8 July 2024
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Consultation Paper

Supervisory expectations for the management body

Responding to this paper

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex I. Comments are most helpful if they:

- Respond to the question stated;
- Indicate the specific question to which the comment relates;
- Contain a clear rationale; and
- Describe any alternatives ESMA should consider.

ESMA will consider all comments received by 18 October 2024**.**

All contributions should be submitted online at www.esma.europa.eu under the heading 'Your input - Consultations'.

Publication of responses

All contributions received will be published following the close of the consultation. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure.

Data protection

Information on data protection can be found at www.esma.europa.eu under the heading 'Data protection'.

Who should read this paper?

This paper may be of interest to users of benchmarks, users of credit ratings, Benchmark Administrators, Credit Rating Agencies, Data Reporting Service Providers and their participants, Securitisation Repositories and their participants, Trade Repositories and their participants, Third Country Central Counterparties that qualify as systemically important and their participants and members. It may also be of interest to entities considering to apply as a registered Benchmark Administrator, a Credit Rating Agency, a Data Reporting Service Provider, a Securitisation Repository or a Trade Repository.

1. Table of Contents

1. Executive Summary

Reasons for publication

ESMA is responsible for the supervision of Credit Rating Agencies (CRAs), Benchmark administrators (BMAs) of EU critical benchmarks and third-country recognised benchmarks, TC-CCPs that qualify as systemically important (Tier 2 TC-CCPs), Data Reporting Service Providers (DRSPs), Securitisation Repositories (SRs) and Trade Repositories (TRs).

In light of this expanded group of supervised entities, ESMA has sought to clarify and harmonise its approach to certain aspects of its supervisory engagement. The supervisory expectations set out in this consultation paper are intended to provide all of ESMA's supervised entities with the same reference point for ESMA's expectations regarding governance arrangements. In the context of this document, governance arrangements focus on the management body. The publication of these expectations will ensure that all ESMA supervised entities are equally aware of ESMA's expectations in this area. It will also increase transparency for any potential applicant or future supervised entities as to what ESMA expects in this area.

Contents

This consultation paper is composed of 8 sections. Sections 2 and 3 set out the background and purpose of ESMA's proposed expectations on governance while section 4 gives an overview of their application. Sections 5, 6, 7 and 8 set out ESMA's proposed expectations on (i) key concepts, (ii) the roles and responsibilities of the management body, (ii) the operation of the management body and the role of the chair, and (iii) the effectiveness and the composition of the management body. Further to this:

- Annex I sets out the list of questions contained in this consultation paper.
- Annex II sets out the preliminary cost benefit analysis
- Annex III sets out the proposed Supervisory Expectations on Governance

Next Steps

ESMA will consider all feedback received and look to publish the finalised supervisory expectations in Q1 2025. ESMA will consider these supervisory expectations for the purpose of its supervision three months after the publication of the final report.

2. Background

1 With the introduction of the ESMA Regulation in 2011, ESMA became responsible for the supervision of EU registered CRAs.

2 With additional supervisory mandates under a number of other regulatory frameworks, ESMA's approach to supervision has had to adapt, both to encompass a broader set of entities as well as to evolve its approach for existing entities. Specifically, since 2013 ESMA has on-boarded five new supervisory mandates in the areas of BMAs, Tier 2 TC-CCPs, DRSPs, SRs and TRs.

3 Looking forward, ESMA anticipates that this number will continue to grow on the basis that mandates such as EU Green Bond external reviewers[1], ESG rating providers[2] and Consolidated Tape Providers (CTPs)[3] will be added to our supervisory remit.

4 As a result of this expanded remit, it is relevant to provide all ESMA's supervised entities with the same reference point for ESMA's expectations regarding governance arrangements. A common reference point will ensure a consistent and harmonised approach to ESMA's supervisory practices as well as a common compliance-oriented culture among ESMA's supervised entities. These Supervisory Expectations on the management body are a first step towards achieving these efficiencies.

3. Purpose

5 This document sets out ESMA's expectations and describes what we consider good practice in relation to governance arrangements within the firms ESMA supervises. Where we refer to governance arrangements, we focus on the set-up and operation of the management body of a firm.

6 As such, these expectations will form the basis for ESMA's supervisory engagements with those firms. We may ask firms to carry out a self-assessment against these expectations to understand which practices they apply and how they envisage to evolve. Where firms fall short of ESMA's expectations, we will engage ns with those firms to identify ways to strengthen their governance arrangements.

7 Where there is a case of conflict, requirements stipulated in primary or secondary legislation will prevail over any supervisory expectation set out in this document.

[1] Under the EU Green Bond Regulation
[2] Under the Proposal for a Regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities
[3] Under the Markets in Financial Infrastructure Regulation

4. Application

8 This document sets out ESMA's supervisory expectations (the expectations) regarding the management bodies of the firms which we directly supervise. ESMA directly supervises 6 types of entities: BMAs, Tier 2 TC-CCPs, CRAs, DRSPs, TRs and SRs with an increasing number of firms. These firms have a wide range of backgrounds, historical approaches and experience of being subject to regulation. As a result, there are also differing approaches to governance and the conduct of management bodies.

9 Almost all entities within ESMA's supervision remit are required to establish a management body which oversees the organisation as a whole and specifically the identification and management of risks. This is because the oversight exercised by the management body of an entity is a core component of an effective governance and internal control framework[4], including a firm's corporate culture. Ineffective or superficial oversight as well as poor tone from the top are likely to have a negative impact on all other aspects of internal control and may result in substantial control failings and corresponding breaches.

10 ESMA considers there are certain best practices that firms should adhere to when setting up their governance and oversight arrangements to ensure their robustness and effectiveness. We have grouped these into three areas set out in this document.

11 ESMA is looking to establish common regulatory expectations for all its supervisory mandates, current and future so that entities under our supervision, have increasing clarity on our expectations in these areas.

Proposed scope of application

These supervisory expectations are relevant to all firms directly supervised by ESMA. Currently, these are Benchmark Administrators (BMAs) of EU critical benchmarks and third-country recognised benchmarks, TC-CCPs that qualify as systemically important (Tier 2 TC-CCPs), Credit Rating Agencies (CRAs), Data Reporting Services Providers (DRSPs), Securitisation Repositories (SRs) and Trade Repositories (TRs).

Where there is a case of conflict, requirements stipulated in primary or secondary legislation will prevail over any supervisory expectation set out in this document.

Unless otherwise stated, ESMA considers that these expectations will also apply to any future mandate.

[4] ESMA is working on Internal Control Guidelines for the firms it supervises.

Q1: Do you agree with the proposed scope of application of these supervisory expectations? If not, please explain.

