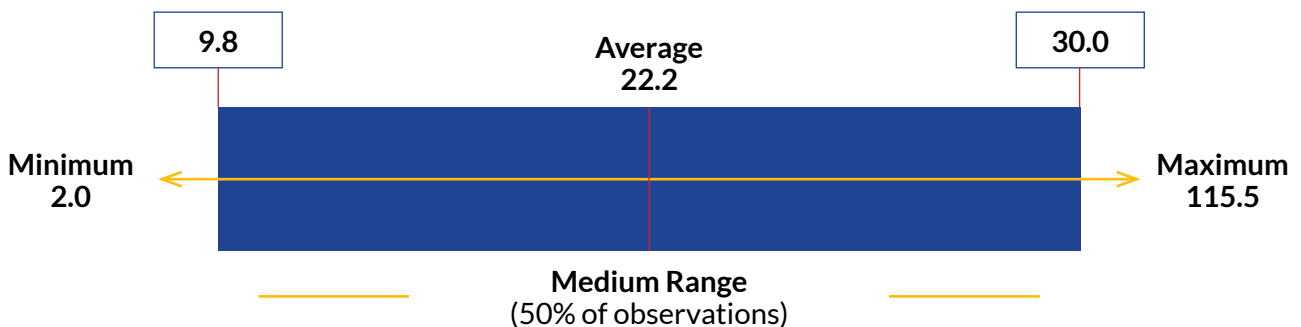
- Is the bank active in private banking?
- Is the bank active in the custody business?
- Does the bank have retail clients and does it offer universal banking services?
- In how many countries is the bank active?
- Does the bank have trading activities for its own account?

In a study conducted by the European Central Bank (Report on declared time commitment of non-executive directors in the SSM, May 2019) it appeared that INEDs declared between 2 and 115.5 days per year for their board activity in a bank controlled by the ECB. The average stood at 22.2 days per year.

#### CHART 1

##### Time commitment declared by non-executive directors

(average, medium range, minimum and maximum of declared time commitment, (in days per year))



Source: ECB Banking Supervision.



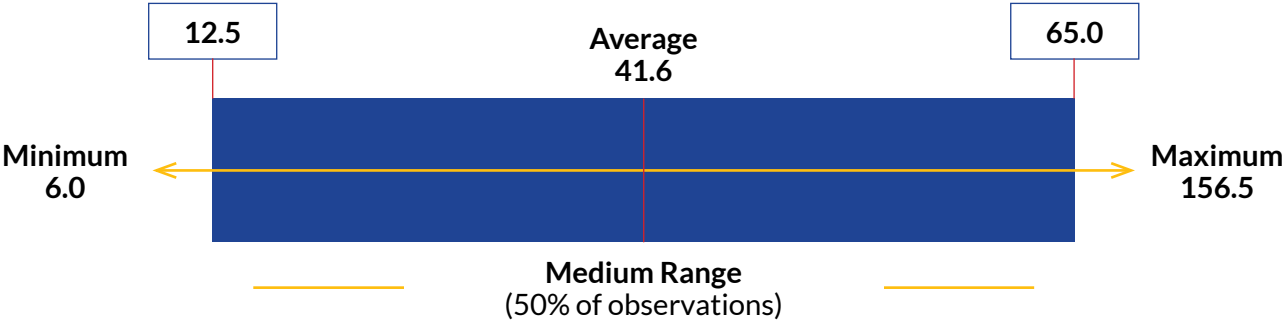


For the Chair, the range was between 6 days and 156.5 days and the average was 41.6 days.

**CHART 2**

**Time commitment declared by chairpersons**

(average, medium range, minimum and maximum of declared time commitment, (in days per year))



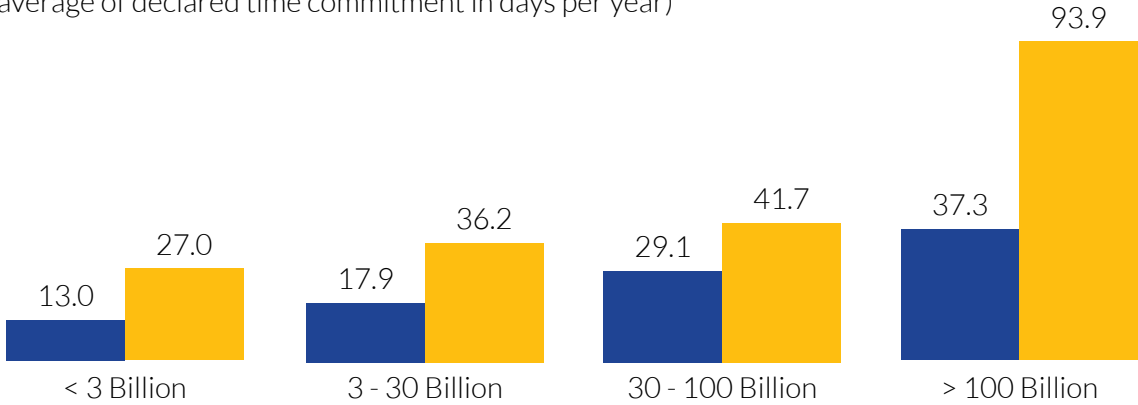
Source: ECB Banking Supervision.

The size of the supervised entity also had an impact on the time commitment:


**CHART 3**

**Average time commitment declared by non-executive directors and chairpersons by size of the supervised entity**

(x-axis: size of supervised entity in EUR billion of total assets;  
y-axis: average of declared time commitment in days per year)



Source: ECB Banking Supervision.



It also appeared that membership on board committees almost doubled the time commitment. Chairing a board committee takes more time again than just being a standard member.

The number of board meetings per year clearly also plays a role. The same survey showed that board members devote on average 2.8 days per board meeting, while Chairs must commit 3.5 days on average for a board meeting.

As an example, the time commitment could probably be roughly estimated as follows:

- 1 day for participation in each board meeting
- 1.5 days for the preparation of each Board meeting
- 0.5 day for participation in each board committee meeting
- 1 day for the preparation of each board committee meeting
- 4-5 days per year for specific INED briefings
- Add 50 % to the sum of all the preceding items.

Taking all of this into account, it is probably prudent to consider that a board mandate in a bank can require the commitment of at least 25 days per year.

### 3.1.9 Training for Directors

Article 38-2 (7) of the Banking Law provides for the obligation for regulated entities to have the adequate human and financial resources to initiate and train members of management. Many larger institutions have put director training in place via either their corporate secretaries or outside providers. It is clear that not all entities have the resources to do so and it should not be expected that they need to provide for this training internally.

The training obligation is explicitly linked to each director's profile. It is also applicable to

all directors, whether executive, non-executive, independent, employee representatives, very experienced or less-experienced directors. Of course, directors will also be expected to attend training regularly and such attendance should be recorded and tracked.

It is clear that Luxembourg-focused training is more relevant to directors than more generic global training, given the regulatory specificities of the Luxembourg market. It is also clear that there is not yet much offered in terms of specialized training for directors in Luxembourg. The ILA Banking Committee hosts an annual event in October aimed at bank directors and governance professionals. ILA is also working on extending its offer of workshops but also on providing more guidance on key regulatory points that are of interest to directors and governance professionals.

### ILA RECOMMENDATION

ILA recommends all directors attend relevant training at least annually. We also encourage company secretaries and board chairs to emphasize to all board members the importance of continuous training. It has now become mandatory and an important tool to ensure that a director is acting with the necessary competence and skills, and in the best interest of the entity he/she serves. It is especially important to emphasize these points to individuals who might traditionally feel less concerned about the need for training.

Beginning in 2013, ILA's Banking Committee organizes a two-day forum for board members. The sessions are delivered by representatives of the Luxembourg banking industry sector including governance professionals and advisers. The annual Forum for Directors aims to give directors of credit institutions and other governance professionals the opportunity to dialogue with the CSSF and governance professionals on various governance subjects, to network, and share concerns and experiences as well as best practices.

## 3.2 DUTIES & RESPONSIBILITIES OF LUXEMBOURG BANK DIRECTORS: OVERVIEW AND BEST PRACTICES

This section provides an overview of the duties and responsibilities that apply to directors of a Luxembourg credit institution (also referred to hereafter as a **bank**), whether based on the Luxembourg commercial companies law (the **Companies Law**), the Luxembourg banking law (the **Banking Law**), the applicable CSSF circulars or otherwise. It also serves the purpose of giving practical tips on how to mitigate the liability risk of directors, and what to watch out for when exercising mandates.

