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Document Title: EBF's Comments on BCBS consultative document concerning Corporate Governance Principles for Banks – October 2014

General Comments:

The European Banking Federation (EBF) welcomes the opportunity to provide its comments to the BCBS consultative document concerning the revised Guidelines on Corporate Governance Principles for Banks of October 2014. The EBF considers that the revised principles broadly reflect the existing high standards of corporate governance in banking sector, as implemented in the European regulations, although not in all instances.

The revised principles represent a visible evolution of expectations with regard to responsibilities imposed on a Bank's Board. However, it is the opinion of some members of the EBF that these expectations often go too far with regard to scope and expected level of commitments. In this regard we believe that the management's and board's functions should be well distinguished as they play different roles from a corporate governance stand point.

Furthermore, we think it is important that the revised principles take different corporate governance systems duly into account, since there are significant differences in the legislative and regulatory frameworks across countries regarding the governance structure. In describing different corporate governance systems, a distinction is often made between the Anglo-American model/the one-tier model (the United States and the United Kingdom) and the Continental European Model/the two-tier model (the countries in continental Europe, particularly Germany). There are, however, more corporate governance models that must be considered when a recommendation or principles are decided.

Some of the principles seem to be contradictory; therefore, further elaboration is required.

It is the EBF's view that the principle of proportionality as well as a general principle of relevance merits greater emphasis. Even though it is mentioned in paragraph 13 of the guidelines, it receives little reference throughout the paper. The principle of proportionality as well as a principle of relevance should apply in particular to subsidiaries of SIFs and smaller institutions.

We regret that the reference to accounting and financial information (and thereby, the role of the Finance function) is nearly absent from the proposed guidelines. Aside from a rather stand-alone

requirement related to the Audit Committee, this dimension is not conveyed by the proposed guidelines. Yet, we consider that financial and accounting data are fundamental tools which allow sound Corporate Governance to develop. As a matter of fact, they convey relevant, formalized and robust information to stakeholders and provide a common, consistent language to capture key issues or weaknesses and assess situations, at various levels of the Corporate Governance framework. For instance: risk appetite and strategy will be significantly informed by financial data; the capital and liquidity situations are assessed on the basis of accounting and financial information; prudential ratios that are key drivers of the banking industry are most of the time prepared and monitored by the Finance Function. We think that the importance for banks to maintain a robust Finance function responsible for accounting and financial data should be mentioned, as well as the necessity for Corporate Governance actors to refer (each in their own scope of responsibility) to appropriate sets of financial or accounting data. In particular, we think the BCBS could introduce such reference in principles 1 (part "Risk appetite, management and control"), 4 (paragraph 93), 5 (paragraphs 94 & 95), 7 and 8.

Moreover, we believe that the current revised principles impose an ever growing requirement of independence on Board members. This is a problem for the banks operating typically in a group structure. One should not try to deny use of ownership control, a basic feature of a limited company. (The problem concerns also other types of banks such as cooperative or savings banks.) In CRD IV it is enough to have certain non-executive directors. The revised principles have defined an independent director as non-executive and additionally is "not under any other undue influence, internal or external, that would impede the board member's exercise of objective judgment". It is not clear what 'undue influence' means, therefore, we would welcome clarification.

Specific Comments:

Introduction

1. Paragraphs 12 and 14

As already mentioned in paragraph 12, we would like to highlight the importance of a well-balanced and adequately flexible guidelines to reflect the significant differences in the legislative and regulatory frameworks across the countries regarding the governance structure.

However, there appears to be inconsistency between paragraph 12, which states that *'[t]he Committee recognises that there are significant differences in the legislative and regulatory frameworks across countries, which may restrict the application of certain principles or provisions therein'* and paragraph 14 which provides that *'[t]he principles set forth in this document are applicable regardless of whether or not a jurisdiction chooses to adopt the Committee's regulatory framework'*. We believe that consistency is required between these principles.