5. Introduction

The management body concept

12 When discussing governance arrangements, this document refers to the concept of the management body. *Management body* is a generic term that refers to the most senior governing bodies within an organisation. It describes the same bodies as are typically referred to as “the board” or “management and supervisory boards”.

13 A management body is composed of a supervisory function and a management function and as such includes the non-executive directors of a firm and its most senior executive managers. The management body concept is agnostic to unitary and two-tier governance structures and is therefore used in a wide range of EU financial services regulation[5]. Using the concept of the management body ensures ESMA’s expectations are aligned with the most recent EU legislation and covers all narrower concepts referred to in primary legislation for the mandates under ESMA’s supervision.

Proposed approach to the management body concept

This document refers to the concept of the management body. This is defined as “the body or bodies [..] which are appointed in accordance with national law, which are empowered to set the entity’s strategy, objectives and overall direction, and which oversee and monitor management decision-making and include persons who effectively direct the business of the entity”[6].

Management body is a generic term that refers to the most senior governing bodies within an organisation. A management body is composed of a supervisory function and a management function and as such includes the non-executive directors of a firm and its most senior executive managers. The management function has responsibility for the day-to-day management of the firm whereas the supervisory function is charged with overseeing the firm and its executive management.

Where this document refers to the management body, the expectations described apply to all its members. Otherwise, the document refers to the management body in its supervisory or management function in order to set out expectations which apply only to these respective parts. It is noted that this document does not set out expectations

[5] For example, see Article 3(1), point (7), of CRD and Article 4(1), point (36), of MiFID II.
[6] See Article 3(1), point (7), of CRD and Article 4(1), point (36), of MiFID II which are effectively identical.

for the fitness and propriety of individuals carrying out specific functions (e.g. CEO, Independent Non-executive Directors (INEDs etc).

Proportionality

14 Entities under ESMA's supervision have highlighted to us that some of ESMA's supervisory expectations could risk being overly burdensome without the possibility for entities to apply them in a proportional manner. ESMA considers most of the expectations set out in this document to be best practice and believes entities of all sizes and levels of complexity should aim to comply with them.

15 For a number of expectations we have highlighted that adherence to them should be subject to the nature, scale and complexity of the entity in question. This is to prevent our expectations from being overly burdensome.

Proposed approach to proportionality

This document sets out ESMA's supervisory expectations in relation to governance and oversight arrangements in order to ensure their robustness and effectiveness. ESMA considers most of these expectations to be best practice and believes that entities of all sizes and levels of complexity should aim to comply with them.

However, ESMA recognises that some of the expectations laid out in this document can be onerous for some entities. For entities of smaller sizes and with lower levels of complexity, it will be appropriate to adhere to ESMA's expectations by designing processes which are applied with lower frequency and/or intensity.

ESMA will calibrate its expectations according to the nature, scale, complexity and overall risk profile of an entity and based on how these characteristics may affect investor protection, orderly functioning of markets and financial stability.

When assessing the nature of an entity, ESMA will consider the business and type of operations of the entity, including its market role/mission, type, diversity and criticality of products and services offered.

When assessing the scale of the business, ESMA will have regard to relevant factors including headcount, revenue, number of clients and products, market share, interconnections with other industries/infrastructures, ancillary services and their relationship with core services and other factors specific to the size and market impact of the entity.

When assessing the complexity of an entity, ESMA will consider, amongst other factors, its organisational structure and arrangements (group structure/relationships, shared services, outsourcing, etc.) as well as its operational characteristics with regard to people, processes, technology, product offerings and interconnections.

When assessing the overall risk profile of an entity, ESMA will consider, amongst other factors, its risk exposure, the strength and maturity of its internal control environment, its business culture, attitude and prevailing behavioural patterns.

We have specifically set out which of the expectations we consider to be subject to proportional implementation by referring to the nature, scale and complexity of the entity in question.

Q2: Do you agree with the proposed approach to proportional application?

6. The role and responsibilities of the management body

The role of the management body

16 In this section, ESMA clarifies the role of the management body of an entity. As previously noted, almost all entities within ESMA's supervision remit are required to establish a management body which oversees the organisation as a whole and specifically the identification and management of risks. As such, the management body is the ultimate decision-making body of an entity and oversees and provides challenge to the senior executives.

17 In practice, we have observed cases where the supervisory function of the management body was limited to overseeing only some risks the entity was exposed to and was restricted from receiving information on the entity's business strategy, let alone overseeing its effective implementation. ESMA considers that oversight and challenge can only be effective if the management body in its supervisory function has a complete view of the entity it oversees. ESMA further clarifies that it does not wish to prescribe specific corporate governance arrangements but that any arrangement chosen should ensure that the management body can exercise its fundamental function of providing oversight and challenge.

Proposed approach to the role of the management body

The management body of an entity should be empowered to set its strategy, objectives and overall direction. The management body should also be responsible for setting and overseeing the entity's overall risk management framework, including its risk appetite. Members of the management body should be fully aware of the regulatory framework and requirements governing the operations of the entity.

The duties of the management body should be clearly defined, distinguishing between the duties of the management (executive) function and of the supervisory (non-executive) function.

Subject to the provisions of national law, the management and supervisory functions of a management body may be assigned to different bodies or different members within one body. Effective governance arrangements ensure that the supervisory function oversees and challenges the management function. The latter in turn is responsible for the day-to-day management of the entity and the implementation of the strategy set by the management body as a whole.

Members of the management body in its supervisory function should collectively be able to effectively challenge and monitor decisions made by the management body in its management function. It is noted that different governance structures are used across Member States, typically either in the form of unitary or dual board structures. These expectations are intended to embrace all existing structures without advocating any one in particular.

Accountability and delegation

18 The importance of accountability for the conduct of an entity has been demonstrated by regulatory failures, including the 2007-2008 Global Financial Crisis. In ESMA's view, the members of the management body of a regulated entity are collectively accountable for its oversight and compliant conduct. Therefore, at least in principle, all matters relating to the activities of an entity are subject to the oversight of and, where necessary, decision by the management body.

19 In practice, ESMA believes that it can be appropriate for the responsibility for decisions to be delegated, for example to a single member of the management body. However, the rationale for such delegation, and its operational arrangements, should be properly documented and overseen so that the management body maintains visibility and retains the ability to intervene. In this section, ESMA specifies its expectations in this regard.

Proposed approach to accountability and delegation

The management body is responsible for the oversight of the entity supervised by ESMA. ESMA expects that the management body is involved in all key decision-making in relation to the regulated entity and receives all necessary information to oversee its operation in a timely manner.

The management body should have the appropriate legal authority to fulfil its mandate, in accordance with applicable law.

