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## **EBF Response to the CEBS Consultation Paper on the Guidebook on Internal Governance**

The European banking industry welcomes the opportunity to comment on the CEBS Consultation Paper regarding the guidebook on Internal Governance (CP 44).

The CEBS Consultation Paper on the Guidebook on Internal Governance is one of several initiatives at European and national level which are currently undertaken or already implemented. Therefore, the EBF would like to ask CEBS to bear in mind the already implemented or currently planned initiatives before considering if further principles are necessary.

Moreover, the EBF believes that the design of internal corporate governance depends on the structure, size and business model of the concerned company. As the national provisions vary a lot, the corporate governance provisions should be adequately flexible and formulated as comply or explain-principles. In this regard, the EBF appreciates that the Consultation Paper states in **paragraph 22** that the principle of proportionality applies to all guidelines and that no "one size fits all" approach is possible.

Furthermore, regarding the group structure, it is important to note that local supervisors always refer to the social interest of the entity which they control. In this context, it is important to note however that if the liability of the management body of a parent company is increased regarding the structure, reporting lines and internal control, it is necessary that the local authorities/supervisors take more into account the group structure and reality.

Finally, the term "management body" as used in the CEBS' document is misleading  
In the CEBS' document this term refers to both the board in its supervisory function, and the executive management of an entity. As a consequence, some of the issues raised in the document referring to the management body are not clear as there is a doubt on the legal entity which is concerned. Thus, on many issues, our point of view would be totally different if the said issue is meant to refer to the executive management or to the board in its supervisory function (paragraphs 37, 39-42, 53, 97, 122). More details can be found in the specific comments.

## Specific Comments

Because of the different structures in Europe, it is necessary to make a clear distinction between the One-Tier and Two-Tier systems. The CEBS consultation paper acknowledges the differences in the systems but decides to favour none of them and avoids the discussion through referring to the functions of the boards, namely the “management” or the “supervisory” function.

In **paragraph 15**, the guidelines do not refer to the Scandinavian One and a half-Tier company structure which might impact the applicability of the guidebook if it does not fit into this particular system.

**Paragraph 16** stipulates that the Guidebook generally does not state whether a particular task or responsibility falls within the management body’s management or supervisory function. It states that this will vary according to the national legislation within each Member State. “The crux is that the task or responsibility is fulfilled.” The EBF appreciates this solution but it has to be born in mind that several areas are eventually not regulated through national provisions and therefore the implementation might be made difficult.

**Paragraph 33** emphasises the role of independent members on the management body. The EBF is well aware of the important role those members can play. However, we believe there is no need to increase the number of independent directors at the level of the individual entities of a group. Independent directors do not always offer the best possible guarantee for a sound governance of the subsidiaries, because they are often not familiar with the business or with the operating procedures. The principal aim must be the effective, efficient and sound governance of the (operational) entities. There is however a tendency to try addressing any problem by imposing formal conditions as well as structures, not taking into account the specificity of each individual company. Moreover, this principle seems difficult to apply for most wholly owned subsidiaries.

**Paragraph 36** stipulates that the management body of an institution’s parent company should understand not only the corporate organisation of the group but also the purpose of its different entities and the links and relationships between them. This includes understanding group-specific operational risks, intra-group exposures and how the group's funding, capital and risk profiles could be affected under normal and adverse circumstances. However, the management body does not have all the tools to manage the problems related to funding as the group’s interest is not recognized in national law. Moreover, local supervisors tend to adopt a protective attitude regarding the subsidiary under their control.

CEBS is trying to improve the exchange of information intra group and in particular between the parent company and its subsidiaries but it is not providing the necessary tools to do so, for instance to manage funding intra group.

In **paragraph 37**, it is indicated that "The management body of an institution's parent company should ensure the different group entities (including the institution itself) receive enough information for all of them to get a clear perception of the general aims and risks of the group". The EBF believes that it is not the role of the board in its supervisory function to deal with a day-to-day check on information received by each entity.