Principle 1: Board's overall responsibilities

2. General comment

Generally speaking the role of the board should be clearly differentiated from the role of the senior management. For instance, the board should not fulfil the day-to-day duties of the senior management, which might be implied by the prescriptive terms used to define the board's overall responsibility.

We believe that certain terms used in the revised guidelines confer a role which is too operational on the board. We support footnote 10 that states that the board has the ultimate responsibility and consequently is not directly accountable of the elaboration and implementation of the business. In

order to promote checks and balances, the board shall have an oversight role and cannot approve the implementation of the bank's capital adequacy, compliance policy or establish corporate culture. It cannot be assimilated to an operational function as this would undermine its supervisory power.

3. Paragraphs 20

In our view a general statement that the board has ultimate responsibility for key personnel decisions establishes an excessive scope of responsibility for the board. We further believe that the board should not be made directly accountable for the decisions adopted by the management in every event, but only when the board supervises or agrees to those decisions.

4. Paragraph 23

With regard to the 6th bullet point of this paragraph we believe that the board should approve and oversee only the key plans and policies, as the total amount of such plans and policies may be extremely large. The same applies to paragraph 40; only the key policies should be approved by the board.

Similarly, with regard to the 7th bullet point we believe that the board should oversee the performance of key senior management and not every member of the senior management.

Principle 2: Board qualifications and composition

5. Paragraph 48

Given the role assigned to the nomination committee in some jurisdictions, we consider that the first sentence of paragraph 48 should be amended as follows: 'Boards, **or where appropriate companies' nomination committee**, should have a clear and rigorous process for identifying, assessing and selecting board candidates.'

6. Paragraph 49

It is not clear what a term 'independence of mind' means in this context. We would welcome clarifications.

7. Paragraph 50

We consider it excessive to take into account all the past positions held by the candidates, regardless of how long ago the candidate has left those positions, in order to evaluate possible conflicts of interest of Board candidates.

8. Paragraph 52

It states that '*[t]he bank should have in place a nomination committee or similar body*'. Considering that the principle of proportionality should be given greater weight, we propose replacing the word "should" with "should, if deemed appropriate", taking into account the context of the business, the overall size and structure of an institution.

Principle 3: Board's own structure and practices

9. Paragraph 60

Regarding the role of the chair, in the revised principles a new provision is included in a very prescriptive way that the chair of the board should be '*a non-executive board member and not serve as chair of a board committee to promote checks and balances*'. Taking into account that the document is based on principles, we understand that this mandatory statement is beyond the scope of the Guidelines.

It is our understanding that no single formula will necessarily best fit all cases and each bank must be able to analyze the costs and benefits entailed by one governance structure over another, factoring in various matters, such as the internal organization and the nature, scope and complexity of their activities, their size, the robustness and sufficiency of their internal control systems, the requirements of domestic governance codes etc.

The next paragraph of the guidelines (61), in which banks are advised to have measures in place to achieve appropriate checks and balances would make it unnecessary to include the imposition stated in paragraph 60. Therefore we believe paragraph 60 should be removed.

Moreover, the possibility of the chair of the board also chairing other board's committee exists in some EU Member States. We believe that this should continue to be allowed under proportionality principle expressed in paragraph 13.

Also, another question which rises following this paragraph is whether the chair of the board should be also independent.

10. Paragraphs 62-69 (Board Committees)

We consider it desirable that the document, as far as the presence of independent or non-executive Board members is concerned, should state a regime similar to the one in the CRD IV Directive. It would also be very convenient to foresee the possibility that some of those committees could assume several functions, on a proportionality principle basis.

11. Paragraph 62

Paragraph 62 states that the specialized board committees established by the board should be created and mandated by the full board. This is a new provision and the requirement of unanimity for such decision should be clearly stated in the charter of the board and in any case, this requirement may interfere with the national applicable legislation. Therefore, we consider that instead using the word "should" it should be replaced with "should, if deemed appropriate".