Given that there is no specific treatment of independent directors<sup>20</sup> under Luxembourg corporate law, independent directors are subject to the same obligations and liabilities as the other members of the board of directors of a bank<sup>21</sup>. Whether independent<sup>22</sup>, executive, or non-executive, this report may be used by all directors representing a credit institution's shareholders or any other private or public entity.

This section reflects Luxembourg legislation in force as at the date of issuance of the guide and is not meant to be exhaustive.<sup>23</sup> Readers of this guide are strongly encouraged to conduct their own due diligence and keep up-to-date in respect of the expectations related to their mandates, the strategies, rules, and regulations of the banks employing them.

### 3.2.1 General duties of a Director

As a general principle, pursuant to Article 441-9, §1 of the Companies Law, directors are liable to the bank for the execution of their mandate and for any misconduct in the management of the bank's affairs<sup>24</sup>.

Directors are jointly and severally liable, both towards the bank and any third parties, for damages resulting from the violation of the Companies Law or the articles of incorporation of the bank. In the case of a violation of which he or she is not a party, directors may be discharged from the aforementioned liability. This is contingent on the director reporting detected misconduct at the shareholders' meeting immediately following detection, assuming no misconduct is attributable to the director in question<sup>25</sup>.

At all times, members of the Board must act as a "bon père de famille", applying a standard of care which, among other duties, includes:

- a duty to act within the bank's corporate object and to comply with applicable legislation, regulations, and the bank's articles of incorporation;
- a duty to preserve the continuity of the activity of the bank (in particular in the event of a crisis);

20. According to point 23 of the CSSF Circular 12/552 as amended, an independent director is defined as a director who does not have any conflict of interest based on a business, family or other link/relationship with such entities, a controlling shareholder or the management of any of them and which could alter his/her capacity of judgement. Institutions should apply criteria defined in section 9.3 of EBA/GL/2017/12 to assess directors' independence.

21. An independent director is however more likely to have his/her liability standard ["bon père de famille"] appreciated more severely by Luxembourg courts due to his/her independent status.

22. As regards the appointment of independent directors to a bank's board, there are no minimum requirements under Luxembourg law to date. However, according to the Circular 12/552, as amended, each institution should have at least one independent member in its supervisory body while significant institutions should have a sufficient number of independent members in their supervisory body based on their organization as well as the nature, size and complexity of their activities. It should be noted that ILA recommends that banks appoint at least two independent directors.

23. For instance, the requirement of the law of 25 July 1990, as amended concerning the status of a Director representing the State or a public entity is not considered.

24. " Les administrateurs sont responsables envers la société conformément au droit commun, de l'exécution du mandat qu'ils ont reçu et des fautes commises dans leur gestion".

25. The said director will be expected by courts to have, as applicable, pointed out and voted against such violation also at the relevant board meeting.

- a duty to manage the bank's business in good faith, with reasonable care in a competent and active manner;
- a duty to stay informed;
- a duty to generally act in the best interests of the bank itself (which may, in some instances, differ from the interests of its majority shareholder or its management, for example);
- an obligation to disclose any potential conflict of interest<sup>26</sup> (re. any personal, financial, direct or indirect interest that conflicts or may conflict with the interests of the bank) and abstain from participating in any deliberations where such conflict exists; and
- a duty of confidentiality.

As a matter of principle, directors have a duty to act with the highest degree of honesty, loyalty, and in the best interest of the bank<sup>27</sup>.

### 3.2.2 Specific duties of a bank's board of directors

The board of directors must preserve business continuity through the establishment of sound central administration and internal governance arrangements for the purpose of protecting the institution and its reputation. It is, among other matters, in charge of defining the long-term strategy of the bank. It must also:

- encourage a positive attitude towards internal control and compliance mechanisms<sup>28</sup> and be active in the implementation of structures aiming at achieving such internal control and compliance mechanisms;
- determine applicable compliance principles as well as principles governing the bank's internal control mechanisms (including compensation schemes and policies), central administration, management of continuing activities and crisis events and the appointment and replacement of individuals holding key functions at the bank (succession plan);
- determine the risk strategy and tolerance/resistance towards that risk;
- determine the strategy of the bank in terms of capital adequacy and liquidity reserves;
- determine the appropriate structure of the information technology systems and internal communication process for the bank. This is especially in respect of information flow to ensure sound and prudent management. Such flows and processes must be appropriately documented to ensure the board of directors can assess the controls, evaluate management efficiency, the whistleblowing process<sup>29</sup>, and the adequacy of the internal control functions;
- assess, test and rectify, as applicable, the implementation of agreed general strategies;
- approve the compliance charter and the audit charter;
- evaluate and determine, at least annually, the management of compliance risk within the bank; and
- inform the competent authority<sup>30</sup> as soon as the internal governance or central administration system no longer guarantees a prudent and sound management of the bank<sup>31</sup>.

26. In this context, it also may be important for directors to know the composition of the board, in particular in terms of dependent/independent directors.

27. The concept of corporate interest is not legally defined under Luxembourg law but has traditionally been applied restrictively to mean the individual and differentiated interest of a company. This notion does however tend to become subject to a more flexible interpretation of the concept by the courts, which may include not only the interests of the shareholders (i.e. the "internal" corporate interest) but also the interests of other stakeholders such as the bank's creditors, suppliers, employees and others (i.e. the "external" corporate interest).

28. Such internal control systems are set out in writing by the management and must encompass all aspects of the bank, including operational, administrative and accounting aspects.

29. Circular 12/552, point 92.

30. ECB for significant institutions, CSSF for less significant institutions.

31. Circular 12/552, point 17.



### 3.2.3 Delegation of Powers

Certain tasks of the board of directors of a bank may be delegated:

- to sub-committees (ex: audit, risk, nomination and/or remuneration committees) in respect of certain areas;
- for day-to-day management (authorised management<sup>32</sup>); and
- to signing authorities provided they are limited in scope and time.

While the signing authority and the implementation of specific decisions of more global strategies may be delegated, the responsibility linked to the exercise of management powers may not. The board of directors retains overall responsibility for the acts of management and for the approval of the acts of any execution, implementation etc. that resulted from a delegation of powers.

Set-up of specialized committees for the purpose of increasing Board of Directors effectiveness (example)



**External independent experts**



**AUDIT COMMITTEE**

**REMUNERATION COMMITTEE**

**RISK COMMITTEE**

Sub-committees include directors who are neither members of the authorized management nor of the bank's staff.

### 3.2.4 Practical Tips

#### THE IMPORTANCE OF INFORMATION

The following are a few best practice tips with regards to the information and communication surrounding a bank director's role:

- accept a position only if the requisite level of expertise is satisfied (lack thereof will offer no protection against liability);
- understand and keep up-to-date with the affairs of the bank and your role, duties and responsibilities;<sup>33</sup>
- read and understand key documents<sup>34</sup> that are circulated beforehand or, alternatively, ask for them sufficiently in advance or postpone discussion until the next Board meeting in order to allow sufficient time for review;
- understand the commercial and legal context as well as the structural and contractual set-up by doing your own due diligence, by asking relevant experts, requesting documentation, reports etc.; and
- be aware of foreign "universally" applicable legislation that may have an impact on the duties/liabilities/affairs of the bank (e.g. FATCA, Sarbanes-Oxley etc.)

32. See in particular Circular 12/552 in respect of the authorized management's duties and liabilities.

33. Training offered "locally" will be especially relevant for a Luxembourg bank director role. ILA ([www.ila.lu](http://www.ila.lu)) offers regular training opportunities in this respect.

34. Such key documents include, among others, the audit report, the management letter and the ICAAP/ILAAP report.

## CONDUCT OF BOARD MEETINGS

The following are additional best practice tips with regards to attendance and conduct of bank board meetings:

- meet on a regular basis (frequency) and in an appropriate manner (consider duration of meeting) other board members, specialized committees, management and key internal central functions;
- attend board meetings whenever possible (an important part of the "duty of diligence");
- ensure proper discussion and deliberation;
- meetings and evidence of "real" discussions, such as face-to-face meetings rather than conference call meetings or written resolutions, are always preferred;
- ensure that written evidence of the board's work is available, relevant documents are tabled to board minutes and board minutes are signed and well-maintained, with an agenda, matters arising/actions list, appropriate descriptions of decisions and their context etc.<sup>35</sup>;
- ensure that, when opposing a decision, expressing one's opposition or refraining from voting, such acts/absence thereof is clearly evidenced in the minutes;
- verify proper delegation and generally that procedures are being followed;
- if threat of insolvency or distress etc., seek professional advice without delay to verify liability risks and statutory obligations;

- be active regarding your director role by seeking outside advice, expert opinions, or valuation when there is doubt or a lack of expertise on matters that support board decisions;
- be discreet regarding the information you are privy to or that you receive through your directorship mandate, and be aware of what you can or cannot divulge outside the strict sphere<sup>36</sup> of the board;
- be aware of the legal limitations<sup>37</sup> on the number of directorship mandates than can be assumed;
- ensure that you have the capacity, time etc., to comply with your duties for each of these mandates;
- ensure adequate insurance/indemnification is in place<sup>38</sup>; and
- seek an annual discharge of liability from shareholders.