Irrespective of the entity's governance structure, the management body's role, responsibilities and operation should be set out in formal documentation which should specify the decisions reserved for the management body and if and how it may delegate certain parts of its role. Such documentation may take the form of terms of reference for the board.

Where delegation occurs, the management body remains accountable for such delegated responsibilities and should therefore maintain visibility of how they are addressed and be prepared to intervene if it does not meet the needs of the regulated entity.

Where the management body considers that key strategic initiatives or risk exposures may lead to the entity failing to meet its regulatory obligations and/or those to its stakeholders, it should require remedial actions and oversee their implementation.

Overseeing strategy setting and implementation

20 ESMA has observed that management bodies in their supervisory function have been excluded from overseeing the setting and implementation of an entity's business strategy. Typically, this is the case where the entity has a strong executive leadership with a strong vision for the entity's strategic direction; or where the entity is part of a larger group and is considered as simply executing group strategy.

21 ESMA acknowledges that in many cases, the development and execution of an entity's business strategy is the responsibility of the management body in its management function. However, the business strategy of an entity is a key driver of the risks it will be exposed to. Consequently, it is important that the supervisory function of the management body has appropriate oversight of the setting of business strategy and its implementation.

22 ESMA considers the same to be true where an entity's business strategy is largely developed at group level. ESMA expects that all members of the management body of the supervised entity are appropriately involved in setting and implementing the business strategy and provide challenge and demand changes where this is necessary for the management of risks and compliance with EU-specific requirements.

Proposed approach to overseeing strategy setting and implementation

The management body of the entity should oversee the setting and implementation of the entity's business strategy. Where the entity's business strategy is determined by the management body in its management function, the supervisory function should be involved in key decisions, in particular those which could affect the entity's ability to continue to meet its regulatory and/or client obligations.

Where the entity is a subsidiary of a group, the group's business strategy may to a large part determine the strategy of its subsidiary. The management body of the entity should maintain a good awareness of the group's overall business strategy and the role played by the entity as the subsidiary in its implementation. To that extent, it is vital that the management body of the entity is provided with sufficient notice of any group-level discussions which may affect the entity.

The management body of a subsidiary should have a sufficient level of independence from the group to enable it to act in the interests of the EU regulated entity. It should consider whether key strategic initiatives set by the group pose a risk to the entity meeting its regulatory obligations including towards stakeholders, as well as market integrity and financial stability. The management body should also have the ability to escalate its concerns to the group board.

Overseeing risk

23 Overseeing the identification and management of risks is a core role of the management body of an entity. In ESMA's view, this involves setting and operationalising risk appetite and receiving and reviewing meaningful information that allows for the monitoring of an entity's risk exposure. For the avoidance of doubt, ESMA accepts that risks can manifest in unexpected ways or crystallise suddenly. This section describes our expectations with regard to an entity's set-up which should enable it to identify emerging risks and react quickly to changes in risk exposure.

Proposed approach to overseeing risk

The management body should oversee the identification, assessment, and management of the key risks the regulated entity is exposed to. The management body should have a comprehensive understanding of the risk universe[7] applicable to the entity and the risks' relative likelihood and impact.

The management body should approve and regularly review the entity's risk appetite and risk tolerance levels in relation to the key risks and define measures that enable it to monitor their status and development. To this end it receives information on risks directly from the Heads of the Internal Control Functions without interference of any other members of staff.

Where the information reported to the management body indicates that a part of the entity operates outside the risk appetite, the management body should ensure that appropriate mitigation action is taken. The owner of such action should regularly report to the management body until mitigation is considered effective.

[7] A risk universe is a list of the risks an entity faces, which can be combined with an assessment of each risk's severity of impact and frequency of occurrence.

The management body should formally establish and document roles and responsibilities of the internal control functions and approve any material changes thereto.

Tone from the top

24 Rules and processes set out in policies and procedures are essential for an effective internal control framework. However, insights from behavioural science also indicate the importance of unwritten norms for the positive conduct of an organisation. Together, these written and unwritten components make up an entity's corporate culture. ESMA is aware that corporate culture is hard to measure. However, we believe that it is important for the management body of an entity to play an active role in setting it. This is typically described as setting the tone from the top.

25 In practical terms it involves an active engagement by the members of the management body with the key drivers of employee behaviour (such as communication from management, objectives, remuneration, acknowledgement of effort) and calibrating them to foster the culture they intend for the entity. It also involves efforts to monitor the entity's corporate culture so that the management body can intervene where it deviates significantly from its stated goal.

Proposed approach to tone from the top

The management body of the entity is responsible for setting the tone from the top. The term describes the efforts of the management body and executive senior management in ensuring a positive corporate culture that promotes and rewards honesty and integrity as well as compliance with rules and regulations. In this context, it is also noted that an entity's approach to remuneration is a vital part of its incentive structure and deserves attention from the management body.

The tone from the top is expressed through different means of communication, for example the entity's business strategy or a code of conduct. It is also given expression through the actions and behaviours of members of the management body and executive senior management and whether they align with the stated ethical values.

The management body of the entity should agree on the corporate culture it intends to establish within its organisation and how it will effectively communicate it. Members of the management body should ensure that their decisions and actions are in line with the cultural expectations communicated to the employees of the entity.

The management body should also seek to monitor and assess the corporate culture prevalent at the entity.

Q3: Do you agree with the expectations regarding the role and responsibility of the management body? If not, please explain.

Q4: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.

7. Operation of the management body and role of the chair

The operation of the management body

26 Management bodies must meet with sufficient regularity to perform their role effectively. The appropriate frequency depends on the nature, scale and complexity of the organisation. The management bodies of entities that have more complex organisational arrangements, are subject to more frequent change or have larger operations will typically need to meet on a more frequent basis to effectively monitor developments.

27 For the management body to provide effective challenge and oversight, it is also vital that its members can critically reflect on the direction taken by the organisation and use their experience and expertise to identify risks or offer alternative courses of actions. This is typically referred to as the concept of the independence of mind which ESMA has reflected in this section.

Proposed approach to the operation of the management body

The management body should meet at an appropriate frequency in proportion to the nature, scale and complexity of the entity it oversees. Meetings should be of sufficient length so as to allow the full discussion of key items and the active participation of all members of the management body.

The management body in its supervisory function and in its management function should interact effectively. Both functions should provide each other with sufficient information to allow them to perform their respective roles.

Members of the management body should act with independence of mind, which is different to being independent from the perspective of an individual's connections with the regulated entity or related third parties.

