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The legal power of the Financial Market Supervisory Authority in the Scope of the Appointment of Management Board Members

Introduction

The activity of the financial market supervisory authority must focus on overseeing all types of risks taken by financial institutions, among them the operational risk and the legal risk. Therefore, it seems indispensable for the supervisory authority to be authorised to control and to vet primary decision-makers in financial institutions.

The aim of the present article is to present the currently applied legal solutions in the scope of the legal power of the Polish Financial Supervision Authority (KNF) concerning its influence on the composition of management boards of financial institutions. It also attempts to assess the current framework and presents the author’s suggestions of legal solutions that could be applied in this area.

1. Current Legal State in Individual Sectors of the Financial Market

Pursuant to the general rules set forth in Article 11 sec. 5 of the Act of 21 July 2006 on Financial Market Supervision (Official Journal of 2006, No. 157, item 1119, as amended), proceedings before the Polish Financial Supervisions Authority with regard to issuance of approval for the appointment of management board members of a financial institution are governed by the provisions of the Polish Code of Administrative Procedure. Thus, the matter of issuing decisions concerning granting approvals in the aforementioned scope is regulated by the general provisions of the Polish Code of Administrative Procedure pertaining to deadlines for issuing decisions.

1.1. Banking Sector

Pursuant to Article 12 of the Act of 7 December 2000 on the Functioning of Cooperative Banks, their Associations and Associating Banks (Official Journal of 2000, No. 119, item 1252, as amended) and Article 17 of the Act of 29 August 1997 - Banking Act (Official Journal of 2002, No. 72, item 665, as amended) the president of the management board of a cooperative bank or a state-owned bank, as appropriate, is appointed and removed by the supervisory board, with the reservation that the appointment requires approval of the Polish Financial Supervision Authority. The remaining management

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board members are appointed and removed by the supervisory board at the request of the president of the bank’s management board [Zoll, lex, 2005].

Therefore, during the period in which a bank awaits the approval of the appointment of the president by the Polish Financial Supervision Authority it is impossible to appoint the remaining board members. Pursuant to Article 22b of the Banking Law the management board of a bank must be composed of at least three natural persons. Two of the members of the management board, one of which is the president, are appointed at the request of the supervisory board with the approval of the Polish Financial Supervision Authority (this does not apply to cooperative banks, in the case of which the approval of the Polish Financial Supervision Authority is required only for the appointment of the president of the management board).

1.2. Capital Sector

It arises from Article 27 of the Act of 29 July 2005 on Trading in Financial Instruments (Official Journal No. 183, item 1538, as amended) that any changes in the composition of the stock exchange management board requires approval of the Polish Financial Supervision Authority, which is granted at the request of the body authorised to appoint and remove members of that board. The Polish Financial Supervision Authority refuses such approval if the proposed changes do not ensure the conduct of the operation in a manner guaranteeing the security of trading in financial instruments or duly protect the interests of trade participants. As regards appointing and removing members of the stock exchange management board, Article 27 of the aforementioned Act imposes the requirement of obtaining an approval of the Polish Financial Supervision Authority in the case of any changes in the composition of the management board of the company running the stock exchange [Michór, lex, 2010].

1.3. Insurance Sector

Pursuant to Article 27 of the Act of 22 May 2003 on Insurance Activity (Official Journal of 2010, No. 11, item 66, as amended) two members of the management board, one of which is the president of the insurance company, are appointed upon approval of the supervisory authority, unless the appointment concerns persons who performed the function of a member of the management board in the previous term of office. The approval is applied for by the body of the insurance company competent for appointing management board members.

1.4. Pension Sector

Pursuant to Article 59 of the Act of 28 August 1997 on Organisation and Functioning of Pension Funds (Official Journal of 2010, No. 34, item 189 and No. 127, item 858) an approval of the supervisory authority must be obtained in the case of appointment of management board and supervisory board members of a pension fund company, unless the appointment concerns persons who performed the function in these bodies in the previous term of office [Chróścicki, lex, 2010].