## CONTRACTUAL LIMITATIONS AND STATUTORY PROCEDURES

A liability risk or the impact of liability on a director can be mitigated in practice by using the following:

- insurance and indemnity, limitation of liability provisions<sup>39</sup>; and
- discharge by shareholders or ad hoc approval/ratification by shareholders of a board decision.

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35. As per point 25 of CSSF Circular 12/552, as amended, the minutes of the meetings of the supervisory body should contain enough details, namely as regards the discussion of topics involving risks or in case of debates, in order to allow the reader to follow the discussions and to identify the positions of the members.

36. The banking secrecy obligation or general or contractual confidentiality obligations may apply.

37. This limitation is introduced into the Luxembourg Law with the implementation of the Capital Requirement Directive IV as provided in article 91 of its version of 27 June 2013.

38. It is strongly advised that you verify the scope of the insurance policy as well as the insurance validity period. Insurance policies often lapse a few years after the end of a director's mandate and would thus not cover legal action started after the lapsing date. It is thus advisable to verify whether an additional/complementary insurance would be needed to cover a longer period of time.

39. Under Luxembourg law, it is however not possible to validly exclude or limit one's contractual liability in the case of gross negligence ("faute lourde") or wilful misconduct ("faute intentionnelle" or "dol") or for a criminal offence. Also, a party cannot de facto negate an essential obligation that it otherwise owes, that is, the contract mandate may not be emptied of all substance.

### 3.2.5 General Director liability

#### MISCONDUCT OF MANAGEMENT<sup>40</sup>

This type of liability towards the bank is rooted in the director mandate.

A claim on the basis of Article 441-9 §1 of the Companies Law can be made by the bank, creditors of the bank to the extent that the bank itself fails to act (“action oblique”)<sup>41</sup>, and the liquidator of the bank.

In the event of liquidation of the bank, the conduct of directors may be investigated by the liquidator and possibly reported to a public prosecutor.

Such claims will only be successful to the extent that the plaintiff can prove clear misconduct (“faute”) by the director and/or the board<sup>42</sup>, the loss suffered, and the causal link between the misconduct and the loss.

An individual director may have a defense against such a claim if: he/she can prove that he/she did not take part in the decision or action which is the subject of the legal action; and that he/she reported said misconduct at the subsequent shareholders’ meeting.

Examples of management misconduct include, for example:

- entering into material or significant contracts on off-market terms or terms detrimental to the entity or;

- not arranging adequate insurance;
- not pursuing the payment of debts to the entity;
- making payments that are not (yet) due;
- lack of diligence in executing the entity’s affairs;
- excessive or inappropriate remuneration; and
- violation of the Companies Law or the articles of incorporation of the entity.

#### GENERAL TORT LIABILITY<sup>43</sup>

##### Criminal liability under the Companies Law<sup>44</sup>

Under the Companies Law, criminal offenses for which the directors of a Bank (also classified as a commercial company) can be held liable include:

- failure to ensure that mandatory publications are made or made in a timely manner;
- distribution of fabricated dividends under certain conditions; and
- misappropriation of the entity’s assets.

40. Article 441-9 §1 of the Companies Law.

41. This action by the creditors does however occur rarely in practice in this context given that the damages ordered by the court, if any, would be paid out to the bank and not to the creditor having initiated such a procedure.

42. Clear misconduct is deviation from the behaviour of a normal and prudent director.

43. Article 441-9 § 2 of the Companies Law.

44. Art. 1500-11 of the Companies Law makes it a criminal offence for legal and shadow directors to, in bad faith, use the assets or the credit of a company, or use their power or their votes, for a purpose which is against the corporate interest of such company, for their sole benefit or for the benefit of companies in which they hold an interest.

### 3.2.6 Specific bank Director liability

Bank directors who are directors approved by the competent authority<sup>45</sup> of a regulated entity are subject to specific liability under the Banking Law. Such liability may be sanctioned through the imposition of:

- injunctions, mandate suspension, administrative fines imposed by the ECB/CSSF; and
- criminal fines imposed by a Luxembourg court.

#### ADMINISTRATIVE SANCTIONS<sup>46</sup>

Administrative fines may be imposed on a Bank director and a Bank director may be prohibited from exercising his/her mandate where said director:

- fails to comply with the applicable instructions, articles of incorporation, or applicable statutes;
- refuses to provide information requested by authorized persons, e.g. the CSSF, public authorities;
- provides incomplete, incorrect or false documentation or information to the CSSF or any other authorized person (e.g. public authorities, shareholders);
- hinders the CSSF in the pursuit of its supervision, inspection and investigation mission;
- infringes the rules governing the publication of balance sheets and accounts;
- fails to act in response to injunctions from the CSSF; or
- jeopardizes the sound and prudent management of the Bank.
- A director may also be prevented from exercising his/her mandate, a particular activity, or conducting a particular transaction.

#### CRIMINAL SANCTIONS UNDER THE BANKING LAW<sup>47</sup>

Criminal sanctions under the Banking Act apply, in the following instances (among others):

- a term of imprisonment and/or a (criminal) fine may be imposed on any person failing to request an authorization from the CSSF and/ or, as the case may be, the relevant Ministry, where such authorization would have been required (for instance in case of an amendment to the Bank's corporate object, denomination or corporate form, the creation or acquisition of agencies, branches, subsidiaries in Luxembourg or abroad, or the extension of the Bank's license);
- a criminal fine may be further imposed on any person failing to notify a change in the composition of the Bank's administrative, management, and supervisory bodies to the CSSF or failing to provide the CSSF with the documentation and information requested on such bodies; and
- a criminal fine may also be imposed on the relevant persons for failing to file the Bank's relevant accounting documents on time.

#### CRIMINAL SANCTIONS UNDER THE LUXEMBOURG CRIMINAL CODE

The statutory sanctions most relevant in the context of Bank directorships are:

- breach of banking secrecy (unless authorized/required by law) is a criminal offense (délit) punishable with a term of imprisonment and/or a criminal fine; and
- money laundering and terrorist financing are criminal offenses punishable with a term of imprisonment and/or a criminal fine.

45. ECB for significant institutions, CSSF for less significant institutions.

46. Article 63 of the Banking Law.

47. Articles 64 and 64-1 of the Banking Law



### 3.3 COMMITTEES: ORGANISATION AND REPORTING

The EBA guidelines on internal governance point 39 state that “all institutions that are themselves significant, considering the individual, sub-consolidated and consolidated levels, must establish risk, nomination and remuneration committees to advise the management body in its supervisory function (the Board) and to prepare the decisions to be taken by this body”.

Point. 41 also notes that “Institutions may establish other committees (e.g. ethics, conduct and compliance committees).”

This means that some committees are mandatory for significant banks (audit committee, risk committee, nomination and remuneration committee) whilst others can be set-up on a voluntary basis.

The board shall ensure that the various committees effectively interact and report to the Board on a regular basis. The board **may not** delegate its decision-making powers and responsibilities to specialised committees pursuant to circular 12/552. The EBA guidelines on internal governance also state that delegating to committees does not in any way release the Board from collectively fulfilling its duties and responsibilities. **Committees should support the Board** in specific areas and facilitate the development and implementation of a sound internal governance framework. Practically, this means that committees can review and deliberate on all topics under their responsibility, but final approval must be given by the board.

#### 3.3.1 Audit Committee Director

The role of banks’ audit committees has evolved during the past ten years and is becoming increasingly important as a sub-committee of the board.

Since the implementation of CSSF circular 12/552, the role and responsibilities of the audit committee (“AC”) have been clearly defined and as well as the governance of the Board, the Authorised Management and the specialized committees (including the AC and the risk committee).

