

Comments on the Consultative document of the Basel Committee on Banking Supervision on Corporate governance principles for banks

About EAPB:

The European Association of Public Banks (EAPB) gathers member organizations (financial institutions, funding agencies, public banks, associations of public banks and banks with similar interests) from 16 European Member States and countries, representing directly and indirectly the interests of over 90 financial institutions towards the EU and other European stakeholders. With a combined balance sheet total of about EUR 3,500 billion and a market share of around 15%, EAPB members constitute an essential part of the European financial sector.

We welcome the opportunity to respond to the Basel Committee on Banking Supervision's (BCBS) consultation on revised guidelines for corporate governance principles for banks. We support the purpose of the guidelines in general, whose aim is to build a framework to achieve robust and transparent risk management in banks, and promote public confidence in the banking system. Nevertheless, we would like to provide some comments on the proposed principles which we believe helpful in order to improve the proposed principles.

INTRODUCTION

• para. 13 – Applicability, proportionality and differences in governance approaches

In our opinion, one should be cautious when introducing a single set of standards of corporate governance since governance standards for financial institutions have been subject to comprehensive revision through the adoption of the CRD IV/CRR package in the European Union. However, one of the key issues could be to identify a set of principles that companies could as a minimum be subject to, taking account of the different frameworks existing within the EU. Therefore, we support the reference to proportionality aspects according for example to the size and the risk profile of the

bank as mentioned in paragraph 13. A certain element of flexibility could be built into these principles. These principles would represent a minimum level of compliance. The principles should also be subject to regular review and updating.

- **para. 15:**

We would like to stress the importance of drawing a distinction between the functions and duties of the chairperson of the board of directors and the chief executive officer. These functions should be clearly divided and should preferably not be combined in one person. Moreover, the mandatory implementation of such a requirement may not be appropriate in smaller companies with limited shareholder bases. The potential risks of combining the two roles can, in some cases, be mitigated by other counterbalancing measures. However, the introduction of measures in this area should not involve changes to systems that have already successfully addressed this issue. Jurisdictions with a dual corporate governance structure strictly separating between management and supervisory functions should be acknowledged and respected by the BCBS corporate governance principles for banks (e.g. para. 43).

PRINCIPLE 1: Board's overall responsibilities

- **para. 28–29 – Corporate culture and values**

In our point of view, introducing strict definitions of acceptable and unacceptable behaviour would be difficult to implement in practice since this might constitute a second layer of rules to the detriment of legal certainty. The legal systems of the Member States (civil, criminal and administrative law) as well as European law already foresee regulations of lawful and unlawful behavior so that the rules for behavior are already clearly defined.

PRINCIPLE 2: Board qualification and composition

- **para. 52 – Board member selection and qualifications**

We believe that the mandatory requirement to establish a nomination committee should be rethought taking into account proportionality aspects. The establishment

of a nomination committee could be regulated in a way similar to the voluntary establishment of a board committee foreseen in para. 62.

PRINCIPLE 3: Board's own structure and practices

- **para. 62–66 – Board Committees:**

As a general remark, we believe that it is essential that directors devote sufficient time to their role. However, we believe that introducing a European-wide absolute limit on the number of the mandates held would not be the best way to achieve this result. Increased oversight within the company regarding the type of non-executive roles directors are taking on coupled with greater transparency and accountability of the performance of the board are perhaps areas that the BCBS should further consider.

We would recommend that any measures taken in this regard should be on a recommendation basis. Requirements should allow enough flexibility, taking into account the size and complexity of the company and also the specific mandate (responsibilities and work load on other boards). Further, it should be taken into account whether other/further mandates held by a board member are within the same group of companies or not.

Moreover, special attention should also be given to directorships held by executive directors, whose functions by definition require greater involvement.

- **para. 67 and 70 – Audit and risk committees:**

In our opinion, the proposed principles should leave sufficient leeway for situations where the chair of a committee or the chair of the supervisory board is chairing another committee. This could also contribute to a better overview of issues which need special attention of the supervisory board. In addition, this would be in line with the stipulations foreseen by the recently adopted Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

PRINCIPLE 8: Risk communication:

- **para. 125–130 – An effective risk governance framework requires robust communication within the bank about risk, both across the organisation and through reporting to the board and senior management.**

It is crucial that the board defines a company's risk appetite and its risk strategy, taking into account the interests of the shareholders it represents. Also, a meaningful and consistent risk reporting to the shareholders is important. Boards should ensure that control systems are effective and in accordance with the company's risk profile. The board should then monitor how the executives deliver the strategy and hold the executives accountable, and be responsible for reporting on performance. The results of all these findings should be reported on a regular basis to shareholders.

However, regular reporting of risk appetite as such may be more appropriate to a financial institution in which managers are in a position to alter risk appetite according to the desires of investors rather than to non-financial companies more generally. In non-financial companies, the risks concerned often have more to do with the nature of the business itself. A decision regarding those risks will have already been taken when the company decided to enter the particular market. These are better termed "risk factors" than "risk appetite". Consequently, we believe that effort should be made to develop a set of key principles on how these risk factors should be disclosed by non-financial companies to encourage greater comparability across companies and across markets.