In **paragraphs 39-42**, CEBS mentions concerning non-standard or non-transparent activities, in particular, the use of special purpose vehicles that "The management body should only accept these activities when it has satisfied itself the risks will be appropriately managed". Once again, this is not the role of the board in its supervisory function: it has neither the time nor the means to approve particular business situations. The EBF thinks that this is the role of the executive management. More specifically, **paragraph 42** stipulates that "the same measures should be taken when an institution performs certain activities for clients". The attention should be brought on the fact that, when helping clients, the role of the bank is one of an advisor and that the bank has not the power to take decisions for its clients. Certain measures may be taken when acting for clients (advised information to the client on such matters for instance), but we do not think that, in nature, such measures can be exactly the same as the ones taken internally for the bank's own account.

In **paragraph 53**, it is indicated that "The management body should have policies for selecting, monitoring and planning the succession of its members". If this principle refers to the executive management, we agree that it is absolutely necessary to put in place policies to ensure a planned succession of the management team. However, concerning the board in its supervisory function, such assertion seems inappropriate.

**Paragraph 58** stipulates that a minimum expected time commitment for all members of the management body should be indicated in a written document (in the same way paragraph 57 stipulates that the members of the management body should have only a limited number of mandates or other professional time-consuming activities ).

The EBF does not see the usefulness of imposing such limitations as for the minimum expected time commitment or the number of mandates at European level. The existing set of national laws and regulations are sufficient for guaranteeing the required level of the directors' availability and competence and for giving companies enough room, more particularly in the standing orders of the body concerned, for determining the number of mandates acceptable in those particular circumstances.

**Paragraph 65** states that the members of the management body need to acquire, maintain and deepen their knowledge and skills to fulfil their responsibilities. Institutions should ensure that members have access to individually tailored training programmes which should take account of any gaps in the knowledge profile the institution needs and members' actual knowledge. It seems only natural for the members of the management body to keep up and develop the knowledge that pertains to their level of responsibility. For the EBF, this does not necessarily have to result in cost and time consuming "individually tailored training programmes" that could also be misused.

**Paragraph 71** recommends that the chair of the management body and the CEO should not be the same person.

There is neither empirical evidence nor academic agreement about which of these two formulas is better than the other because each one of them has advantages and disadvantages for the institutions (clear leadership or not, lack of proper checks and balances...).

Although it is not a compulsory rule but a mere recommendation, the EBF considers that this mention should be eliminated or, at least, drawn in a manner that CEBS does not consider one of them as more appropriate than the other, regardless the maintenance of the recommendation of having certain measures in the case that the same person had the two responsibilities.

**Paragraph 72 (Specialised committees) – 75 (Audit Committee) & 78 (Risk Committee)**

The purpose of Principle 10 is to provide for the organisational functioning of the institution, in that it states that the management body should define appropriate internal governance practices and procedures for its own organisation and functioning. Paragraph 72 deals more particularly with the various specialised committees that can be created. Within this context, the EBF would like to point out that the Board as a whole (collegial body) should continue to be in charge of the oversight of risk management, but indeed with the possibility (no obligation) to set up a separate risk committee or a similar committee within the Board.

A number of financial institutions have created separate committees (Risk Committee, Audit Committee, etc), whereas others combine Audit and Risk (and compliance as well, in some cases) into one Committee. Other institutions have split up the Audit Committee into a Risk Committee and an Accounts Committee. According to the EBF, this should be a possibility rather than an obligation given the principle of proportionality and the specific characteristics of each institution. More than ever before, the Board must pay special attention to risk management. However, it should also be pointed out that it is up to the chairman of the Board of Directors to speak on behalf of the Board as a whole, and by the special Committees preparing the decisions to be made by the Board. The Board's joint liability towards the shareholders must be maintained. The role of the Committees within the Board is and must stay a purely advisory role exclusively towards the Board. Taking into account that the Committees have solely a role towards the Board, they should not intervene at the general assembly unless the Chairman of the Board at its sole discretion decides otherwise. The Board of Directors determines the orientation of the company's activity and oversees its implementation. Thus, the Board of Directors reviews the main aspects of the risk policy and makes sure that the firm has built an efficient risk information and management system..

**Paragraph 81-83** impose to establish, implement and maintain effective policies to identify actual and potential conflicts of interest so they can be prevented. Without the intention of questioning the usefulness of policies such as these, the EBF draws the attention to the difficulty of drawing up a list with the maximum number of potential conflicts of interest. In this respect, the EBF also wants to stress the huge number of “written policies” institutions must comply with including, among other things:

- the responsibility of the management body (paragraph 43)
- the conflicts of interest within the management body (paragraph 60)
- a general policy for conflicts of interest (paragraph 81)
- the outsourcing policy (paragraph 86)
- the remuneration policy (paragraph 90 & 101)
- a new product approval policy (paragraph 113)
- the compliance policy (paragraph 148).

