

15 June 2010

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sirs

Re: Consultative Document: Principles for Enhancing Corporate Governance

We welcome the opportunity to respond to the referenced consultative document (CD) on behalf of the members of the Association for Financial Markets in Europe (AFME). A description of AFME and its activities are attached hereto. For a list of our members please consult our website at www.afme.eu.

We share the view of the Basel Committee on Banking Supervision (the Committee) that there is a need to re-visit the principles of corporate governance in banks in the light of failures and lapses which have come to light in some banks as a result of the financial crisis that began in mid-2007. We have also engaged in the consultation processes conducted by Sir David Walker in the UK and by the UK FSA.

We think that the proposed revised guidance will facilitate a more focused review of corporate governance practices by each bank and by bank regulators globally. We also agree with the Committee's assertion that the boards and senior management at each financial institution have an obligation to pursue good governance in addition to understanding their own risk profiles (risk appetite/tolerance).

Our concerns centre on the need for the Principles to more explicitly recognise a small number of key concepts, including:

- that the corporate governance structure of a subsidiary or branch should reflect the appropriate use of group structures and oversight by the parent; and

- permitting, to the extent appropriate, global groups of companies to continue to monitor and manage their operations on a group-wide basis rather than on a legal entity basis.

We strongly endorse para 6 of the CD which clearly notes that the proposed guidance is not intended to establish a new regulatory framework to be layered on top of existing national legislation, regulation or codes. We concur that the implementation of the proposed principles should be proportionate to the size, complexity, structure, economic significance and risk profile of the bank and the group (if any) to which it belongs. We also agree with the Committee's view expressed in para 17 that sound governance can be achieved regardless of the form used by a banking organisation so long as several essential functions are in place. For example this may include oversight by the board, oversight by senior management, direct line supervision of different business areas and independent risk management, compliance and audit functions. However, it will be necessary for the bank regulators in each country to carry forward this perspective in implementing the principles and policies discussed in the CD within the context of their local legal and regulatory frameworks. Thus, it is critical that a prescriptive regime not be promulgated by the Committee.

We do have some comments pertaining to the discussion of corporate government principles (Part III of The Consultation Document) and to the discussion pertaining to the role of supervisors (part IV).

- Paras 25 and 37 regarding succession planning should reference the practical point that a board of a subsidiary will be subject to the influence of its parent in making decisions such as these.
- Para 27 should recognise the role of senior executive management-- as distinguished from the board which may have more of an oversight role in many jurisdictions -- in setting and enforcing lines of responsibility and accountability throughout the organisation. The board through its oversight of senior management as described in para 26 should ensure that a bank's organisational structure facilitates good governance.
- Para 28 should recognise the direct role of senior management in ensuring the regular review of policies, processes and the control functions while differentiating the board's responsibility to ensure that the control functions are set up to operate independently and efficiently. The board should satisfy itself through its meetings and other interactions with senior management (and others if deemed necessary) that the control functions along with the policies and procedures of the bank are robust, appropriate and proportionate.

- Para 37 would benefit if footnote 17 were incorporated into the para (but without its parenthetical example), since it describes the key characteristic of independence in a board member.
- Para 47 suggests that boards may find it useful to consider the occasional rotation of the membership and chairmanships of their special committees. We would suggest that the para indicate that any rotation of the membership or of the chairmanship of a board committee should be subject to the first priority of maintaining the quality and depth of expertise of the committee in question. For example, it is very difficult for large and complex banks to find experienced chairmen who are well versed in the bank's complex products and services, and it is fitting that experienced incumbents have a long utility. Other examples would be the chairmen of board audit and risk committees where experience and a solid understanding of the underlying functions are essential to the role, if it is to provide the appropriate oversight, independence and challenge to the executive.
- Para 49 - we would suggest that this para recognise that in many cases the boards of subsidiaries of banking parent companies may not need a separate board audit committee, for example if the parent board's audit committee has taken full responsibility for that function in the subsidiary, subject to the law and regulations of the jurisdiction in question.
- Para 59 states that "The board of a regulated banking subsidiary should adhere to the same corporate governance principles as those expected for its parent company absent other legal requirements or reasons of proportionality". This statement implies that the starting point for a large subsidiary is that it should replicate all of the corporate governance structure utilised by its parent although there is recognition that the group dimension is likely to affect the corporate governance structure of both parent and subsidiaries "to a certain extent". Similarly, para 62 requires a subsidiary to set its own corporate governance responsibilities, whilst noting that it should check that group-level decisions and practices do not cause it to breach any rules applicable to it.