Consequently, recent developments in national legislation, in corporate governance codes or in supervisory regulations have led to defining and clarifying the role of boards with regard to the responsibility on risk strategy. Therefore, it can be doubted whether at this time new rules are necessary.

PRINCIPLE 9: Compliance

- **para. 131 – The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function.**

First of all, it would be desirable to define the Compliance function uniformly, since there are inconsistencies between the definition of the BCBS and the European Supervisory Authorities. According to the European Securities and Markets Authority (ESMA), the Compliance function within an investment firm is responsible for identifying, assessing, advising, monitoring and reporting on the investment firm's compliance risk. However, in respect of the BCBS, this function is responsible for ensuring compliance with laws and regulations only regarding to regulated (compliance) areas of the company's operational legal environment.

Even if the independent compliance function is a key component of the bank's second line of defense, there are no unified EU rules for the first and third line. However, the same regulatory framework of the compliance function is needed for the main sectors, because without the major common principles the risk of incoherent and inconsistent application might lead to future failures.

Comparing the compliance function to the others in the internal control functions, it can be stated that the regulations of the Internal Audit and Risk Management are clearer and more detailed than the one related to Compliance.

- **para. 132:**

Paragraph 132 mentions the importance and the situation of the Compliance function in the whole organization and that the board should ensure its independence and integrity. However, we believe that a clear proposal is needed on whether the bank should demonstrate its compliance – both – to the management and to the public, or whether it would be sufficient to demonstrate it only to the management. Moreover, if the publication is necessary, the respective channel for the publication is also in question. We would recommend that it should be publicized on the organization's website in the form of a Compliance Commitment/Declaration.

- **para. 135:**

Before mentioning any type of trainings and qualifications, the exact definition of the standard Compliance function should be determined. It should be determined, among others, whether the Compliance function is responsible for the bank's whole compliance or only for those problems which appear in their field.

In this paragraph, it is mentioned that the staff should be educated about the compliance issues, however, minimum competency and qualification standards for the Compliance function are lacking. Moreover, the National Competent Authorities (NCA) should be charged with ensuring that proper professional training is available for the Compliance Officers.

- **para. 136:**

In paragraph 136 the separate reporting is prescribed, but the frequency of this task is not mentioned. This can cause concerns because of different practices, so the same reporting frequency as for other internal control functions should be determined, because handling the complete and global information from the internal control functions separately from each other is not acceptable. Besides, the other questionable part of paragraph 136 is to whom the Compliance function should report, because the subject of the report can be determined by the responsible body.

Additionally, it is crucial to ensure that there are no obstacles and that no undue influence can be exerted that could prevent the prudent reporting obligations of the Compliance function (e.g. someone's prior checking, legal signature, other forms of prior approval).

- **para. 137:**

Based on paragraph 137, the Compliance function must have sufficient resources, but the independent budget for its operators is not clear. Without this condition, the independence of the Compliance function can be damaged. Mentioning the role of the board, they have to determine whether the level of the Compliance Officer's bonuses and other incentives should be linked to the financial results of the company or the whole group.

The important question of the Compliance function's access to the Internal Audit's work is not mentioned at all. To resolve this problem, the circumstances should be determined and assessed in order to ensure a proper conduct of the Compliance function by setting main principles about the right of access to the Internal Audit's work. A comprehensive solution to this problem could be to:

- o Ensure the independent organizational operation of the Compliance function, determining the content of the independence in case the Compliance function is not clearly separated from other functions such as the legal department;
- o Measures to ensure its independence from other independent functions such as internal auditors at least annually in a documented way;
- o Approval of the local supervisory authority if the smaller firms cannot appoint a separate Compliance Officer.

The BCBS document “Principles for enhancing corporate governance” mentions that “While the board is responsible for the overall compensation system for the bank, this does not mean that the board or its compensation committee is responsible for determining compensation for large numbers of individual employees. The board should, however, develop and issue the compensation policy for the bank as a whole, determine the bonus pool, and review and approve compensation for senior management and for the highest paid non-executive employees in the firm.”¹¹ In order to ensure the independence of the compliance function, the bonuses/remuneration of the head of the compliance office should be addressed as well. These questions are very important in respect of the prohibition or the permission of any remuneration, linked to the business result of the company or of the whole group for compliance employees.

- **para. 138:**

According to paragraph 138, the Compliance function’s responsibilities include compliance with the rules regarding reputational risks for the bank, bribery, money laundering, country sanctions, fair treatment of the consumer and practices raising ethical issues. We believe that the extension of the responsibility to the reputational risk is questionable since the BCBS’s responsibility for the reputational risk is not entirely clear.

PRINCIPLE 12: Disclosure and transparency

- **para. 154 – The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.**

We believe that the focus should be on listed companies, but it also should be taken into consideration that promoting development and application of voluntary codes for non-

listed companies is worth of further consideration particularly where such companies have wide public ownership (e.g. through employee share schemes) or are traded on a public market.

ⁱ 1. BCBS (2010): Principles for enhancing corporate governance, p 25