The law of 23 July 2016 on the audit profession and Regulation (EU) N° 537/2014 also assigns new roles and responsibilities to ACs. This law clearly defines what entity type must have an AC. The entities required to establish an AC are public interest entities (“PIEs”) and this includes credit institutions. Some exemptions can be obtained based on the size and complexity of the credit institution (small and less complex banks). However, it is best practice for banks to have an AC.

#### Key points:

All banks in Luxembourg should have an AC on a voluntary basis (if not already imposed by regulation), as it reflects best banking practice and is in line with regulatory expectations.



#### Roles and responsibilities

According to the CSSF Circular 12/52, “the purpose of the AC is to assist the board in the areas of financial information, internal control, including internal audit as well as the control by the ‘réviseur d’entreprises agréé’ (external auditor)”.

Most of the responsibilities are detailed either in CSSF circular 12/552, in the EBA guidelines on internal governance, in the EBA/ESMA guidelines on the assessment of the suitability of members of the management body and key function holders, or in the law of 23 July 2016 on the audit profession. This latter law underscores the importance of the AC on the monitoring of external audit activities and the relationship with the external auditors, as well as the monitoring of the financial reporting process and recommending the financial statements for approval by the board. According to the EBA guidelines on internal governance and CSSF circular 12/552 one other major responsibility of the AC is the oversight of the internal control environment and the risk management process. The AC may also cover the compliance function without creating a separate compliance committee. For the purpose of this document, we will consider that the compliance committee is part of the audit committee, although it may also be a part of the risk committee or be created as a standalone committee (although this latter option is rarely used). In this case, the mandate and composition of the AC shall reflect these additional tasks. In particular, the individuals associated with the AC shall include the Chief Compliance Officer.

The main subjects to be covered by the AC are (as detailed by CSSF circular 12/552):

- The AC is in charge of the procedure for the selection, renewal, dismissal and remuneration of statutory auditors. It assesses the respect of accounting rules and the adequacy of services linked to the audit of financial statements.
  - The AC must confirm the internal audit charter; it shall assess whether the human and material resources used for the internal audit are sufficient and shall ensure that the internal auditors have the required skills and that the independence of the internal audit function is safeguarded.
  - The AC shall confirm that the internal audit plan is confirmed by the authorised management. It shall take note at least once a year of the information on the state of the internal controls provided by the authorised management.
- The AC shall deliberate, on a regular basis and with a critical approach on:
    - the compliance with accounting rules and the financial reporting preparation process;
    - the state of the internal audit and compliance with the rules set in this respect, in particular, of the internal audit function reports;
    - the quality of the work carried out by the internal audit function and compliance with established rules;
    - the quality of the work carried out by the external auditor, including his/her independence and objectivity, and his/her compliance with the rules of professional ethics applicable areas well as the scope and the frequency of the audit. In this respect, the audit committee shall assess:
      - the financial statements, the management letters, the long-form reports and, where applicable, the appropriate nature of the services other than those related to the audit of the financial statement which would have been provided by the external auditor;
      - the appropriate follow-up, without undue delay by the authorised management, of the recommendations of the internal audit function and the external auditor and the actions taken to remedy the problems, deficiencies and irregularities identified;
    - The AC shall propose to the board of directors the necessary measures to promptly correct any problems, deficiencies and irregularities identified and inform the board of the findings of the external audit, of its work to ensure the integrity of the statutory reporting and of the role of the audit committee in this process.



## Composition

### Members of the Audit Committee:

The AC shall comprise at least three members and its composition shall be determined in accordance with its mission and its mandate. Best practice is that members of the AC are appointed by the board in consultation with the chair of the AC and that the chair of the board is not a member of the AC. As well, the AC members can also be appointed directly by the shareholders' meeting. The chair of the AC must be independent from the audited entity, and most members of the AC must also be independent from the audited entity (the same applies to the chair of the AC). Depending on the size and complexity of the bank, the AC may also include non-executive members as well as independent members. The EBA guidelines on internal governance also states that, "all committees should be chaired by a non-executive member of the Board who is able to exercise objective judgement (Art. 52, Law of 23 July 2016) and independent members of the board should be actively involved in these committees."

The collective competences of the members of the AC shall be representative of the activities and risks of the institution, and include specific competences regarding audit and accounting (at least one member of the AC must have competence in accounting and/or auditing - Art. 52, Law of 23 July 2016).

For Global Systematically Important Institutions (G-SIIs) and Other Systematically Important Institutions (O-SIIs), the required composition of the AC when combined with the risk committee is different, as stated in Directive 2013/036/EU (see "interaction between the different specialized committees" below).

Institutions should consider rotating the role of chair and committee membership, taking into account the specific experience, knowledge and skills that are individually or collectively required for those committees.

### Permanent Guests:

CSSF circular 12/552 notes that the audit committee can be assisted by the chief internal auditor as well as the external auditor of the institution. These individuals may attend the committee's meetings; they are not members of it.

We have observed different practices across Banking institutions. Among possible guests, the Chief Financial Officer (CFO), the Chief Risk Officer (CRO) and the Chief Compliance Officer (CCO) can attend the AC as permanent or ad hoc guests. The challenge is to limit the involvement of permanent guests.

### Other Guests:

The AC may invite other guests on an occasional or ad hoc basis including the Authorised Management, CFO, CRO, CCO (if not permanent guests) or experts on specific topics and others.

## Key points:

It is best practice to have independent members in the AC and this is especially important for the chair who should be independent.



### Functioning

The functioning of the AC – in particular in respect of frequency and duration of the meetings – shall be determined in relation to its mandate and its mission to assist the board. Best practice is for the frequency of the meetings to be at least four times a year. When scheduling meetings, there should be a sufficient interval between AC meetings and board meetings to allow for proper reporting from the AC to the Board.

The AC should have a documented mandate which is approved by the Board (terms of reference), including the scope of its responsibilities and the establishment of appropriate working procedures.

Members of the AC should engage in open and critical discussions during which dissenting views are discussed in a constructive manner.

The AC should document the agenda of committee meetings and their main conclusions.

Outside of formal meetings, the AC chair shall maintain a dialogue with key individuals involved in the company's governance, including the board chair, the chief executive, the finance director, the external audit lead partner and the control functions.

## Key points:

There should sufficient time (ideally at least one week) between the AC meeting and the Board meeting when the AC is reporting to the Board (for example, the AC should not take place in the morning and the Board in the afternoon).



### Interactions between the different specialized committees

The EBA guidelines on internal governance state that, "committees should interact with each other as appropriate. Such interaction could be in the form of cross-participation so that the chair or a member of a committee may also be a member of another committee. However, "institutions should ensure (...) that committees are not being composed mostly of the same group of members which form another committee".

Where the AC and the risk committee are two separate committees, the chair of one committee is often a member of the other committee. In addition to his/her permanent guest function in the risk committee, the Chief Risk Officer is also typically invited to the AC and in addition to his/her permanent guest function in the AC, the Head of internal audit is invited to the Risk Committee.

The risk committee should in particular report to the AC on risks that may have an impact on the financial statements and newly-identified risks which should be considered in the audit plan. On the other hand, the AC should collaborate with the risk committee and inform the committee on changes in risks that may have an impact on the risk strategy. Both committees should ensure that the Terms of Reference of both committees are aligned and that responsibilities are clearly defined without overlap. Most importantly, all risk topics, audit topics (internal and external) and the financial statements must be covered. In practice there is, at least once a year, a joint meeting between the risk committee and the AC.

Depending on the size and complexity of the bank, the risk and AC can form one single committee. In that case, additional requirements must be fulfilled for the composition of the risk and AC according to the EBA guidelines on internal governance: “In Global Systematically Important Institutions (G-SIIs) and Other Systematically Important Institutions (O-SIIs), the risk committee should include a majority of members who are independent. In G-SIIs and O-SIIs the chair of the risk committee should be an independent member. In other significant institutions, determined by competent authorities or national law, the risk committee should include a sufficient number of members who are independent and the risk committee should be chaired, where possible, by an independent member. In all institutions, the chair of the risk committee should be neither the chair of the board nor the chair of any other committee.”

Where a risk committee and AC are combined, all items covered by the risk committee must be covered by the risk committee and AC.

### 3.3.2 Risk Committee

CSSF Circular 12/552 impose to significant institutions and recommends to larger institutions and institutions with a higher or more complex risk profile create a risk committee. This would be in order to facilitate effective risk control by the board of directors. This is also reiterated by the EBA guidelines on internal governance (Art. 41).