Acting with independence of mind is a pattern of behaviour, shown in particular during discussions and decision-making within the management body, and is required for each member of the management body regardless of whether the member is an Independent Non-Executive Director (INED)[8]. All members of the management body should engage actively in their duties and should be able to make their own sound, objective and

[8] For further detail on the concept of independent non-executive directors, refer to Annex II of Commission Recommendation 2005/162/EC of 15 February 2015 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board

independent decisions and judgments when performing their functions and responsibilities.

Reporting and record keeping

28 As the members of the supervisory function of the management body are not involved with the day-to-day running of the entity, ESMA considers it vital that the information provided enables each member to maintain an effective overview of the key points being raised and understand what they are being asked to do. The reporting should also carefully reflect the important business areas and not simply follow the same template for all meetings of the management body.

29 The control functions of an entity should have unhindered access to the management body. ESMA has observed a practice where senior executives have sought to restrict such direct access. Whilst we understand that it is important for senior managers to provide to the management body their views on concerns identified, ESMA does not consider it appropriate if they act in a gatekeeper role.

30 ESMA also considers it important for discussions, follow-up actions and decisions by the management body to be recorded effectively. We have in the past provided entities with specific comments on the quality of their minutes and these have been reflected in the document as a high-level expectation.

Proposed approach to reporting and record keeping

Reports to the management body should ensure a balance between providing a comprehensive overview of a proposal or issue and the need to be concise. Reports should be clear on whether a decision is being sought or whether the item is brought for input or simple notification.

Reporting should be designed to provide the management body with a comprehensive, risk-focused view of the operations of the entity. In addition to the control functions, reporting should also include first-line and support functions, such as IT, business development and other core operational areas.

Given the independent role of internal control functions, they should have unfettered access to the entity's management body in its supervisory function. Internal control functions outsourced to group level should still regularly report and seek discussion with the entity's management body.

Members of the management body's management function and executive senior management should not prevent or interfere with the direct communication between management body and the internal control functions.

Where the management body's management and supervisory functions are carried out by two separate bodies (i.e. in dual board structures), reporting to each body should be meaningful and allow its members to carry out their respective function. Whilst reporting to the supervisory function may be focused on exceptions and key risks and initiatives, it must still be sufficiently comprehensive to allow for the effective oversight of the entity.

The management body should provide regular feedback on the quality of the reporting it receives and what improvements might be made, or additional topics might be covered.

The entity should ensure that a comprehensive, accurate, impartial and balanced internal record is maintained (in electronic format) of each meeting of the management body. At a minimum, such records should capture the key points of discussion including key contributors and dissenting voices, any decisions made and their corresponding rationale and agreed actions (including, for example action owners, timeline, deliverables).

Committees and pre-board meetings

31 ESMA acknowledges that especially for larger and more complex organisations, it is appropriate to delegate some of the oversight responsibilities of the management body to committees. At the same time, ESMA considers that the establishment of committees is not proportional for many entities under our supervision.

32 We have also observed a practice whereby members of the supervisory function of a management body have bilateral meetings with the heads of control functions or important business functions. We understand that this serves to gain a better and more detailed understanding of some of the key initiatives or concerns highlighted by those functions and enables direct access by control function members to the management body.

33 However, whilst delegation to committees and direct meetings with heads of business and control functions can be very useful, ESMA has observed that at times, decision-making has in effect been moved to such forums when it should legitimately sit within the management body. On occasions, ESMA was unable to find records of certain decisions at management body level and was told that instead these had been taken in discussion at committee level or in private discussion with functional heads.

34 As noted above, whilst delegation can increase the effectiveness of a management body, ESMA is concerned that delegation without proper records being kept and without ultimate

oversight by the entire management body can lead to fragmentation of decision-making and a lack of accountability for such decisions.

Proposed approach to committees and pre-board meetings

Depending on the nature, scale and complexity of the entity, a management body may choose to create committees and task them with certain key responsibilities[9]. This can be a useful way of ensuring more detailed oversight of complex areas without involving all members of the management body. As set out in section 2.2, whilst responsibility can be delegated, the management body ultimately remains accountable for the effective oversight of the entity.

Other management bodies may decide that its non-executive directors have regular meetings with key function holders within the organisation such as key first-line departments or control functions such as Compliance, Risk, Internal Audit or other functions depending on the requirements in regulation. This can allow the members of management bodies to discuss key areas or concerns in more detail than would be possible in the setting of a board meeting.

ESMA considers that such arrangements can increase the effectiveness and quality of oversight and challenge provided by the management body. However, committee or pre-board meetings may result in an insufficient level of formality so that their discussions, follow-up actions and decisions are not recorded and tracked. This in turn can lead to the fragmentation of oversight by the management body. As a result, ESMA considers that committee meetings and pre-board meetings should be recorded to a sufficient level to ensure that key discussions, decisions and follow-up actions are tracked and reported to the entire management body.

Role of the Chair

35 ESMA considers that the effectiveness of a management body also depends on how its meetings are prepared, how they are chaired, and how discussions and decision-making are facilitated. This is typically the role of the chair. Depending on the corporate structure, chairs either oversee the entire management body or management body in its supervisory function.

36 The chair role is typically non-executive in nature. This is not to say, that the chair of a management body must always be a non-executive director. Rather, it highlights that the role of the chair is to allow the management body to carry out its crucial role of providing challenge to executive senior management. This may be harder where the chair of the management body is also the CEO or equivalent of the entity and requires the application of the principle of independence of mind as mentioned above.

[9] It is noted that some entities supervised by ESMA are required to create committees with specific tasks.

37 ESMA has observed that most of the management bodies of the entities under our supervision typically appoint one member to lead through the agenda, give other members and presenters the floor whilst also ensuring that the discussion of topics remains within the timeframe allocated. Some of the entities opt for the model of a rolling chair who is appointed anew at the beginning of each management body meeting. In ESMA's view, appointing chairs on a rolling basis risks creating a disconnect between meetings and may result in a low level of preparation for each meeting.

38 It may also affect the activities around the review of the composition and effectiveness of the management body (set out in the next section) which should typically be led by the chair. Given such activities typically stretch over at least two meetings of the management body, this would potentially be led by two or more individuals.

Proposed approach to the role of the chair

ESMA considers the role of the chair of the management body (or the chair of the management body in its supervisory function) is vital to the effectiveness of the body. The chair should lead the management body's efforts in overseeing the entity's strategy and risk management. As a result, the role of the chair is non-executive with sufficient distance and independence from the day-to-day management of the regulated entity.

The chair of the management body should contribute to an efficient flow of information within the management body and between the management body and the committees thereof, where established, and should be responsible for its effective overall functioning.

In consultation with executive senior management and other members of the management body, the chair should determine the agenda for each meeting, ensuring appropriate prioritisation of key topics. The chair should lead the management body's meetings, ensuring fair and full discussions and clear decision-making.