We note the reference to the proportionality in para 59 but believe that more could be done to allow for the many different situations that may prevail, in particular:

- o We believe it would be useful to make clear that the extent to which the principles should be implemented by a particular

subsidiary will be for the board of that entity to decide, subject to review by its supervisor (see section IV);

- o As subsidiaries typically will benefit from the corporate governance structures applied at the parent level and the oversight of group employees, there should be no presumption or requirement that a subsidiary should replicate exactly the same structure as its parent;
 - o In particular, the benefits of ensuring harmonised standards and achieving a global view of risks point to the use of firmwide committees (with appropriate regional and entity representation) rather than establishing equivalent committees for each relevant entity. We also believe, however, that there may be cases where it will make sense to have entity-specific committees operating in coordination with equivalent firmwide committees.
 - o For example, banks with firmwide audit or risk committees may also choose to establish one or more entity-specific committees to ensure detailed focus on the specific risks carried in the group's major subsidiaries.
 - o In addition, we suggest that there is less of a need to have non-executive directors or independent members on the boards of subsidiaries or on their committees (see Para 52);
- Para 69 - we do think that the dual-hatting of the CRO should be acceptable where the board determines that the result will be a more integrated and focused risk management system. In fact, this arrangement has worked very well in some global banks. We would propose that the para read in pertinent part: "Whatever the title, at least in large banks, the board should consider whether the CRO role should be held separately from other executive functions and business generating functions. A bank board may decide that it is appropriate for its CRO to have another executive role, provided that the other role must be part of a control function or other function posing no direct conflict with a control function". For example, a CRO should not also be a director of sales or trading under normal circumstances. However, a CFO, a Chief Compliance Officer or similar senior executive role (subject to the party's experience and the specific role envisioned, etc.) could also be the CRO, if a board has determined that such is the most efficient and practical way forward. As noted in the comments on Para 73 below, the board's decision will be significantly affected by the final decision on the scope of risk to be covered by the CRO role and the oversight responsibility and liability associated with the role.

We are concerned that the prescriptive nature of Para 69 as currently worded would unduly curtail a board's authority to manage the affairs of

the bank as it considers appropriate. It would also undercut existing and effective risk management systems in place at some large banks. We are concerned that the current wording would create a box-ticking exercise with potentially counter-productive, unintended consequences.

- Para 73 - this does not distinguish among the multitude of risk types which banks manage. Some risk areas are managed by control functions (such as legal, compliance and Internal Audit) which have independent reporting lines up through to the board (or one of its committees) and are not overseen or directly managed by roles such as those of the CRO or CFO. It has been suggested by our members that—provided there is appropriate coordination with these other control functions—the most appropriate focus of the CRO and the risk management function is financial risk. On this basis we suggest that the para should read as follows: “The risk management function is responsible for identifying, measuring, monitoring and reporting on financial risk exposures and for advising on the control or mitigation of such exposures. This should encompass all financial risks to the bank, on-and-off-balance sheet and at a group-wide, portfolio and business-line level.”
- Para 84, please see our response to Para 73.
- Para 99 - it would be appropriate to add a reference to risk management to the list of functions with which non-executive directors have a right to meet regularly.
- Principles 12 and 13 - Parent bank boards are generally oversight bodies that are not charged with managing the daily activities of the company. Principles 12 and 13 should be modified to reflect this oversight role or at a minimum should be revised to refer to “the board and / or senior management” as appropriate. In a complex financial institution, there will be many subsidiaries and SPVs and it is impractical for a board to be aware of the details of individual entities to the degree suggested. The Principles should explicitly recognise the concept of materiality, policy review and the ability to delegate.

The Role of Supervisors

- Para 135 should include a statement that it is ultimately the responsibility of the board to structure its control functions in a way which best fits its business model as well as noting that “one size does not fit all”.

- Para 139 should also stipulate a process which would ensure reasonable consideration of the views of the bank board in question and which would prevent arbitrary determinations or remedial orders.
- Para 140 should provide for an appeal process where a bank considers a remedial order to be unfair or ill considered. The ultimate decision should be outcome focused. This might be addressed by the introduction of an independent party.

Yours faithfully

A handwritten signature in black ink, appearing to be 'WJ Ferrari', with a stylized, overlapping structure.

William J Ferrari
Managing Director

AFME (Association for Financial Markets in Europe) was formed on November 1st 2009 following the merger of LIBA (the London Investment Banking Association) and the European operation of SIFMA (the Securities Industry and Financial Markets Association). AFME represents a broad array of European and global participants in the wholesale financial markets, and its 179 members comprise all pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with SIFMA in the US, and the Asian Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association), and provides members with an effective and influential voice through which to communicate the industry standpoint on issues affecting the international, European, and UK capital markets. For more information including a list of our members please visit the AFME website, www.AFME.eu.