#### Key points:

All Banks in Luxembourg should have an RC on a voluntary basis (if not already imposed by regulation), as it reflects best banking practice and is in line with regulatory expectations.



## Roles and responsibilities

According to CSSF Circular 12/552, “the purpose of the risk committee is to advise the board of directors on the global risk strategy and risk appetite and to assist the board of directors in assessing the adequacy between the risks incurred, the institution’s ability to manage these risks, and the internal and regulatory own funds and liquidity reserves. The risk committee shall confirm the specific policies of the authorised management (risk, capital and liquidity policies).”

Most of the responsibilities are detailed either in CSSF Circular 12/552, in the EBA guidelines on internal governance, or in the EBA/ESMA guidelines on the assessment of the suitability of members of the management body and key function holders.

The main subjects to be covered by the RC are:

- advice and support to the board on the monitoring of the institution’s overall current and future risk appetite and strategy, taking into account all types of risks. This is to ensure that this is in line with the business strategy, objectives, corporate culture and values of the institution;
- assist the board to oversee the implementation of the institution’s risk strategy and the corresponding agreed limits;
- oversee the implementation of the strategies for capital and liquidity management, as well as for all the remaining relevant risks of an institution. These include market, credit, operational, reputational, and information technology risks. This is in order to assess their adequacy against the approved risk appetite and strategy;
- provide the board with recommendations on necessary adjustments of the risk strategy resulting from, inter alia, changes in the business model of the institution or market developments, or from recommendations made by the risk management function;

- advise the board on the appointment of external consultants that the board may decide to engage for advice or support and;
- review a number of possible scenarios, including stressed scenarios, to assess how the institution's risk profile reacts to external and internal events (including review of ICAAP and ILAAP);
- examine the alignment between all financial products and services offered to clients and the business model, as well as the risk strategy of the institution. The risk committee should assess the risks associated with the financial products and services offered, and examine alignment with the prices assigned and profits gained from those products and services.
- assess the recommendations of the risk control function and follow up on the appropriate implementation of measures taken.

The risk committee should collaborate with other committees whose activities may have an impact on the risk strategy (e.g. audit and remuneration committees) and communicate regularly with the institution's internal control functions, in particular the risk management function.

When established, the risk committee must, without prejudice to the tasks of the remuneration committee, examine whether incentives provided by remuneration policies and practices take into consideration the institution's risk, capital and liquidity, and the likelihood and timing of earnings.



## Composition

### Members of the Risk Committee:

The RC shall comprise at least three members and its composition shall be determined in accordance with its mission and its mandate.

Best practice is that members of the RC are appointed by the board in consultation with the chair of the RC and that the chair of the board is not a member of the RC.

According to EBA guidelines on internal governance, the risk committee should be composed of non-executive members of the board. In G-SIIs and O-SIIs, the risk committee should include a majority of members who are independent. In G-SIIs and O-SIIs the chair of the risk committee should be an independent member. In other significant institutions, determined by competent authorities or national law, the risk committee should include a sufficient number of members who are independent and the risk committee should be chaired, where possible, by an independent member. In all institutions, the chair of the risk committee should be neither the chair of the board nor the chair of any other committee.

Members of the risk committee should have, individually and collectively, appropriate knowledge, skills and expertise concerning risk management and control practices.

### Permanent Guests:

CSSF circular 12/552 notes that the risk committee can involve the authorized management as well as the persons in charge of the internal control in its work. These persons can attend the committee's meetings; they are not members of it.

We have observed different practices across banking institutions. Among possible guests, the Chief Risk Officer (CRO) and the Chief Compliance Officer (CCO) can attend the RC as permanent or ad hoc guests. The challenge is to limit the involvement of permanent guests.

### Other Guests:

The RC may invite other guests on an occasional or ad hoc basis, including the Authorised Management, CFO, CRO, CCO (if not permanent guests) or experts. This might concern any type of topic.

### Key points:

It is best practice to have independent members in the RC, and this is especially important for the chair, who should be independent.



### Functioning

The functioning of the RC, in particular in respect of frequency and duration of the meetings, shall be determined in relation to its mandate and its mission to assist the board. Best practice is for the frequency of the meetings to be at least four times a year. When scheduling meetings, there should be a sufficient interval between RC meetings and board meetings to allow for proper reporting from the RC to the board.

The RC should have a documented mandate which is approved by the board (terms of reference), including the scope of its responsibilities and establish appropriate working procedures.

Members of the RC should engage in open and critical discussions, during which dissenting views are discussed in a constructive manner. The RC should document the agenda of committee meetings and their main conclusions.

Outside of formal meetings, the RC chair shall maintain a dialogue with key individuals involved in the company's governance, including the board chair, the chief executive and the control functions.

### Key points:

There should sufficient time (ideally at least one week) between the RC meeting and the Board meeting, when the RC is reporting to the Board (for example, the RC should not take place in the morning and the Board in the afternoon).

### 3.3.3 Nomination Committee / Remuneration Committee

The EBA guidelines (December 2015) on sound remuneration policies state that “all institutions which are themselves significant, considering the individual, parent company and group level, must establish a remuneration committee.” Where a remuneration committee is established in a non-significant institution, the institution should comply with the requirements of these guidelines concerning the remuneration committee, but may combine the tasks of the remuneration committee with other tasks, as long as they do not create conflicts of interest.

In line with the EBA guidelines on internal governance, the CSSF circular 12/552 clearly split, for significant institutions, the nomination and the remuneration committee.:



#### Roles and responsibilities

According to the EBA guidelines on sound remuneration, the remuneration committee should:

- advice and support to the board on the monitoring of the institution’s overall current and future risk appetite and strategy, taking into account all types of risks. This is to ensure that this is in line with the business strategy, objectives, corporate culture and values of the institution;
- assist the board to oversee the implementation of the institution’s risk strategy and the corresponding agreed limits;
- oversee the implementation of the strategies for capital and liquidity management, as well as for all the remaining relevant risks of an institution. These include market, credit, operational, reputational, and information technology risks. This is in order to assess their adequacy against the approved risk appetite and strategy;

- provide the board with recommendations on necessary adjustments of the risk strategy resulting from, inter alia, changes in the business model of the institution or market developments, or from recommendations made by the risk management function;

Where the institution has established a remuneration committee, it should directly oversee remuneration and performance measurement of the executive management and the senior officers in the independent control functions, including the risk management and compliance functions. The remuneration committee should make recommendations to the supervisory function on the design of the remuneration package, specifying how much remuneration is to be paid to senior staff members in the control functions.

The remuneration committee should also have its say on remuneration structures in the company as a whole, on training and on talent development.

The responsibilities of the nomination committee are also underlined in the EBA guidelines on the assessment of the suitability of members of the management body and key function holders as stated below:

When recruiting members of the management body (without prejudice to the shareholder’s rights to appoint members), the management body in its supervisory function or, where established, the nomination committee, should:

- contribute to the selection of candidates for vacant management body positions, in cooperation with human resources
- be involved in the description of the roles of and capabilities for a particular appointment;
- evaluate the adequate balance of knowledge, skills and experience of the management body;



- assess the time commitment expected; and
- consider the objectives of the diversity policy

The nomination committee should ensure that the individual and collective suitability assessments of the members of the management body are carried out before they are appointed. The nomination committee should report the result of the assessment of collective suitability to the management body, even if no changes to its composition or other measures are recommended. Recommendations may include, but are not limited to, training, change of processes, measures to mitigate conflicts of interest, the appointment of additional members with a specific competence, and the replacement of members of the management body.

The nomination committee is also in charge of succession planning.



## Composition

### Members of the Nomination Committee / Remuneration Committee (NRC):

The NRC shall comprise at least three members, and its composition shall be determined in accordance with its mission and its mandate. Best practice is that members of the NRC are appointed by the board in consultation with the chair of the NRC, and that the chair of the board is not a member of the NRC.

According to the EBA guidelines on internal governance, in G-SIIs and O-SIIs, the nomination committee should include a majority of members who are independent, and be chaired by an independent board member. In other significant institutions (as determined by competent authorities or national law), the nomination committee should include a sufficient number of members who are independent. Such

institutions may also consider as a good practice having a chair of the nomination committee who is independent.

The EBA guidelines on sound remuneration policies also state that “if employee representation on the management body is provided for by national law, it must include one or more employee representatives”.

Members of the nomination committee should have, individually and collectively, appropriate knowledge, skills and expertise concerning the selection process and suitability requirements.