12. Paragraphs 63

Paragraph 63 requires that *"The board should consider the occasional rotation of members and of the chair of such committees as this can help avoid undue concentration of power and promote fresh perspectives"*. We consider that the said rotation would be difficult to achieve in small boards. Furthermore we believe that "fresh perspective" could be guaranteed by the access of external expert advice, as allowed by paragraph 69.

Accordingly, we suggest rephrasing the paragraph as follows: *"The board should consider – **on strict proportionality principle basis and according to its size** - the occasional rotation of members and of the chair of such committees as this can help avoid undue concentration of power and promote fresh perspectives"*

13. Paragraph 66

Paragraph 66 mentions that "A committee chair should be an independent, non-executive board member". Considering the restrictive conditions set to the chairs of the committees (board chair should not serve as a chair of any board committee, both the chair of the audit committee and risk committee may not be chair of the board or any other committee), we understand that at least 2 (two) independent members must exist. This condition is difficult to fulfil in the case of some credit institutions (where, according to the legislation in force, the minimum required number of board members is 3 (three)). Therefore, we believe that this should be also read in connection with the proportionality principle.

14. Paragraph 67

Paragraph 67, bullet 3 mentions that “The audit committee should have a chair who is independent and is not the chair of the board or any other committee.” The new provisions are extending the conditions to be fulfilled by the chair of the audit committee and in practice, the new conditions might be difficult to fulfil.

Bullet 4 states that “The audit committee should be made up entirely of independent or non-executive board members”. We consider that this condition should be better explained, considering that the two notions “independent” and “non-executive” are not comparable and/or similar.

The existing EU regulations require only to have a chair for the audit committee who is independent. Therefore, we believe that this should be also read in connection with the proportionality principle.

15. Paragraph 68

We suggest that the audit committee’s responsibilities and duties should be stated in a less prescriptive way (for example bullet 6 mentions the responsibility of overseeing, which is not clear in what specific attribution this is translated into), and, in particular, that the last bullet of this statement regarding the overall risk governance framework should be eliminated since it could be one of the risk committee’s functions.

16. Paragraph 70

This paragraph requires that the risk committee of the board: *‘should have a chair who is an independent director and not the chair of the board, or any other committee’*. Having the Chair of the Risk Committee as a separate individual to the chair of the Audit Committee may be difficult in a small institution or a subsidiary with few independent directors. Therefore, we believe that this requirement should also be subject to the principle of proportionality.

Also, it is required that it “should include a majority of members who are independent”. This condition might be excessive, considering that the risk committee is usually composed by a small number of members. In this context a majority of independent members might be exceeding the envisaged requirement.

It should be noted that the texts of CRD IV and CRR do not comprise provisions related to such conditions to be fulfilled by the chair of the risk committee and its members.

Furthermore, in the 7th bullet point, there is a requirement to review the bank’s risk policies at least annually. Considering the amount of policies banks have today (and more will be written due to these guidelines) this is a heavy burden. Only the key policies should be reviewed annually.

Also, the term “risk policies” is too general and should be properly defined, in order to clearly state what really is intended to be reviewed by the Risk committee in terms of risk policies. In this respect please consider that the types of internal regulations in force in a credit institution may considerably vary in terms of content.

17. Paragraph 74

According to this paragraph the risk committee should meet periodically with the audit and other risk-relevant committees. Although members of sub-committees are also members of the full board it is important that for instance, the risk sub-committee meets with the remuneration committee to make sure that incentives are compatible and aligned with risk appetite. However, this requirement

should be subject to the proportionality principle; for example smaller subsidiaries may not have a remuneration committee.

18. Paragraph 75

We believe that the reference to the 'Compensation Committee' should be replaced with the wording '*Remuneration Committee*' which is more appropriate and inclusive.

19. Paragraph 76

We suggest amending the first bullet point of this paragraph as follows: "*Nominations/human resources/governance committee*: provides recommendations to the board, **or where appropriate to the shareholders' meeting**, for new board members and members of senior management; (...)". In some jurisdictions the sole task of the nomination committee is to propose decisions to the shareholders' meeting on electoral and remuneration issues and, where applicable, procedural issues for the appointment of the following year's nomination committee.