2. Assessment of the Current Legal State
In the current legal state there is one hundred percent certainty that there will be a time gap between the removal of a member of a governing body and the appointment of a new one, as the entity must await the approval of the supervisory authority. In practice the legal regulations in force may cause difficulties in managing the aforementioned entities in the period of awaiting the approval of the Polish Financial Supervision Authority. For instance, should a whole management board resign, the entity may be unable to appoint new management board members. The case of MTS-CeTO S.A. (presently BondSpot S.A.) of 2009 may serve as a prime example here: the company had to obtain approval of the Polish Financial Supervision Authority to remove one of its management board members, which was not granted for a few months. Companies such as Bank Gospodarstwa Krajowego, PKO BP S.A. and PeKaO S.A. were in the similar situation: they had to wait a long time for the decision of the Polish Financial Supervision Authority concerning appointment of the president or a member of their management boards. By providing these examples the author does not by any means criticise the supervisory authorities, but only attempts to present advantages and disadvantages of the currently applied and suggested legal solutions.

Taking into consideration the national and intra-company statutory regulations, in most instances during the time when an entity waits the approval of the Polish Financial Supervision Authority for appointing the president of its management board the remaining members of that body cannot be appointed either. This may have a negative impact on the activity of a financial institution, as it may lead to an increase in the operational risk as a result of lack of continuity of that financial institution’s operations.

In practice in the banking system occur situations in which due to changes in the composition of a bank’s management board, the body appointed by the supervisory board comprises not a single one member that has obtained the approval of the Polish Financial Supervision Authority for exercise this function. It is also worth noting that the period of awaiting for a decision of the Polish Financial Supervision Authority is relatively indeed long - from a few to a dozen months.

Another frequent practice is that the supervisory board or another body of a financial institution competent for appointing members of its management board appoints a given person as a president, an acting president or a member of the management board and only then applies to the Polish Financial Supervision Authority for approval of the given appointment. In spite of interpretational discrepancies as to whether such a practice is admissible or not, so far there are known no cases in which the Polish Financial Supervision Authority would impose any sanctions on entities resorting to this practice. While the institution awaits the decision of the Polish Financial Supervision Authority, appointed member of the management board de facto exercises his or her function and enjoys all the competencies vested in his or her office, e.g. the president of the management board recommends other board members for the appointment and
the supervisory authority examines the request for their approval. Therefore, in reality a refusal to grant approval means in fact that the Polish Financial Supervision Authority raises objection to an already effected appointment.

Some financial institutions appoint management board members without any reservations and do not wait for the Polish Financial Supervision Authority to approve newly appointed persons. In the legal doctrine it still remains disputable whether such an act is at all valid and legally binding. However, there have been cases in which the Polish Financial Supervision Authority continued the proceedings and approved persons who had been unconditionally appointed to the management board and, what is more, actually exercised their mandate prior to the approval of the supervisory authority. Apart from the literary interpretation of the law and the actions of the Polish Financial Supervision Authority integrated in the process, it must be pointed out that in such specific cases the decision of the Polish Financial Supervisory Board on a refusal to grant approval would be in fact an objection, and this due to its legal effect, expiration of that member’s mandate. In contrast, given to the mere nature of the juridical figure of a refusal to grant approval for appointment of a given person to the management board that such a refusal may not possibly trigger expiration of a mandate of an appointed person, as such a person has never been a member of the management board in the first place.

Not only the issues brought up in the preceding paragraph cause serious legal controversies. Equally contentious are situations in which a given candidate is appointed to a governing body on the precedent condition that its nomination must be approved by the supervisory authority, thus what is most important, the appointed member of the management board has no mandate until he or she has been approved by the Polish Financial Supervision Authority. Until then such a member is not authorised to take any intra-company actions on behalf of the company or conclude any legal transactions with external entities in his or her capacity of a member of that company’s management board. Therefore, there may arise the problem mentioned above, i.e. lack of continuity of the management board’s activity and various risks associated with it. On the other hand, it must be noted that the practice of a conditional appointment of management board members could serve as a basis for later actions aimed at challenging resolutions and other decisions shaping the management board’s composition.

