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Consultative document corporate governance principle for banks

FRENCH BANKING FEDERATION RESPONSE

The French Banking Federation (FBF) is the professional body representing the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 450 commercial and cooperative banks. FBF member banks have 40,000 permanent branches in France. They employ 400,000 people and serve 60 million customers.

From a general standpoint, the FBF feels that:

- Some of the wording of the guidelines should be adapted in order to give more flexibility (The FBF will propose changes hereunder in each principle).
- The European Capital Requirement Directive IV (directive 2013/36/EU of 26 June 2013, hereafter referred to as "CRD IV") is already a comprehensive regulation in force in the EU that has considerably strengthened corporate governance in banks, focusing in particular on the board supervisory missions as well as its role in the risk area.
- The FBF regrets 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, such 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, formalised 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; capital and liquidity situation is 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...

The FBF thinks 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, the FBF thinks the BCBS could introduce such reference in principles 1 (part "Risk appetite, management and control"), 4 (item 93), 5 (items 94 & 95), 7 and 8.

- The FBF suggests that the BCBS should refrain from formally defining the concepts of “Duty of Care” and “Duty of Loyalty” as these concepts are a matter for national or European regimes.

Introduction

Jurisdictional differences

Point 12

As an overarching principle, we believe that guidance regarding effective corporate governance should be principles-based, balanced and adequately flexible to reflect different national structures and business models. Adopting such an approach would allow the guidance to be used by the widest range of banking institutions as banking institutions around the world have significant differences in size, structure and environment. It would also allow corporate governance principles to function in an optimal manner. For instance, we appreciate the fact that the definition of “board” encompasses the different national models. However, we feel that the missions given to the board of directors in the principles are often of an executive nature. Indeed, it is the case in certain European countries, but not in all.

Applicability, proportionality and differences in governance approaches

Principle 1: Board’s overall responsibilities

- **Role of the Board**

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.

The FBF agrees with the definition of the board's responsibilities if it is understood as an oversight responsibility. In that respect, the FBF considers that certain terms used by BIS confer a role which is too operational to 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, establish corporate culture; it cannot be assimilated to an operational function as it would undermine its supervisory power.

For example:

- ✓ Points 23 and 24: all action verbs should be deleted. The board do not establish, develop, monitor, approve or ensure. The Board should oversee that the bank strategic objectives are dealt with in the right way.
- ✓ Similarly, point 28, the board will not set corporate value, neither promote risk awareness within a strong risk culture, neither ensure that employees, including senior management are aware of the action that will follow unacceptable behaviour.
- ✓ Point 40 this is not the board's job to "approve compliance policies that are communicated to all staff".
- ✓ Neither point 42 "the board should regularly review policies and controls"

Slight wording modifications would be sufficient to address these comments

- **Corporate culture and ethic**

The FBF is in full accordance with BIS guidelines aiming at emphasis corporate culture and values. However, sometimes, the proposed guidelines go very far in that subject and even might be counterproductive. The FBF agrees on point 29 which state that behaviour that could lead to any reputational risk or improper or illegal activity should be disallowed. But the second bullet point goes much too far while stating that "employee are expected to conduct themselves ethically in addition to complying with laws, regulations and company policies". How the company could evaluate what is ethical conduct and what is not?

- **Whistleblowing**

Point 30

The FBF agrees on the necessity of a whistle blower policy and scheme. However, to be efficient and to ensure *bona fide* warning, it should be stated that the identity of the whistle-blower shall accompany the warning.

Point 26

The FBF suggest the following amendment:

"In discharging these responsibilities, the board should take into account the interests of the shareholders and the legitimate interests of the company which shall include the interests of depositors and other relevant stakeholders".

Principle 2: Board qualifications and composition

Point 45

The FBF fully agrees with the necessity of having a sufficient number of independent directors. However, in fully owned or controlled subsidiaries, it might be difficult to reach a sufficient number of independent directors, in particular given the rules limiting the number of directorships that a single person may hold. The FBF asks for flexibility for such entities within banking groups.