The chair should also encourage and promote open and critical discussion and ensure that dissenting views can be expressed and discussed within the decision-making process.

The chair should have responsibility for ensuring the composition and collective skillset of the management body remains appropriate given the nature, scale and complexity of the business. The chair should also lead efforts to review the effectiveness of the management body and design appropriate mitigation where gaps are identified (see section 4). Lastly, the chair should take responsibility for ensuring the management body and its individual members adhere to high standards of integrity and conduct.

As a result of the high importance of the chair role, ESMA considers it important that the person fulfilling the role is appointed for a standard term.

Q5: Do you agree with the expectations regarding operation of the management body? If not, please explain.

Q6: Do you agree with the expectations regarding the role of the chair? If not, please explain.

Q7: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.

8. Effectiveness and composition of the management body

Composition of the management body

39 ESMA considers that entities should be thoughtful about the skillset and time commitment needed by their management body to ensure effective oversight. Clearly, the composition of a management body must be proportional to the nature, scale and complexity of the entity it oversees. Smaller entities with relatively non-complex organisational arrangements and product offerings may need fewer skillsets on its management body than a larger entity with a relatively wide variety of the products and services offered.

40 However, in all cases, ESMA expects to be able to understand the rationale behind the skillset chosen and the vision for its future development. ESMA does not believe that skill-sets are static but instead should typically evolve with both the business and its operating environment.

41 A management body's effectiveness, particularly in its supervisory function, also depends on the time its members are able to dedicate. ESMA considers it good practice for entities and individual members to mutually agree up-front the time commitment necessary.

42 ESMA believes that diversity of the membership of the management body is an important driver of its effectiveness and strongly encourages entities under our supervision to make this a regular consideration with regard to their composition.

43 Lastly, in ESMA's experience, the same individual may be appointed to several management bodies within a wider group. Such an approach can have a negative impact on the effectiveness of a management body in light of the considerations set out in this section regarding the collective skillset and time commitment needed. For the avoidance of doubt, ESMA does not expect that all members of a management body are dedicated only to a single entity. Instead, we expect entities to be mindful of the potential effects of multiple memberships and manage them accordingly.

Proposed approach to the composition of the management body

In line with its nature, scale and complexity, an entity should ensure that the management body has an appropriate number of members. At a collective and individual level the management body should have the skills, experience and knowledge required to perform its role and duties. Entities of smaller scale and/or lower complexity will likely require fewer and potentially less specialised skillsets and experience than those of larger scale and/or complexity.

The entity should ensure a good balance between the skillsets represented at the management body.

It is noted that whilst the skillset requirements of members of the management and supervisory functions of the management body overlap, they may also differ, and the entity should reflect this in its approach to recruitment and training.

The entity should consider the time commitment needed by members of the management body and should make this transparent to existing and prospective members. Prospective members in turn should agree to such time commitment before joining the management body.

Members of the management body should also have a sufficient understanding of the entity's activities, sectors and the risks such activities entail. The skillset of the management body should evolve with the business and the environment it operates in to prevent the development of oversight gaps.

The entity should, in accordance with the nature, scale and complexity of its business, put in place a recruitment and diversity policy to ensure that a broad set of qualities and competences are considered when recruiting members of the management body. To that end, the entity should consider setting concrete objectives in terms of diversity.

ESMA acknowledges that some entities may choose to appoint the same individual as a member of multiple management bodies within a wider group. This may mean that an individual is simultaneously a member of the management body of the EU regulated entity and another entity. Whilst this may have certain benefits, it can also hamper the individual's ability to dedicate sufficient time to and focus on the EU regulated entity. Where firms chose this approach, they should consider how they will mitigate this risk and regularly review the effectiveness of their arrangements.

Reviewing effectiveness

44 ESMA considers that regular reviews of the performance of management bodies are a crucial tool to ensure their continued effectiveness. This should not be confused with the appraisal of individuals. Rather, such reviews focus on the feedback from individual members and therefore are largely based on self-reflection. They are often supplemented by a review and comparison to best practice in the industry and at peers.

45 Such reviews are typically conducted periodically, looking back over a longer period of time and identifying areas or practices where the members of the management body consider change is needed or improvement is possible. Of course, they may also serve to affirm the status quo.

46 The frequency and intensity of effectiveness reviews should be proportional to the nature, scale and complexity of the entity. Entities that operate relatively non-complex business models, whose operating environment is relatively stable, and which have recorded only moderate business growth may not need to carry out frequent reviews of the effectiveness of their management body. By contrast, entities that have a large and growing range of products and services, frequently amend their operating models (e.g through outsourcing and use of technology) and/or operate in volatile environments should regularly seek such a review. This may be because the management body no longer considers that reporting to it covers all key risks and/or that its skillset is insufficient to oversee them.

47 The management body should also consider the appropriate intensity of the review. ESMA has observed that reviews performed by external parties can provide most insightful reflections, including benchmarking against peers and the wider industry. At the same time, external reviews are typically resource and time intensive and therefore can only be used sparingly, for example where an entity has recently undergone large organisational or business changes or where the members of the management body are concerned regarding their ability to effectively oversee the organisation.

Proposed approach to reviewing effectiveness

Management bodies should regularly review their own effectiveness. Such reviews should cover at a minimum:

- The operation of the management body: meeting frequency, length, agenda, management information; the quality of discussions and the effective participation of all members; follow-up of raised concerns and agreed actions
- The management body's communication with key stakeholders within and outside the entity, including the tone from the top
- The continued adequacy of the management body's collective skillset
- The time commitment required of members of the management body
- The management body's training and education needs
- Succession and recruitment planning

The frequency of such reviews and their form should be proportional to the nature, scale and complexity of the entity. Reviews can take the form of, inter alia, self-assessments by the members of the management body, interviews with members carried out by the chair, a review by Internal Audit or the appointment of a third party with experience of carrying out board effectiveness reviews.

Training and recruitment

48 Given the importance of the management body, all entities under ESMA's supervision should have a view of the skills the body needs and where there may be potential gaps. Often, such documents are referred to as a skills matrix, in effect mapping the key business activities and risks the entity is exposed to against the collective skills of the management body.

49 This allows the management body to identify any gaps in its collective skillset. ESMA considers that entities should use this view to devise both their training and recruitment strategy in order to address such gaps. We acknowledge that most skills gaps will be closed by additional training offered to members of the management body. However, all entities should keep under consideration whether they need to recruit individuals with additional skills, especially where these cannot easily be taught to the level required.

50 ESMA acknowledges that the recruitment of additional members of the management body has cost implications and must be balanced with the interests of shareholders. However, we believe that entities can actively consider replacing leaving members with individuals who bring additional skills.