Given the current legal state, a person whose appointment to the management board of a financial institution requires approval of the Polish Financial Supervision Authority has no mandate until such an approval has been granted. From the legal point of view such a person is not a member of the management board and as then may not act on behalf of the legal entity in the capacity of a member of its governing body. The Polish law does not provide for the institution of an ‘acting’ president or member of the management board. Thus, there is no possibility for a candidate awaiting the approval of the Polish
Financial Supervision Authority to exercise the function of a management board member as a so called ‘substitute’. This opinion has been confirmed by the common practice of registry courts, which refuse to make entries in the register on the basis of resolutions appointing certain persons as ‘acting’ presidents or members of the management board. As an example there may serve the decision of the registry court of 20 September 2010 in which the court refused to enter the previous member of the management board of TVP S.A. as acting president of the management board considering that neither the Act on Broadcasting nor the Polish Code of Commercial Companies and Partnerships provides for the possibility to entrust with the duties of the president of the management board another board member on a ‘temporary basis’.

Therefore, for the duration of the vetting procedure, even if pertaining only to some members of the management board, the whole body may be unable to act due to the fact that it does not have the number of members required by the relevant act or the entity’s statues or that the number of existing members is not sufficient for the body to represent the company externally. However, a much more frequent situation is that the number of management board members is expressed as a range, and until the Polish Financial Supervision Authority issues the decision concerning the approval of some of its members (precisely two in the case of banks being joint-stock companies and of national insurance companies) the remaining board members run the company’s affairs and represent it in contacts with external entities. In this to the financial institution operates properly. In this context, there arise doubts the possible aim of this supervisory tool if the remaining members of the management board - i.e. those not subject to the vetting procedure - fulfil their functions and manage the financial institution, without the candidates who are yet to be granted their mandates in some indefinable future, among them the president, having any influence on or control over their actions.

Nonetheless, the procedure of appointing management board members at the request of the president has its practical justification: the involvement of the president of the management board in the process of appointing the remaining board members allows the president to select his or her partners in order to ensure their harmonious and efficient cooperation. It is not without significance that the person appointed as president of the management board has this means of shaping the composition of this body.

The foregoing considerations suggest that the problem of financial institutions having no management board during the period in which the Polish Financial Supervision Authority examines the application for the approval of the appointment of the management board president’s exists not only in state banks, but also some other institutions from all sectors of the financial market. The literal interpretation of the legal regulations cited would mean that during the period of awaiting the continuity of operations of such entities would be interrupted. This state would last until the receipt of the relevant approval of the Polish Financial Supervision Authority and the actual appointment of the
period, which in fact could temporarily destabilise the operation of the financial institution. This would have negative consequences not only for the conduct of the company’s affairs, but predominantly in the sphere of its representation, given the principle that a legal person acts through its bodies (Article 38 of the Polish Civil Code) [Kidyba, lex, 2009].

During that period a financial institution would be unable to enter into agreements and conclude other civil law transactions, and would be deprived of the capacity to act in court proceedings in civil cases. Therefore, it would be impossible for the institution to participate in trade, and prolongation of this state would ultimately lead to legal person’s winding-up (Article 42 of the Polish Civil Code).

Another possible conclusion would be that in the light of the currently binding legal regulations the operational and legal risk associated with a financial institution lacking in a body competent to conduct its affairs and represent it during the transitional period occurs only in state and cooperative banks, as only in the case of these institutions legal regulations provide explicitly that members of the management board are appointed upon the motion of the president. As a result of that, in the case of other financial institutions the construction of objection would be unjustifiable from the point of view of continuity of their operation. In practice, however, many institutions adopt a solution under which members of the management board are appointed at the request of the president even though there is no such statutory imperative. In this cases such a requirement has solid legal basis in the form of provisions of statues of individual financial institutions, e.g. Giełda Papierów Wartościowych w Warszawie S.A. or PZU S.A., which are approved by the Polish Financial Supervision Authority.