Members of the remuneration committee should have, collectively, appropriate knowledge, expertise and professional experience concerning remuneration policies and practices, risk management and control activities; namely with regard to the mechanism for aligning the remuneration structure to institutions’ risk and capital profiles.

### Permanent Guests:

Members of the Executive Management involved in HR

Head of HR

### Other Guests:

External advisors on HR matters

## Key points:

It is best practice to have independent members in the NRC, and this is especially important for the chair who should be independent.



### Functioning

The functioning of the NRC, in particular in respect of frequency and duration of the meetings, shall be determined in relation to its mandate and its mission to assist the board. In particular, structured performance measurement (with reference to different risk parameters) can require a few meetings. It is not rare to see NRCs meet 4-5 times a year. When scheduling meetings, there should be a sufficient interval between NRC meetings and board meetings to allow for proper reporting from the NRC to the Board.

The NRC should have a documented mandate which is approved by the board (terms of reference), which will include the establishment of the scope of its responsibilities and appropriate working procedures. Members of the NRC should engage in open and critical discussions, during which dissenting views are discussed in a constructive manner. The NRC should document the agenda of committee meetings and their main conclusions.

Outside of formal meetings, the NRC chair shall maintain a dialogue with key individuals involved in human resources topics, including the board chair, the chief executive and the head of human resources.



### Interactions between the different specialized committees

The EBA guidelines on sound remuneration policies state that “the remuneration committee should collaborate with other committees of the supervisory function whose activities may have an impact on the design and proper functioning of remuneration policies and practices (e.g. risk, audit and nomination committees); and provide adequate information to the supervisory function, and, where appropriate, to the shareholders’ meeting about the activities performed.”

When established, the risk committee should (without prejudice to the tasks of the remuneration committee) examine whether incentives provided by the remuneration policies and practices take into consideration the institution’s risk, capital, and liquidity, as well as the likelihood and timing of earnings.

A member of the risk committee should participate in the meetings of the remuneration committee, where both committees are established, and vice versa.

#### 3.3.4 Other committees

The Board may request the set-up of other committees, depending on the activities and needs of the organization. These committees are not mandatory but must nevertheless operate under similar rules to those used in mandatory committees. We recommend that banks have terms of reference for all voluntary committees, and ensure that all committees are minuted. In Luxembourg the number of voluntary committees which have been established is limited, but we see a trend towards more strategically-oriented committees.

### 3.4 BOARDS OF DIRECTORS SCOPE OF SUPERVISION – SUGGESTED BOARD MEETING AGENDA AND EXECUTION/IMPLEMENTATION

The attached document (the Proposed Agenda or Agenda) aims at providing directors with an overview of matters that have been identified as reserved for consideration by the board of directors, in compliance with Luxembourg laws and regulations in force as of January 2021.




This document also includes items considered to be best practice that would normally be tabled periodically at bank Board meetings.

This Agenda is for guidance purposes only. Any bank wishing to use this Agenda should adapt it to reflect the nature, scale, and complexity of its activities. In addition, if the bank is the parent company of a group falling under the consolidated supervision of the CSSF, matters may need to be addressed, where applicable, both on a solo and a group basis.

The board may consider taking into account the size and complexity of the bank, and the use of specialized committees to review specific matters and report to the board. These practices were detailed in the previous section.

Review items which may be delegated to specialized committees are highlighted in colour in the following agenda. These are for illustrative purposes only and may vary from one Bank to another. Any reference to “approval” in this agenda is to be understood as final approval by the Board (i.e. decision-making cannot be delegated to specialized committees).

#### Legend/tips used in the document:

-  Items for which review may be delegated to a nomination & remuneration committee
-  Item for which review may be delegated to a risk committee
-  Item for which review may be delegated to an audit committee

1. EBA – ESMA joint guidelines on suitability of members of management body and key functions holders – section 23 – point 155: significant institutions should perform a periodic suitability re-assessment of the members of the management body at least annually (every 2 years for non-significant institutions).
2. Banking law of 05/04/1993 as amended – art 7(3): any change in the composition of the Board of Directors, management body and shareholders or partners shall be communicated in advance to the CSSF; the latter can oppose the proposed change.
3. Banking law of 05/04/1993 as amended – art 10(2): any change in the external auditors shall receive prior approval from the CSSF.
4. CSSF circ. 12/552 – section 4.2.1 – point 53: Authorized Management should be permanently on site.
5. CSSF circ. 127552 – section 6.2.4 – point 117: appointment and removal of the Heads of internal control functions shall be approved by the CSSF (specifying the reasons in case of removal).
6. CSSF circ. 12/552 – section 6.2.4 – point 123: special cases related to the function of Internal Audit (outsourcing of internal audit function) shall be authorized by the CSSF. CSSF circ. 12/552 – section 6.2.4 – point 122: special cases related to the function of Head of Compliance and Head of Risk shall be duly authorized by the CSSF. EBA – ESMA joint guidelines on suitability of members of management body and key functions holders – section 23 – point 172 (for significant institutions) the appointment of the CFO should be assessed by the competent authority.
7. CSSF circ. 12/552 – section 7.4.1 – point 182: outsourcing of a significant activity shall receive prior approval from the CSSF.
8. CSSF circ. 15/602 – documents to be submitted on an annual basis to the CSSF (or to the ECB for significant institutions).
9. Banking law of 05/04/1993 as subsequently amended – art 57: any undertaking in a qualified participating interest shall receive prior approval from the CSSF.
10. As required by the Directive 2014/59/EU establishing a framework for recovery and resolution of banks.
11. Bank Law of 06/05/1974 – art.10 (2): “Comités mixtes dans les entreprises du secteur privé”: all documents submitted to the General Assembly of Shareholders shall also be communicated to the Comité Mixte prior to the meeting.



AGENDA ITEM	References		Practical tips		
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type	
				Suggested frequency of submission	
<b>1 BOARD ADMINISTRATION</b>					
1.1	Agenda	-	-	-	Each meeting
1.2	Minutes [setting out the items on the agenda and clearly stating the decisions made and agreed upon actions]	-	-	Document for approval	Each meeting
1.3	Matters arising/action list	Best practice	-	Review	Each meeting
<b>2 BOARD INTERNAL GOVERNANCE</b>					
2.1	Internal regulations of the Board	-	-	Document for approval	On creation & Ad Hoc
2.2	Conflict of interest policy of the Board	-	-	Document for approval	On creation & Ad Hoc
2.3	Declaration of no conflict of interest on agenda items	Best practice	-	Declaration	Each meeting
2.4	Inception and continuous professional training programmes for new and existing members	Best practice	-	Document for approval	On creation & Ad Hoc
2.5	[Annual] declaration of independence (for independent members)	Best practice	-	Review	At least annual
2.6	[Annual] declaration of mandates held in other companies	-	-	Review	At least annual
2.7	[Annual] suitability assessment (individual and collective)	EBA GL S	-	Review	Annual / every 2 years <sup>1</sup>
2.8	[Annual] performance self-assessment	-	-	Assessment	At least annual
2.9	Reminder of fiduciary obligations of directors	Best practice	-	Reminder	At least annual
<b>3 BOARD MEMBERSHIP AND OTHER APPOINTMENTS</b>					
3.1	Changes to the structure, size, and composition of the Board. This includes appointment of new members, reappointment of current members, replacement of resigning members, all of which need to be submitted to the General Assembly of shareholders for approval.	Company/ Banking Law/ EBA GL S	Approval <sup>2</sup>	Approval	As required
3.2	Policy for selecting new members [including suitability policy as appropriate]	-	-	Document for approval	On creation & Ad Hoc
3.3	Policy on suitability of directors [can be embedded in the policy for selecting new members]	EBA GL S	-	Document for approval	On creation & Ad Hoc
3.4	Succession planning for the Board	-	-	Document for approval	On creation & Ad Hoc
3.5	"Membership and chairmanship of board-delegated committees (e.g. Audit Committee, Risk Committee, Nomination & Remuneration Committee)"	-	-	Approval	As required
3.6	"Appointment, reappointment or removal of the external auditors"	-	Approval <sup>3</sup>	Approval	Approval
3.7	Appointment or removal of the Authorised Management ("direction autorisée")	Company/ Banking Law	Approval <sup>2,4</sup>	Approval	As required
3.8	Appointment or removal of the heads of internal control functions (Compliance, Internal Audit and Risk)	-	Approval <sup>5,6</sup>	Approval	As required
3.9	Succession planning for the Authorised Management and Heads of Internal Control Functions	-	-	Document for approval	On creation & Ad Hoc
3.10	Appointment to the boards of directors of [significant] subsidiaries	Best practice	-	Approval	As required
<b>4 DELEGATION OF AUTHORITY</b>					
4.1	Approval of internal regulations (terms of reference) of board-delegated committees	-	-	Document for approval	On creation & Ad Hoc
4.2	Approval of terms of reference of the executive/management committee	Best practice	-	Document for approval	On creation & Ad Hoc
4.3	Receive and review reports from Board-delegated and other relevant executive committees	-	36 & 43 & 49	Review	Each meeting
4.4	[Annual] assessment of the Authorised Management	Best practice	-	Assessment	At least annual
4.5	Review of [annual] self-assessment of the Board-delegated Committees	Best practice	-	Review	At least annual