Proposed approach to training and recruitment

The management body should have a detailed view of the individual and combined skillsets it requires in order to ensure effective oversight of the entity. It should seek to close existing or anticipated skills gaps through a mix of individual and collective training as well as recruitment.

The management body should require the entity to establish training plans for its members, including external and/or specialist training where particular skills gaps exist.

All new members of the management body should receive a sufficiently comprehensive induction training, including at a minimum the entity's business model and strategy, governance and departmental structure, approach to risk management, internal control and regulatory compliance and key policies and procedures.

Q8: Do you agree with the expectations regarding the effectiveness and composition of the management body? If not, please explain.

Q9: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain

Q10: Are there any topics or areas that you would have expected to be covered or covered in more detail? If so, please explain

Annex I – Summary of questions

Q1: Do you agree with the proposed scope of application of these supervisory expectation? If not, please explain.
Q2: Do you agree with the proposed approach to proportional application? If not, please explain.
Q3: Do you agree with the expectations regarding the role and responsibility of the management body? If not, please explain.
Q4: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.
Q5: Do you agree with the expectations regarding operation of the management body? If not, please explain.
Q6: Do you agree with the expectations regarding the role of the chair? If not, please explain.
Q7: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain.
Q8: Do you agree with the expectations regarding the effectiveness and composition of the management body? If not, please explain.
Q9: Do you expect that adherence to the expectations set out in this section would be overly burdensome or otherwise difficult for your entity? If so, please explain
Q10: Are there any topics or areas that you would have expected to be covered or covered in more detail? If so, please explain

Annex II – Cost-benefit analysis

The cost-benefit approach takes into account ESMA's regulatory and supervisory experience. It presents, first, the benefits collectively for all entities and market participants including investors, issuers, users of the services provided by the entities under ESMA's direct supervision. It then, differentiates between the main costs, including compliance and supervisory costs, which are discussed accordingly.

Options	Qualitative description
Objective	The objective of these supervisory expectations is to communicate a harmonised approach to ESMA's supervision of an entity's governance structures and practices to supervised entities within ESMA's supervisory remit. By delivering a common approach, where feasible and practical, ESMA will streamline its own supervisory processes and promote a common level of conduct within the relevant entities.
Benefits	ESMA considers that by setting out our supervisory expectations in relation to governance and oversight arrangements it will provide additional clarity on ESMA's expectations in this area and ensure a level-playing field for new applicants considering applying for registration. In addition, the publication of our expectations together with the efforts by the entities under our supervision to adhere to them, should result in the further strengthening of industry practice in this space.
Costs to entities	ESMA assesses that adherence to the expectations will result in limited additional costs for the entities affected. Firstly, adherence with most expectations will require updates to existing policies and procedures or terms of reference. Some expectations may require entities to consider previously untouched areas, such as a full formulation of a management body's tone from the top. Very few expectations may result in substantial additional work, most notably in relation to the review of the effectiveness and composition of a management body. ESMA considers that none of the expectations would require entities to recruit additional employees or procure IT systems. Secondly, for firms which are smaller, have limited scope and a low complexity of operation, the expectations provide for them to seek adherence in a manner proportional to their position. Lastly, ESMA's expectations draw extensively on concepts used in existing international and EU standards. This should ensure

	that ESMA's expectations do not go over and above what might be required at national level or within other jurisdictions which the entities under our supervision are active in.
Costs to regulator	The proposed governance expectations are not considered to propose any significant or additional costs to ESMA. The purpose of the expectations is to allow for a consistent and harmonised approach to supervision across ESMA supervisory mandates. As such they are intended to reduce conflicting or overlapping approaches to supervision across ESMA supervisory mandates.
ESG-related aspects	The supervisory expectations on the management body are intended to ensure a harmonised and consistent approach to ESMA's supervision of an entity's governance arrangements. As a result all issues discussed in this CBA are of relevance to the ESG-related aspects.
Innovation-related aspects	Innovation-related aspects are not of direct relevance to the specific nature of the proposed supervisory expectations.
Proportionality-related aspects	The elements proposed apply uniformly to all credit rating agencies. The ultimate objective is the provision to the financial industry of robust credit ratings which are based on the whole spectrum of critical available information. This, by definition, cannot be mitigated by proportionality considerations.

Annex III – Proposed expectations

1. Introduction

1.1. Scope of application

1. These supervisory expectations are relevant to all firms directly supervised by ESMA. Currently, these are Benchmark Administrators (BMAs) of EU critical benchmarks and third-country recognised benchmarks, TC-CCPs that qualify as systemically important (Tier 2 TC-CCPs), Credit Rating Agencies (CRAs), Data Reporting Services Providers (DRSPs), Securitisation Repositories (SRs) and Trade Repositories (TRs).

2. Where there is a case of conflict, requirements stipulated in primary or secondary legislation will prevail over any supervisory expectation set out in this document.

3. Unless otherwise stated, ESMA considers that these expectations will also apply to any future mandates.

1.2. The management body concept

4. This document refers to the concept of the management body. This is defined as "the body or bodies [..] which are appointed in accordance with national law, which are empowered to set the entity's strategy, objectives and overall direction, and which oversee and monitor management decision-making and include persons who effectively direct the business of the entity"[10].

5. Management body is a generic term that refers to the most senior governing bodies within an organisation. A management body is composed of a supervisory function and a management function and as such includes the non-executive directors of a firm and its most senior executive managers. The management function has responsibility for the day-to-day management of the firm whereas the supervisory function is charged with overseeing the firm and its executive management.

6. Where this document refers to the management body, the expectations described apply to all its members. Otherwise, the document refers to the management body in its supervisory or management function in order to set out expectations which apply only to these respective parts It is noted that this document does not set out

[10] See Article 3(1), point (7), of CRD and Article 4(1), point (36), of MiFID II which are effectively identical.

expectations for the fitness and propriety of individuals carrying out specific functions (e.g. CEO, Independent Non-executive Directors (INEDs etc).

1.3. Proportionality

7. This document sets out ESMA's supervisory expectations in relation to governance and oversight arrangements in order to ensure their robustness and effectiveness. ESMA considers most of these expectations to be best practice and believes that entities of all sizes and levels of complexity should aim to comply with them.

8. However, ESMA recognises that some of the expectations laid out in this document can be onerous for some entities. For entities of smaller sizes and with lower levels of complexity, it will be appropriate to adhere to ESMA's expectations by designing processes which are applied with lower frequency and/or intensity.

9. ESMA will calibrate its expectations according to the nature, scale, complexity and overall risk profile of an entity and based on how these characteristics may affect investor protection, orderly functioning of markets and financial stability.