3. The British Financial Service Authority role in approving appointments to the management board of a financial institution

Under the Financial Services and Markets Act 2000, Financial Service Authority (FSA) has powers to regulate three types of individuals: those who have a significant influence on the conduct of a firm’s (including banks’) affairs; those who deal with customers; and those who deal with the property of customers. In all cases, it is the firm - or a bank - that is responsible for making the application to the FSA for approval of a candidate and, by undertaking due diligence checks, to ensure that the candidate is “fit & proper” for the role in question.

The FSA’s website provides a great deal of information about how they assess fitness and properness of an individual. As an example could be the section headed “Doing business with the FSA” [http://www.fsa.gov.uk/Pages/doing/index.shtml, access 15.01.2012 years]. With respect to identifying issues that might adversely affect a decision as to whether or not an individual is of good repute (i.e. honesty, integrity and reputation), these are of course dealt with on a case-by-case basis.
The FSA Handbook sets out all the FSA’s rules made under powers given to us under the Act, and are entirely binding on the firms and individuals that FSA regulates. There are two key sections of the Handbook that set the minimum standards for becoming and remaining authorised as approved persons [http://www.fsa.gov.uk/Pages/handbook/ access 15.01.2012 years]:
1. Statements of Principle and Code of Practice for Approved Persons (APER);
2. The Fit & Proper Test for Approved Persons (FIT).

As well as looking at good repute, they also of course consider the experience of a given individual. FSA recent Consultation Paper (CP10/03 - Effective corporate governance (Significant influence controlled functions and the Walker review) details its proposals to ensure that firms are adequately assessing an individual’s competence to direct the business of a firm. In this context I would like to particularly draw attention to Chapter 4 of the CP, which sets out the approvals process.

All banks in the UK and all individuals responsible for running those banks must be regulated and supervised by the FSA. No individual can carry out a “controlled function” without being first approved by FSA. Approval is not permanent. Once approved, the performance and competence of persons performing a governing controlled function will be reviewed as part of FSA “ARROW” assessments. “ARROW” - or Advanced Risk-Responsive Operating frameWork - is the mechanism used to monitor and regulate firms in order to ensure they are complying with the regulatory requirements [http://www.fsa.gov.uk/Pages/Doing/Regulated/supervise/index.shtml, access 15.01.2012 years]. These reviews include a section on governance, management and culture and obviously take account of our rules, including those contained in APER and FIT, which are relevant to both becoming and, crucially, remaining an approved person. Non-compliance with the regulatory requirements may result in the FSA taking action (including on enforcement action) against the firm (or bank) and/or the approved person concerned.

4. Suggested Direction of Legal Changes

Considering the phenomenon described above and for the purpose of unifying the rules for appointing management board members of financial institutions, in the opinion of the author it would be necessary to introduce amendments to a few acts, i.e. Act on Amendments to the Act on Organisation and Functioning of Pension Funds, Banking Law, Act on Functioning of Cooperative Banks, their Associations and Associating Banks, Act on Insurance Activity and Act on Trading in Financial Instruments, which would replace approval tool of the Polish Financial Supervision Authority with the instrument of objection.

The instrument of objection is already well-established in the Polish legislation and has been used also in financial market regulations. For instance, as regards intention to purchase shares in an insurance company, investment
fund company or brokerage house, the supervisory authority may object to the planned transaction. It should be emphasised that in the banking sector within the framework of the implementation of the provisions of Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector, the existing authorisation tool was replaced with the right of the supervisory authority to oppose to the intended purchase of shares in a state bank. The time limit for raising the objection provided for in acts implementing the Directive is 60 days, equal for all sectors.