The EBF does not contest the need for nor the usefulness of policies such as these, but this will make it difficult for the financial institutions to ensure a systematic coordination and update.

**Paragraph 84** mentions that there should be internal alert procedures from the staff on internal governance concerns. It also mentions that in some Member States, there is the possibility for the staff to alert directly the supervisors on such concerns. We understand that this "external" alert is not presented as being compulsory; however, we would like to draw the attention on the fact that such type of external alert may seem inappropriate.

Regarding **paragraph 85**, even if some Member States have opened the possibility for whistler-blower, we believe this is an internal company matter which is not suitable to regulate in a Guidebook on Internal Governance.

In the introduction to **paragraphs 86-89**, it is stated that "the management body should approve and regularly review the outsourcing policy of an institution". It should be specified that this should only concern the bank's core business activities, and not all types of outsourcing.

**Paragraph 97** indicates that "Business units, under the oversight of the management body, should be primarily responsible for managing risks on a day-to-day basis, taking into account the institution's risk tolerance/appetite and in line with its policies, procedures and controls". This sentence should not be interpreted as giving to the management body in its supervisory function the responsibility of the oversight of risk management on a day-to-day basis. This would be totally unrealistic.

In **paragraph 113**, it is important to precise that it is not the task of the board of directors to approve new products and later changes. This should be left to the management body in its management function.

In **paragraphs 119-120**, it is mentioned that "The control functions should be established at an adequate hierarchical level and report directly to the management body. They should be independent of the business and support units they monitor and control as well as organisationally independent from each other". As it is stated that the control functions should be independent from the business, the EBF understands it is here referred to the management body in its supervisory function. However, we strongly support the fact that the control functions should ultimately report to the executive management and not to the board of directors. This position does not prevent the head of the control function from providing regularly the board of directors with identical or condensed information prepared for the use of the executive management.

**Paragraph 122** provides that "control functions should regularly submit to the management body formal reports on major identified deficiencies". If the management body is understood in its supervisory functions, such transmission of information should not have the consequence to by-pass the executive directors.

As a general principle, the EBF welcomes the strengthening of Risk Management.

**Paragraph 132** states that before any decision is taken by the management body, the Risk Control Function should be addressed. This rule does not fit to the independent managing of the company by the management body. Particularly regarding the example change of the senior management (see paragraph 132), it is not comprehensible for example why the change of the Human Resources' responsible would have any impact on the risk management of the bank. It should be clear that the management body is responsible for the decisions of the company (see paragraph 129 – “the accountability for the decisions taken remains with the business and support units and ultimately with the management body”). Therefore, the management body should have the discretion to involve the risk management prior to a decision. A mandatory involvement of the risk management in the decision process does not match with the legal situation in some Member States, as the management body has to manage the company independently and holds the monopoly on decision. The independence in the decision process concerns also the independence to decide, who is involved in the process and who is not. For these reasons, the decision making process in the consultation paper should be reconsidered.

**Paragraph 137** stipulates that "The group risk control function should review the consistency of the activities of subsidiaries with approved group strategy and report its findings to the management body". This task falls under the responsibility of the internal audit, but not of the risk control function.

**Paragraph 144** stipulates a potential right to veto for the Chief Risk Officer (CRO) in the decision process. This provision does not fit to some Member States' legal provisions which allow the majority principle concerning votes in the management board. A more appropriate measure seems to provide the CRO with the right to contact directly the Chairman of the Board.

**Paragraph 170:** Related parties transactions are published in the financial statements/notes in Austria. An “explanation of how they could influence the entire organisation” is in our opinion not possible because of the lack of a forecast possibility and further it's not clear what is meant by “influence the entire organisation”. Therefore we may ask to delete the wording “explanation of how they could influence the entire organisation”.

Contact Person: Elie Beyrouthy, [e.beyrouthy@ebf-fbe.eu](mailto:e.beyrouthy@ebf-fbe.eu) ; Sébastien de Brouwer, [S.debrouwer@ebf-fbe.eu](mailto:S.debrouwer@ebf-fbe.eu)  
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