Nordic Financial Unions

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NFU Response to the Basel Committee's consultative paper on revised core principles for effective banking supervision

Summary of main points

- Any sanctioning regimes must take the security and well-being of employees into account. Any framework for sanctions must clearly state that an employee must never be punished for following instructions or orders by management.
- National supervisors must not have full discretionary right to stipulate processes for nominating and appointing board members. Supervisory authorities cannot override national legislation granting employees the right to sit on company boards.
- There must be strict rules governing the power of the supervisory authorities to impose capital requirements on banks. A system where national capital requirements can vary significantly from country to country, and even from bank to bank, will lead to uneven competition between finance sector companies.
- Employees can give supervisors direct information on day-to-day practices that is not filtered through management or a board of directors. Whistle blowing is all about ensuring that early warnings from the bottom up will reach the competent supervisory authority that should have the power, the mandate and resources to follow-up on the warnings.

Specific remarks

Principle 2: Independence, accountability, resourcing and legal protection for Supervisors

Essential criteria 2: The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he

is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.

NFU does not agree with the proposed formulation. If the head of a supervisory authority is removed for reasons relating to his or hers physical and/or mental health, it should not be publicly disclosed. This is a matter of personal integrity, and should not be deemed being of public interest.

Principle 11: Corrective and sanctioning powers of supervisors

Essential criteria 4: The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 3 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking licence.

Essential criteria 6: The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.

NFU agrees that there must be sanctions in place when crimes are committed or when a finance undertaking has engaged in unsafe or unsound practices, but it must be ensured that any sanctioning regimes take the security and well-being of employees into account.

It is of the utmost importance that a company is not able to avoid sanctioning by simply blaming the individual employees. NFU supports the idea that supervisory authorities are given corrective and sanctioning powers aimed at both individuals and financial institutions, but, in particular for ordinary employees, the assumption must be that the responsibility rests with their superiors and/or the institution. Any framework for sanctions must clearly state that an employee must never be punished for following instructions or orders by management.

Such a rule must also take into account "unofficial" company policies, where an official policy is contradicted by actions of management, indirect orders or any custom at the workplace. If the person responsible for an infringement acted to the benefit of a financial institution, the sanction should generally be imposed on the institution rather than the individual employee.

Principle 14: Corporate governance

Essential criteria 3: The supervisor determines that governance structures and processes for nominating and appointing a Board member are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members.

Essential criteria 9: The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.

NFU wants to point out that the powers invested in the supervisor must not mean that the supervisor has full discretionary right to stipulate processes for nominating and appointing board members. Supervisory authorities cannot override national legislation granting employees the right to sit on company boards, and the nomination processes for such representatives that are stipulated in said legislation.

Furthermore, when it comes to ensuring that directors and board members have suitable skills and qualifications, it is not only a question of a selection process through recruitment policies. It is also a matter of training. The board members, including employee board representatives, competencies must be continuously updated to fulfil any requirements that have been deemed appropriate or necessary for the task. It is very important that companies have a strong focus on developing and maintaining board members' competencies. In this context it is definitely worth considering recurring evaluations of the function of each board with a view to improving competency and board working methods.

Principle 16: Capital adequacy

The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses.

Additional criteria 2: The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks.

NFU believes that there must be strict rules governing the power of the supervisory authorities to impose capital requirements on banks. All financial market companies should be subject to the same duties and controls. A system where national capital requirements can vary significantly from country to country, and even from bank to bank, will lead to uneven

competition between finance sector companies. This will in turn lead to market instability and losses for employees, customers and the society at large.

Regarding distribution of capital within different entities, such distribution mechanisms must be accompanied with proper safeguard mechanisms, but not only for shareholders and creditors. It must be absolutely certain that any funds transferred from one entity to another do not lead to a situation where reduced profits for companies are balanced with reduced personnel costs. It is also highly important that any such transfer is accompanied with proper information and consultation procedures in relation to the employees of the company in question.

Principle 29: Abuse of financial services

Essential criteria 9: The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilise adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.

Essential criteria 10: Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.

NFU fully support these criteria, and believes that finance sector employees have a vital role to play in the sound governance of finance sector companies. Employees are crucial as a source of information regarding the day-to- day practices in financial undertakings, and are in some respects in a unique position in relation to ensuring that the competent authorities are made aware of adverse developments that can constitute a serious threat to financial stability or to market confidence.

Employees can give supervisors direct information on day-to-day practices that is not filtered through management or a board of directors. From the employee perspective, ensuring sound and efficient "whistle blowing systems" would be appropriate in the context of enhanced supervision. Whistle blowing is all about ensuring that early warnings from the bottom up will reach the competent supervisory authority that should have the power, the mandate and resources to follow-up on the warnings.

Whistle blowing would not only ensure a fast and efficient "point of entry" for supervisors, but also provide employees with a measure where their concerns are taken seriously. On-site supervision is an excellent opportunity to establish such a system.

Such systems should not only be designed to deal with blatant criminal offences, but should also be designed to pick up on risky and unsound business practices. As pointed out in Principle 9, EC 7, supervisor should maintain sufficiently frequent contacts as appropriate with

the bank’s board, non-executive board members and senior and middle management, with a view to understand and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. NFU believes that this approach should be extended to also include regular contacts with employees. This could be done in a way where the supervisors consult with employee representatives in a suitable way, be it through anonymous “hot-lines” or scheduled, consultative meetings with trade unions or other employee representatives.

NFU agrees that it is of the utmost importance that employees are not punished in any way for contributing to identifying and eradicating systemically unsound practices.

About NFU

Nordic Financial Unions (NFU) is the voice of the employees in the Nordic financial sectors. We are an organisation for co-operation between trade unions in the banking, finance and insurance sectors of the Nordic countries. Through our eight affiliated unions in Denmark, Sweden, Norway, Finland and Iceland we represent 160 000 members – a vast majority of the employees in the Nordic financial sectors.

Yours faithfully,

NORDIC FINANCIAL UNIONS (NFU)

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