It must be clearly stated that the fundamental ratio legis for replacing the approval tool of the Polish Financial Supervision Authority with the instrument of objection would result in limiting the operational and legal risk associated with changes in the competition of financial institutions’ management boards. Elimination of these risks would allow a more stable and efficient functioning of entities operating on the financial market. The suggested solution would benefit not only the institutions, but indirectly also their clients. Lower operational risk of a bank or an insurance company would result in higher security of investments in products offered by such entities.

Taking into account the need to ensure security of assets entrusted to financial institutions, it seems necessary to verify qualifications and previous activity of at least some candidates for the function of management board members. However, such a supervisory tool should be constructed in a manner that ensures effectiveness as the undisturbed functioning of entities subject to the supervision. This should be taken into account when assessing the two alternative solutions, i.e. the construction of approval of the Polish Financial Supervision Authority currently applied in the regulations appointment of members of financial institutions’ governing bodies and the institution of objection.

In the present article the author will suggest specific changes pertaining to the banking sector; other sectors of the financial market would require analogous changes.

In the opinion of the author, it would be advisable to formulate new wording of the regulations concerning appointment of management board members. Consequently, it would be necessary to introduce a regulation that upon appointment of the president or a member of the management board indicated by the supervisory board the Polish Financial Supervision Authority would have the right to object to the decision within e.g. 60 days as from the notification of the given appointment. Conditions for raising an objection by the supervisory authority should remain the same as in case of granting or refusing to grant approval.

A body competent to appoint members of the bank’s management board would have the right to appeal to the administrative court against the decision of
the supervisory authority to raise objection within 7 days as from delivery of the said decision. However, the right to apply for re-examination of the case should be excluded by way of exemption of application of Article 127 § 3 and Article 130 § 2 of the Code of Administrative Procedure. In this situation a re-examination of the case seems pointless and would only unnecessarily extend the proceedings. A decision in this matter should become immediately final and binding. It must be noted that a similar construction already exists in the Banking Law. Application of Article 127 § 3 of the Code of Administrative Procedure is exempted in Article 6c sec. 5, Article 141a sec. 4, Article 141b sec. 2, Article 144 sec. 5 and Article 147 sec. 3 of said Law.

In the opinion of the author, in order to ensure transparency of the management board’s functioning it is necessary to introduce a regulation stating that as at the day of delivery of the decision on objection, the resolution of the supervisory board on appointment of the president or member of the management board is revoked by operation of law. As at the day of delivery of the decision on objection to appointment of a management board member indicated by the supervisory board that member would be removed, and the mandate of the president or a member of the management board appointed by the supervisory board would expire. At the same time all actions in the field of with conducting affairs of the entity and representing it in contacts with third parties effectively taken by management board members to which the objection applies would remain in full force and effect.

Moreover, the Act on Functioning of Cooperative Banks, their Associations and Associating Banks, which regulates the functioning of cooperative banks as lex specialis, should be amended by way of introducing a new wording of Article 12 sec. 3 stating that in the case of the appointment of a president of the bank’s management board indicated by the supervisory board the supervisory authority would have the right to oppose thereto by way of a decision issued by reference to the provisions of the Banking Law. The currently applied requirements that must be met by the candidates for the function of president of the management board of a cooperative bank must satisfy would remain unchanged.

Conclusions

The problem of the lack of continuity of governance in a company can be solved by replacing approval of the supervisory authority with the institution of objection. Members of the management board (including president) would be granted the mandate necessary to conduct the institution’s affairs and represent it externally as at the day of the appointment (or any other day indicated in the resolution on the appointment), and a possible objection of the supervisory authority would result in expiration of this mandate. At the same time all activities performed by the member of the management board as from the day of appointment until the day of delivery of the objection would remain in full force and effect. This would allow to avoid situations in which a financial
institution has no governing bodies as a result of a prolonged vetting procedure concerning persons appointed to the management board.