10. When assessing the nature of an entity, ESMA will consider the business and type of operations of the entity, including its market role/mission, type, diversity and criticality of products and services offered.

11. When assessing the scale of the business, ESMA will have regard to relevant factors including headcount, revenue, number of clients and products, market share, interconnections with other industries/infrastructures, ancillary services and their relationship with core services and other factors specific to the size and market impact of the entity.

12. When assessing the complexity of an entity, ESMA will consider amongst other factors, its organisational structure and arrangements (group structure/relationships, shared services, outsourcing, etc.) as well as its operational characteristics with regard to people, processes, technology, product offerings and interconnections.

13. When assessing the overall risk profile of an entity, ESMA will consider amongst other factors, its risk exposure, the strength and maturity of its internal control environment, its business culture, attitude and prevailing behavioural patterns.

14. We have specifically set out which of the expectations we consider to be subject to proportional implementation by referring to the nature, scale and complexity of the entity in question.

2. The role and responsibilities of the management body

2.1. The role of the management body

15. The management body of an entity should be empowered to set its strategy, objectives and overall direction. The management body should also be responsible for setting and overseeing the entity's overall risk management framework, including its risk appetite. Members of the management body should be fully aware of the regulatory framework and requirements governing the operations of the entity.

16. The duties of the management body should be clearly defined, distinguishing between the duties of the management (executive) function and of the supervisory (non-executive) function.

17. Subject to the provisions of national law, the management and supervisory functions of a management body may be assigned to different bodies or different members within one body. Effective governance arrangements ensure that the supervisory function oversees and challenges the management function. The latter in turn is responsible for the day-to-day management of the entity and the implementation of the strategy set by the management body as a whole.

18. Members of the management body in its supervisory function should collectively be able to effectively challenge and monitor decisions made by the management body in its management function. It is noted that different governance structures are used across Member States, typically either in the form of unitary or dual board structures. These expectations are intended to embrace all existing structures without advocating any one in particular.

2.2. Accountability and delegation

19. The management body is responsible for the oversight of the entity regulated by ESMA. ESMA expects that the management body is involved in all key decision-making in relation to the regulated entity and receives all necessary information to oversee its operation in a timely manner.

20. The management body should have the appropriate legal authority to fulfil its mandate, in accordance with applicable law.

21. Irrespective of the entity's governance structure, the management body's role, responsibilities and operation should be set out in formal documentation which should specify the decisions reserved for the management body and if and how it

may delegate certain parts of its role. Such documentation may take the form of terms of reference for the board.

22. Where delegation occurs, the management body remains accountable for such delegated responsibilities and should therefore maintain visibility of how they are addressed and be prepared to intervene if it does not meet the needs of the regulated entity.

23. Where the management body considers that key strategic initiatives or risk exposures may lead to the entity failing to meet its regulatory obligations and/or those to its stakeholders, it should require remedial actions and oversee their implementation.

2.3. Overseeing strategy setting and implementation

24. The management body of the entity should oversee the setting and implementation of the entity's business strategy. Where the entity's business strategy is determined by the management body in its management function, the supervisory function should be involved in key decisions, in particular those which could affect the entity's ability to continue to meet its regulatory and/or client obligations.

25. Where the entity is a subsidiary of a group, the group's business strategy may to a large part determine the strategy of its subsidiary. The management body of the entity should maintain a good awareness of the group's overall business strategy and the role played by the entity as the subsidiary in its implementation. To that extent, it is vital that the management body of the entity is provided with sufficient notice of any group-level discussions which may affect the entity.

26. The management body of a subsidiary should have a sufficient level of independence from the group to enable it to act in the interests of the EU regulated entity. It should consider whether key strategic initiatives set by the group pose a risk to the entity meeting its regulatory obligations including towards stakeholders, as well as market integrity and financial stability. The management body should also have the ability to escalate its concerns to the group board.

2.4. Overseeing risk

27. The management body should oversee the identification, assessment, and management of the key risks the regulated entity is exposed to. The management body should have a comprehensive understanding of the risk universe [11] applicable to the entity and the risks' relative likelihood and impact.

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[11] A risk universe is a list of the risks an entity faces, which can be combined with an assessment of each risk's severity of impact and frequency of occurrence.

28. The management body should approve and regularly review the entity's risk appetite and risk tolerance levels in relation to the key risks and define measures that enable it to monitor their status and development. To this end it receives information on risks directly from the Heads of the Internal Control Functions without interference of any other members of staff.

29. Where the information reported to the management body indicates that a part of the entity operates outside the risk appetite, the management body should ensure that appropriate mitigation action is taken. The owner of such action should regularly report to the management body until mitigation is considered effective.

30. The management body should formally establish and document roles and responsibilities of the internal control functions and approve any material changes thereto.

2.5. Tone from the top

31. The management body of the entity is responsible for setting the tone from the top. The term describes the efforts of the management body and executive senior management in ensuring a positive corporate culture that promotes and rewards honesty and integrity as well as compliance with rules and regulations. In this context, it is also noted that an entity's approach to remuneration is a vital part of its incentive structure and deserves attention from the management body.

32. The tone from the top is expressed through different means of communication, for example the entity's business strategy or a code of conduct. It is also given expression through the actions and behaviours of members of the management body and executive senior management and whether they align with the stated ethical values.

33. The management body of the entity should agree on the corporate culture it intends to establish within its organisation and how it will effectively communicate it. Members of the management body should ensure that their decisions and actions are in line with the cultural expectations communicated to the employees of the entity.

34. The management body should also seek to monitor and assess the corporate culture prevalent at the entity.

3. Operation of the management body and role of the chair

3.1. The operation of the management body

35. The management body should meet at an appropriate frequency in proportion to the nature, scale and complexity of the entity it oversees. Meetings should be of sufficient length so as to allow the full discussion of key items and the active participation of all members of the management body.

36. The management body in its supervisory function and in its management function should interact effectively. Both functions should provide each other with sufficient information to allow them to perform their respective roles.

37. Members of the management body should act with independence of mind, which is different to being independent from the perspective of an individual's connections with the regulated entity or related third parties.

38. Acting with independence of mind is a pattern of behaviour, shown in particular during discussions and decision-making within the management body, and is required for each member of the management body regardless of whether the member is an Independent Non-Executive Director (INED)[12]. All members of the management body should engage actively in their duties and should be able to make their own sound, objective and independent decisions and judgments when performing their functions and responsibilities.

3.2. Reporting and record keeping

39. Reports to the management body should ensure a balance between providing a comprehensive overview of a proposal or issue and the need to be concise. Reports should be clear on whether a decision is being sought or whether the item is brought for input or simple notification.