AGENDA ITEM	References			Practical tips	
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type	Suggested frequency of submission
<b>5 INTERNAL GOVERNANCE</b>					
<b>FRAMEWORK</b>					
5.1	3	-	-	Document for approval	On creation & Ad Hoc
Documentation of proportionality principles in the implementation of central administration and internal governance arrangements					
5.2	11 & 14	-	-	Document for approval	On creation & At least annual
Definition/approval of long term objectives and strategy ("Statements of Policy") of the Bank including					
• Business strategy					
•	11 & 14	-	-	Document for approval	On creation & At least annual
<b>Risk appetite and general risk framework</b>					
•	11 & 14	-	-	Document for approval	On creation & At least annual
<b>Capital and liquidity strategy</b>					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Sound organisational and operating structure					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Security of information systems					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Internal alert process					
•	11 & 14	-	-	Document for approval	On creation & At least annual
<b>Internal control framework</b>					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Governance principles and corporate values					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Escalation, settlement and sanction of non-compliant behaviors					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Contingency and business continuity					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Crisis management					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Administrative, information technology and accounting organisation					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Outsourcing					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Approval of new activities					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Approval of non-standard or non-transparent activities					
•	11 & 14	-	-	Document for approval	On creation & At least annual
• Remuneration framework					
•	11 & 14	-	-	Document for approval	On creation & At least annual
<b>Nomination and succession of key individuals</b>					
•	11 & 14	-	-	Document for approval	On creation & At least annual

AGENDA ITEM	References		Practical tips	
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type
<b>5 INTERNAL GOVERNANCE POLICIES</b>				
5.3	12	-	-	-
Approval of policies as required by the Board or as applicable by law or regulation, such as [list not exhaustive];				
• Code of conduct	12 & 55	-	-	Document for approval
• Suitability policy	12	EBA GLS	-	Document for approval
• Diversity policy	12	EBA GLS	-	Document for approval
• Conflict of interest policy	12 & 55	-	-	Document for approval
• Internal alert (whistle blowing) policy	12	-	-	Document for approval
• Anti-bribery/corruption/fraud policy	12	-	-	Document for approval
• Remuneration policy	12	-	-	Document for approval
• New products/new activities policy	12	-	Approval <sup>7</sup>	Document for approval
• Outsourcing policy	12 & 206	-	-	Document for approval
• Crisis management policy	12	-	-	Document for approval
• Contingency and business continuity policy	12	-	-	Document for approval
• IT security policy	12	-	-	Document for approval
<b>ASSESSMENT</b>				
5.4	14	-	-	Assessment
"[Annual] assessment of the effectiveness of the internal governance framework Focus should be on the changes in internal and external factors affecting the Bank so as to ensure that any necessary corrective actions are taken."				
5.5	14	-	Approval	Review
[Annual] review of the Bank's internal organizational structure (departments/branches etc.)				
5.6	14	-	Approval	Review
[Annual] review of the group structure [if the Bank is a parent company or holds participating interests]				
5.7	61	-	-	Document for approval
Review of the [annual] management report on Internal Governance				
<b>6 CAPITAL AND FUNDING INSTRUMENTS</b>				
6.1	-	Company Law	Notification / approval	Approval
Approval of increase[s] or decrease [s] of the capital of the Bank				
6.2	-	Best practice	Notification / approval	Approval
Approval of issuance[s] or changes in terms and conditions of subordinated loans or other funding instruments issued by the Bank				
6.3	-	Best practice	Notification / approval	Approval
Approval of capital market transactions involving shares of the Bank				
6.4	-	Company Law	Notification / approval	Approval
Declaration of the interim dividend and recommendation of the final dividend to the General Meeting of Shareholders				
<b>7 INVESTMENTS AND RELATED COMMITMENTS</b>				
7.1	-	Best practice	-	Approval
Approval of capital injection[s] into subsidiaries or affiliated companies or modification of the rights attached to the capital of subsidiaries or affiliated companies				
7.2	-	Best practice	-	Approval
Approval of new loan[s] or funding instrument[s] or changes in the terms or conditions of existing loans or funding instruments granted to subsidiaries or affiliated companies				
7.3	-	Best practice	-	Approval
"Approval of financial commitments relative to investments and long-term contracts [exceeding certain thresholds as per the Bank's Statement of Risk Policy defined by the Board]"				
7.4	-	Best practice	-	Approval
Approval of issuance of unlimited guarantees, letters of comfort, and similar matters				
7.5	-	Best practice	-	Approval
Approval of acquisition and encumbrance of real property				

AGENDA ITEM	References		Practical tips	
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type
<b>8 EXTENSION OF ACTIVITIES/ACQUISITIONS/DIVESTITURES</b>				
8.1	-	Best practice	-	Approval As required
8.2	-	Best practice	-	Approval As required
8.3	-	Best practice	Approval <sup>8</sup>	Approval As required
<b>9 INTERNAL AUDIT</b>				
9.1	41 & 147	-	-	Document for approval At least annual
9.2	41 & 152 & 153	-	-	Document for approval At least annual
9.3	158	Best practice	-	Review Each meeting
•	-	Best practice	-	
•	-	Best practice	-	
•	-	Best practice	-	
9.4	158	Best practice	-	Review As required
9.5	116 & 158	-	Notification <sup>8</sup>	Document for approval At least annual
9.6	41	-	-	Assessment At least annual
<b>10 EXTERNAL AUDIT REPORTS</b>				
10.1	41	-	Notification <sup>8</sup>	Review As required
10.2	41	-	Notification <sup>8</sup>	Review At least annual
10.3	41	-	Notification <sup>8</sup>	Document for approval Annual
10.4	41	-	-	Assessment At least annual
10.5	-	Best practice	-	Approval At least annual
10.6	41	-	-	Approval At least annual
<b>11 RISK MANAGEMENT AND MONITORING</b>				
11.1	49	-	-	Document for approval At least annual
11.2	49	-	-	Document for approval On creation & Ad Hoc
11.3	49	-	-	Document for approval At least annual
11.4	171 & 172	-	-	Approval As required
11.5	49	-	-	Review Each meeting
11.6	49 & 130	Best practice	-	Review Each meeting
•	130	Best practice	-	
•	130	Best practice	-	
•	-	Best practice	-	
•	-	Best practice	-	
11.7	-	Best practice	-	Review Each meeting
11.8	-	Best practice	-	Document for approval At least annual

AGENDA ITEM	References		Practical tips		
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type	
				Suggested frequency of submission	
<b>11 RISK MANAGEMENT AND MONITORING</b>					
11.9	116 & 130	-	Notification <sup>8</sup>	Document for approval	At least annual
11.10	130	-	Notification <sup>8</sup>	Document for approval	At least annual
11.11	-	-	Approval <sup>10</sup>	Document for approval	At least annual
11.12	49	-	-	Assessment	At least annual
<b>12 REGULATORY AND COMPLIANCE</b>					
12.1	137	-	-	Document for approval	On creation & Ad Hoc
12.2	143	-	-	Review	Each meeting
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
	-	Best practice	-	-	-
12.3	-	Best practice	-	Document for approval	At least annual
12.4	116	-	Notification <sup>8</sup>	Document for approval	At least annual
12.5	-	Best practice	-	Information	As required
<b>13 BUSINESS</b>					
13.1	-	Best practice	-	Document for approval	At least annual
13.2	-	Best practice	-	Information	Each meeting
<b>14 FINANCIAL AND REGULATORY REPORTING</b>					
14.1	-	Best practice	-	Information	Each meeting
	-	Best practice	-	-	-
	-	Best practice	-	-	-
14.2	42	Best practice	-	Approval	As required
14.3	-	Best practice	-	Document for approval	At least annual
14.4	-	Best practice	-	Review	Each meeting
<b>15 FINANCIAL STATEMENTS</b>					
15.1	42	-	-	Review	As required
15.2	-	Company law	Notification <sup>8</sup>	Document for approval	Annual
15.3	42	-	Notification <sup>8</sup>	Document for approval	Annual/As required