In the opinion of the author, a 60-day deadline for examining the case and raising objection, should the necessity arise, is sufficient. It would be unjustified to adopt the thesis that this deadline is too short for the mere reason that in some special cases it will be difficult to collect evidence within this time limit. This is because a legal regulation should not be formulated from the perspective of a few exceptional cases; the hypothesis of a legal norm should correspond to a certain ‘normal situation’, i.e. circumstances most frequently observable in practice. Moreover, it must be taken into consideration that the suggested deadline is principally consistent with Article 35 § 3 of the Code of Administrative Procedure, pursuant to which cases requiring preliminary investigation must be dealt with within a month and particularly complicated cases within two months. This does not, however, preclude the possibility to develop some special solutions dedicated to exceptional situations. For this reason it seems necessary to work out provisions which would allow suspending the running of the deadline for examining the case by operation of law in cases in which the ability of the vetting authority to collect information required for the proper assessment of the candidacy depends exclusively on other entities. The suspension would last until the Polish Financial Supervision Authority obtains information from the relevant entities. Conditions for suspending the running of the deadline for raising objection could include e.g.:

1. the necessity to obtain information from law enforcement authorities and courts (also foreign authorities) as regards penal proceedings and proceedings involving fiscal offences that were or are currently pending against a given candidate;

2. the necessity to obtain information on the candidate from foreign supervisory authorities.

Having considered the arguments presented in this article, it seems justified to develop regulations that would to the largest possible extent satisfy the interests of the market and at the same time guarantee the security of financial institutions’ clients.

Instead of adopting the changes suggested by the author, alternatively it is also possible to retain the institution of approval, but introduce a time limit of e.g. 60 days: a failure of the supervisory authority to issue the decision within this deadline would automatically have the same effect as an approval. However, this solution would not fully eliminate the problem of the time gap and the operational risk as regards continuity of the activity conducted by financial institutions.

Bibliography
2. Consultation Paper (CP10/03 - Effective corporate governance (Significant influence controlled functions and the Walker review).

**Summary**

The activity of the financial market supervisory authority must focus on overseeing all types of risks taken by financial institutions, among them the operational risk and the legal risk. Therefore, it seems indispensable for the supervisory authority to be authorised to control and vet central decision-makers in financial institutions. The aim of the present article is to present the currently applied legal solutions in the scope of competencies of the Polish Financial Supervision Authority concerning its influence on the composition of management boards of financial institutions. It also attempts to assess them and presents the author’s suggestions of legal solutions that could be applied in this area. It seems justified to develop regulations that would to the largest possible extent satisfy the interests of the market and at the same time guarantee security of financial institutions’ clients. In this article the author tries to prove that the objection tool in the hands of the Polish Financial Supervision Authority would work better than the instrument of approval.

**Key words**

financial supervisory authority, banks, financial institutions

**Streszczenie**

Działania nadzorcy rynku finansowego muszą się skupiać na nadzorowaniu wszelkich rodzajów ryzyk ponoszonych przez instytucje finansowe, w tym ryzyka operacyjnego i prawnego. W związku z powyższym niezbędne wydają się uprawnienia organu nadzoru w celu kontroli i weryfikacji osób podejmujących najważniejsze decyzje w instytucjach finansowych. Celem niniejszego artykułu jest przedstawienie aktualnych rozwiązań prawnych w zakresie uprawnień Komisji Nadzoru Finansowego co do oddziaływania na skład osobowy członków zarządów instytucji finansowych, próba ich oceny oraz przedstawienie autorskich propozycji rozwiązań prawnych w przedmiotowym zakresie. W niniejszym artykule autor podejmie się próby udowodnienia tezy, że instytucja sprzeciwu może okazać się bardziej efektywna niż instytucja wyrażania zgody przez organ nadzoru

**Słowa kluczowe**

nadzór finansowy, banki, instytucje finansowe