40. Reporting should be designed to provide the management body with a comprehensive, risk-focused view of the operations of the entity. In addition to the control functions, reporting should also include first-line and support functions, such as IT, business development and other core operational areas.

41. Given the independent role of internal control functions, they should have unfettered access to the entity's management body in its supervisory function. Internal control functions outsourced to group level should still regularly report and seek discussion with the entity's management body.

[12] For further detail on the concept of independent non-executive directors, refer to Annex II of Commission Recommendation 2005/162/EC of 15 February 2015 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

42. Members of the management body's management function and executive senior management should not prevent or interfere with the direct communication between management body and the internal control functions.

43. Where the management body's management and supervisory functions are carried out by two separate bodies (i.e. in dual board structures), reporting to each body should be meaningful and allow its members to carry out their respective function. Whilst reporting to the supervisory function may be focused on exceptions and key risks and initiatives, it must still be sufficiently comprehensive to allow for the effective oversight of the entity.

44. The management body should provide regular feedback on the quality of the reporting it receives and what improvements might be made, or additional topics might be covered.

45. The entity should ensure that a comprehensive, accurate, impartial and balanced internal record is maintained (in electronic format) of each meeting of the management body. At a minimum, such records should capture the key points of discussion including key contributors and dissenting voices, any decisions made and their corresponding rationale and agreed actions (including, for example action owners, timeline, deliverables).

3.3. Committees and pre-board meetings

46. Depending on the nature, scale and complexity of the entity, a management body may choose to create committees and task them with certain key responsibilities[9]. This can be a useful way of ensuring more detailed oversight of complex areas without involving all members of the management body. As set out in section 2.2, whilst responsibility can be delegated, the management body ultimately remains accountable for the effective oversight of the entity.

47. Other management bodies may decide that its non-executive directors have regular meetings with key function within the organisation such as key first-line departments or control functions such as Compliance, Risk, Internal Audit or other functions depending on the requirements in regulation. This can allow the members of management bodies to discuss key areas or concerns in more detail than would be possible in the setting of a board meeting.

48. ESMA considers that such arrangements can increase the effectiveness and quality of oversight and challenge provided by the management body. However, committee or pre-board meetings may result in an insufficient level of formality so that their discussions, follow-up actions and decisions are not recorded and tracked. This in turn can lead to the fragmentation of oversight by the management

body. As a result, ESMA considers that committee meetings and pre-board meetings should be recorded to a sufficient level to ensure that key discussions, decisions and follow-up actions are tracked and reported to the entire management body.

3.4. Role of the Chair

49. ESMA considers the role of the chair of the management body (or the chair of the management body in its supervisory function) is vital to the effectiveness of the body. The chair should lead the management body's efforts in overseeing the entity's strategy and risk management. As a result, the role of the chair is non-executive with sufficient distance and independence from the day-to-day management of the regulated entity.

50. The chair of the management body should contribute to an efficient flow of information within the management body and between the management body and the committees thereof, where established, and should be responsible for its effective overall functioning.

51. In consultation with executive senior management and other members of the management body, the chair should determine the agenda for each meeting, ensuring appropriate prioritisation of key topics. The chair should lead the management body's meetings, ensuring fair and full discussions and clear decision-making.

52. The chair should also encourage and promote open and critical discussion and ensure that dissenting views can be expressed and discussed within the decision-making process.

53. The chair should have responsibility for ensuring the composition and collective skillset of the management body remains appropriate given the nature, scale and complexity of the business. The chair should also lead efforts to review the effectiveness of the management body and design appropriate mitigation where gaps are identified (see section 4). Lastly, the chair should take responsibility for ensuring the management body and its individual members adhere to high standards of integrity and conduct.

54. As a result of the high importance of the chair role, ESMA considers it important that the person fulfilling the role is appointed for a standard term.

4. Effectiveness and composition of the management body

4.1. Composition of the management body

55. In line with its nature, scale and complexity, an entity should ensure that the management body has an appropriate number of members. At a collective and individual level the management body should have the skills, experience and knowledge required to perform its role and duties. Entities of smaller scale and/or lower complexity will likely require fewer and potentially less specialised skillsets and experience than those of larger scale and/or complexity.

56. The entity should ensure a good balance between the skillsets represented at the management body.

57. It is noted that whilst the skillset requirements of members of the management and supervisory functions of the management body overlap, they may also differ, and the entity should reflect this in its approach to recruitment and training.

58. The entity should consider the time commitment needed by members of the management body and should make this transparent to existing and prospective members. Prospective members in turn should agree to such time commitment before joining the management body.

59. Members of the management body should also have a sufficient understanding of the entity's activities, sectors and the risks such activities entail. The skillset of the management body should evolve with the business and the environment it operates in to prevent the development of oversight gaps.

60. The entity should, in accordance with the nature, scale and complexity of its business, put in place a recruitment and diversity policy to ensure that a broad set of qualities and competences are considered when recruiting members of the management body. To that end, the entity should consider setting concrete objectives in terms of diversity.

61. ESMA acknowledges that some entities may choose to appoint the same individual as a member of multiple management bodies within a wider group. This may mean that an individual is simultaneously a member of the management body of the EU regulated entity and another entity, potentially outside the EU. Whilst this may have certain benefits, it can also hamper the individual's ability to dedicate sufficient time to and focus on the EU regulated entity. Where firms chose this approach, they should consider how they will mitigate this risk and regularly review the effectiveness of their arrangements.

4.2. Reviewing effectiveness

62. Management bodies should regularly review their own effectiveness. Such reviews should cover at a minimum:

- The operation of the management body: meeting frequency, length, agenda, management information; the quality of discussions and the effective participation of all members; follow-up of raised concerns and agreed actions
- The management body's communication with key stakeholders within and outside the entity, including the tone from the top
- The continued adequacy of the management body's collective skillset
- The time commitment required of members of the management body
- The management body's training and education needs
- Succession and recruitment planning

63. The frequency of such reviews and their form should be proportional to the nature, scale and complexity of the entity. Reviews can take the form of, inter alia, self-assessments by the members of the management body, interviews with members carried out by the chair, a review by Internal Audit or the appointment of a third party with experience of carrying out board effectiveness reviews.

4.3. Training and recruitment

64. The management body should have a detailed view of the individual and combined skillsets it requires in order to ensure effective oversight of the entity. It should seek to close existing or anticipated skills gaps through a mix of individual and collective training as well as recruitment.

65. The management body should require the entity to establish training plans for its members, including external and/or specialist training where particular skills gaps exist.

66. All new members of the management body should receive a sufficiently comprehensive induction training, including at a minimum the entity's business model and strategy, governance and departmental structure, approach to risk management, internal control and regulatory compliance and key policies and procedures.