Moreover, we believe that the reference to the 'Ethics/compliance committee' should be replaced with the wording 'Conduct and Compliance Committee', which seems more appropriate.

Principle 5: Governance of group structures

20. Paragraph 80

We believe that this paragraph needs to be further clarified, considering the treatment of conflicts of interests within the group.

21. Paragraph 97

We suggest changing the adjective "independent" (corporate governance responsibilities) to "own" or "particular", which is more appropriate from an internal governance perspective.

22. Paragraph 99

We consider the criticism of "complex structured finance transaction", based only in view of a possible wrong use by clients as inappropriate: this reference should be eliminated.

23. Paragraph 101

We support the board having the ability to commission an independent report of on structures that they consider maybe complex or opaque, in order to assist their own understanding, but stress that the requirement to do so should be at the board's own discretion.

Principle 6: Risk management

24. General comment

We believe that principle 6 has to be clarified since there is a difference between risk control function and risk control and risk management function and risk management on the other side, cf. paragraph 44. Principle 6 deals with the second line of defense and the title should therefore be "Risk control function and Risk control" and not Risk management. The term risk management can be used for activities both in the first and the second line of defense.

25. Paragraph 109

We do not agree with the requirement to disclose publicly in all cases when the CRO is removed from his/her position. While we could accept disclosure to a supervisor, we believe that the requirement to publicly disclose such information for a non-public company does not meet the proportionality principle.

While we understand the necessity to strengthen the role of the CRO within the risk governance framework, there are still a few aspects which need to be detailed. It should be clarified when the reasons for the removal of the CRO should be discussed with the supervisor and what the objective of such a discussion is. Also, considering that the board committees are consultative committees, it should be emphasized that the CRO's performance, remuneration and budget should be endorsed by the risk committee and the remuneration committee and approved, on a case by case basis, depending on the specific provisions of national legislation and afterwards be approved by the board.

Principle 8: Risk communication

26. Paragraph. 127

We consider that the "material risk-related ad hoc information" should be properly defined/detailed.

27. Paragraph 128

We welcome the reference to risk reporting being conveyed "in a concise and meaningful manner". It is important not to overload the Board members, to ensure that they focus on key material risks.

Principle 11: Compensation

28. General comment

We believe that the reference to 'Compensation' throughout the text should be replaced with the word '*Remuneration*' which is more appropriate and inclusive.

29. Paragraph 144

We consider that this statement significantly increases the scope of responsibility of the board, as it confers on the board the duty of the overall oversight of the compensation system for the entire bank. This exceeds the provisions set out in CRD IV applicable to banks, where the remuneration policies for which the board is responsible refer only to risk takers.

Principle 13: The role of supervisors

30. General comment

The role of the supervisors in this area, and in particular the content of the evaluations, must be perfectly consistent with the Supervisory Review Evaluation Process (SREP) stated in the CRD IV Directive and assumed by EBA and ECB. In this view, the Principle 13 gives rise to several elements of uncertainty, therefore making the supervision process very unpredictable and vague, in terms of object, tools and aims.

31. Paragraph 165

This states that "Supervisors should interact regularly with boards of directors, individual board members...". This, together with the reference to an "open dialogue" process including the use of very informal communication tools such as mails and phone calls could conflict with the collective nature of the board.

The individual interactions are definitely not compatible with the structure of the board and its committees, and not consistent with the non-operational nature of the board. Indeed, such interactions with board members who are neither chair of the board nor chair of a committee may lead to a risk of disorganization: this would be counter-productive and would undermine the objectives of the corporate governance principles that banks put in place.

While specialized board committees may be established in order to allow deeper focus in specific areas, it would not make sense for the supervisors to discuss one of those areas with a board member individually other than the chair of the committee specifically dedicated to the matter at stake. The exchange of information would not be efficient and could be even confusing as the board members are not supposed to be day-to-day interlocutors.