AGENDA ITEM	References		Practical tips	
	§ Circ. 12/552	Law, other regulations or best practice	Submission to the CSSF	Action type
<b>16 LEGAL</b>				
16.1	-	Best practice	-	Approval
16.2	-	Best practice	-	Approval
16.3	-	Best practice	-	Approval
16.4	-	Best practice	-	Review
<b>17 OPERATIONS AND INFORMATION SYSTEMS</b>				
17.1	-	Best practice	-	Review
•	-	Best practice	-	-
•	-	Best practice	-	-
•	-	Best practice	-	-
•	-	Best practice	-	-
•	-	Best practice	-	-
•	-	Best practice	-	-
<b>18 HUMAN RESOURCES</b>				
18.1	-	Best practice	-	Approval
18.2	-	Best practice	-	Information
18.3	-	Best practice	-	Review
18.4	-	"Banking law Best practice"	-	Approval
18.5	-	"Banking law Best practice"	-	Approval
18.6	-	"Banking law Best practice"	-	Approval
18.7	-	Best practice	-	Approval
<b>19 COMMUNICATIONS TO THE ASSEMBLY OF SHAREHOLDERS</b>				
19.1	-	Company law	-	Approval
•	-	Company law	-	-
•	-	Company law	Notification <sup>8</sup>	-
•	-	Company law	-	-
•	-	Company law	-	-
•	-	Company law	-	-
<b>20 OTHERS</b>				
20.1	-	Best practice	-	Approval
20.2	-	-	-	-
				As required

### 3.5 OBSERVED AREAS FOR IMPROVEMENT

#### FIX THE BOARD BEFORE PROBLEMS OCCUR

In recent years, there has been a greater regulatory focus on the boardroom and board governance of banks. Board set-up and organization have been enhanced but reforms take time and bad practice takes time to be replaced by better standards. Below are some common board practices that are reflective of potentially ineffective or dysfunctional boards of directors. Being able to identify the signs of potential issues is the first step to help fixing them before problems can emerge.

BAD PRACTICE	ISSUE(S)?
1. Matters are brought to the board for sign-off rather than debate	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities of the board (role of the board)</li> <li>• Potential liability</li> </ul>
2. Management, rather than the board, is setting direction for the organization	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities (role of the board)</li> <li>• Lack of board leadership</li> </ul>
3. The board is adrift: board responsibilities, expectations from board members, corporate values, board's organization are unclear or not defined	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities</li> </ul>
4. Board members do not externally support the decisions that are taken by the board, just those decisions that they agree with	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities of the board</li> <li>• Conflicting interests/personal agendas</li> </ul>
5. There is a reluctance to involve non-executive directors in the discussions or decisions	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities of the directors</li> <li>• Lack of independence</li> </ul>
6. The board fails to recognize the value implications of running the business based on self-interest	<ul style="list-style-type: none"> <li>• Misunderstanding of duties and responsibilities of the board</li> <li>• Lack of independence</li> </ul>
7. There are complacent or intransigent attitudes within the board	<ul style="list-style-type: none"> <li>• Inappropriate or unproductive individual behaviour</li> <li>• Lack of Chair leadership</li> </ul>
8. There is no code of conduct within the board. Discussions of any topic are allowed that might hint at criticism of another board member's actions or behaviour	<ul style="list-style-type: none"> <li>• Inappropriate or unproductive individual behaviour</li> <li>• Lack of collective values</li> <li>• Lack of Chair leadership</li> </ul>
9. There is a dominant personality or group of directors on the board that inhibits contribution from other directors	<ul style="list-style-type: none"> <li>• Lack of collective fitness</li> <li>• Lack of independence</li> <li>• Lack of Chair leadership</li> </ul>
10. Some members sit on the board only for the prestige of the position (rarely speak or offer any opinions on decision)	<ul style="list-style-type: none"> <li>• Lack of collective fitness</li> </ul>



BAD PRACTICE	ISSUE(S)?
11. Board's membership is misaligned to situational requirements: the board lacks an appropriate mix of strategic, product, domain and operational experience; too much reliance is placed on members with finance backgrounds	<ul style="list-style-type: none"><li>• Lack of collective fitness</li></ul>
12. The board lacks outsider perspectives	<ul style="list-style-type: none"><li>• Lack of collective fitness</li></ul>
13. Succession planning is being ignored	<ul style="list-style-type: none"><li>• Lack of collective fitness</li></ul>
14. Board members are selected because of personal friendships	<ul style="list-style-type: none"><li>• Lack of collective fitness</li></ul>
15. Board members are not on the same page with regards to the direction of the bank	<ul style="list-style-type: none"><li>• Conflicting agendas</li></ul>
16. The strategy being followed by the Chair and CEO is not supported by the entire board	<ul style="list-style-type: none"><li>• Conflicting agendas</li></ul>
17. The relationship between the Chair and CEO is particularly close, and decisions are being made without the approval of the full board	<ul style="list-style-type: none"><li>• Lack of independence</li><li>• Inadequate decision-making process</li></ul>
18. Shareholders or non-executive directors have expressed concerns that are not being addressed by the Chair or CEO	<ul style="list-style-type: none"><li>• Lack of independence</li><li>• Abuse of leadership</li></ul>
19. The board is out of touch and is the last to know about problems within the organization	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li><li>• Potential liability</li></ul>
20. The board is out of sync with the times, failing to adapt to changes in size or complexity of the organization. For example, a board that reviews every loan may be acceptable for a small bank, but it is impractical and inefficient after a bank grows)	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li></ul>
21. Board's agenda is primarily focused on administration rather than strategic issues	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li></ul>
22. Board members assume operational authority	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li></ul>
23. The board focuses on micro-management	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li></ul>
24. The board makes [Audit, Risk etc.] committee assignments on paper and is unwilling to rely on committees reports and recommendations that lead to a rehash of topics	<ul style="list-style-type: none"><li>• Inadequate level of oversight</li></ul>
25. The board is complacent when examining the organization's performance, and lacks timely and decisive action	<ul style="list-style-type: none"><li>• Inadequate decision-making process</li></ul>
26. The board pays insufficient attention to risk, and treating risk as a compliance issue rather than as part of the decision-making process	<ul style="list-style-type: none"><li>• Inadequate decision-making process</li></ul>



BAD PRACTICE	ISSUE(S)?
27. The board ignores the financial implications of decisions	<ul style="list-style-type: none"><li>• Inadequate decision-making process</li></ul>
28. The board is meeting too frequently with unstructured meetings or little substance to discuss	<ul style="list-style-type: none"><li>• Inadequate management of the schedule of meetings and/or of the agenda(s)</li></ul>
29. The board is meeting rarely with heavy agendas	<ul style="list-style-type: none"><li>• Inadequate management of the schedule of meetings and/or of the agenda(s)</li></ul>
30. Meetings are systematically stretched and often run short of time. This leaves no time to properly cover, debate and challenge all points on the agenda.	<ul style="list-style-type: none"><li>• Inadequate management of the agenda and/or of the meetings</li><li>• Lack of Chair leadership</li></ul>
31. The board is buried in detail; inadequate information or analysis are provided to the directors; information is not sent sufficiently in advance; mass of information is provided to the board	<ul style="list-style-type: none"><li>• Inadequate management of the agenda and/or of submits to the Board</li></ul>
32. There is poor attendance at board meetings	<ul style="list-style-type: none"><li>• Lack of professionalism</li></ul>
33. Directors come to the board not prepared (e.g. not having reviewed the material and agenda)	<ul style="list-style-type: none"><li>• Lack of professionalism</li></ul>
34. Directors spend time during the meeting handling their emails instead of actively participating in the meeting	<ul style="list-style-type: none"><li>• Lack of professionalism</li><li>• Lack of Chair leadership</li></ul>
35. Directors do not keep information confidential.	<ul style="list-style-type: none"><li>• Lack of professionalism</li><li>• Potential liability</li></ul>

The logo for ILA, consisting of the letters 'ILA' in a white, elegant, cursive script font.

The voice of corporate governance  
in Luxembourg

A graphic celebrating 15 years. It features the number '15' in a white, thin-lined font. Below the '5' is the word 'Years' in a yellow, sans-serif font. To the right of 'Years' is a small yellow circle containing the number '+1' in white.