Point 52

If the board deems it to be in the interest of the bank to have a former executive sitting on the board there should be no waiting period provided that other appropriate processes mitigate the potential conflicts of interest *(footnote n°13).*The FBF requires a clarification concerning the constitution of the nomination committee. Indeed, as specified in point 76, the nomination committee shall not be compulsory.

Principle 3: Board's own structure and practices

Point 57

With regards to the assessment of the board, the proposed Guidelines establish that the board should carry out regular assessments of individual board members. We agree on the need to carry out periodic evaluations of the board. However the board is collegial by nature. Performance should not be assessed on the individual basis, provided that the board makes decisions in a unified way (as a collegiate body). Assessing the performance of each individual member would undermine the collegiate nature of the board and we believe it would be inappropriate. Therefore we suggest deleting the reference to the individual performance assessment

It is suggested that the assessment of individual board members should be done "at least annually". The board members' skill, knowledge, experience and independence are assessed during the nomination process and we agree that it might be useful to regularly check those point. However, this frequency seems to be not viable in practice. As it is part of a comprehensive global process, it would be more realistic to have it done every 3 years.

Point 60

We do not understand why the chair of the board should not serve as chair of any board committee given that he or she would satisfy the same requirement to be independent or a non-executive member of the board.

As a consequence, we suggest amending the wording as follows:

"To promote checks and balances, the chair of the board should be a non-executive board member."

Point 66

To fit the definition of "independent director" a board member is definitely a non-executive board member. However, a non-executive board member does not automatically qualify as an independent director. As a consequence, we are of the opinion that the criteria should be alternative and not cumulative: "A committee chair should be an independent **or** a non-executive board member".

In the same line, point 70 third bullet point shall be amended.

Point 68

We do not clearly understand what kind of third party BIS is spotting in this sentence. In any case, the third party opinion shall not be compulsory. The board might decide that this overview is one of the risk committee's functions.

Point 70

Third bullet point is too prescriptive. We do not see why the chair of the Risk committee cannot chair the board. We feel that BIS shall give some leeway to the corporate governance of each bank and not be too prescriptive, which might lead to outstanding implementing challenges.

Sixth bullet point: The board, through its risk committee, could be overwhelmed by information. The board is not here to manage the day-day business of the company. Only major policies shall be reported to the board, the one that have an impact on the bank strategy. Thus a slight change of wording is needed. The risk committee of the board "should discuss all risk strategies on both and aggregated basis and by type of risk and make recommendations to the board on the **major risks** ~~thereon~~, and on the risk appetite."

Point 82 and 83

The rigorous review and approval process followed by members before they engage in certain activities such as serving as board members shall be moderated. Otherwise, banks might have difficulties to implement it. This is particularly true for listed companies.

We do not think that it would be relevant to publicly disclose the policies on conflicts of interest.

Principle 4: Senior management

Principle 5: Governance of group structures

Point 95

Here again, the board of directors of the mother company, to remain efficient, cannot be loaded with too many missions that would make it impossible for him to handle in practice. For instance, it is not realistic to consider that the board of directors has sufficient resources to directly monitor compliance of subsidiaries with all applicable legal, regulatory and governance requirements. Alternatively, is should be stated that the board of directors must ensure that the subsidiaries have sufficient resources to monitor such compliance.

Point 100

In the same line of idea, the terms “and the board as appropriate” shall be deleted as it would not be realistic to consider that the board of directors could fulfil those operational missions.

Principle 6: Risk management

Point 103

In the third bullet point, the FBF does not agree on the idea that the board is in charge of implementing the wide-enterprise risk governance framework which includes the bank’s risk culture, risk appetite, RAS and risk limits, even with the risk management support. The board can ensure that the framework exist and is in line with strategic options but not implement it.

Point 109

It is stated that appointment, dismissal and other changes to the CRO position should be approved by the board or its risks committee.

Under the CRD IV, the CRO is appointed by the senior management although his dismissal cannot be decided without the prior approval of the board of directors. Moreover, the CRO has, under certain circumstances, a direct access to the board of directors.

The FBF is in the opinion that flexibility shall be allowed concerning the modalities upon which more independence is given to the CRO. As a consequence, the wording of the BCBS principle shall be amended in that respect.

Principle 7: Risk identification, monitoring and controlling

Point 124

The risk management function cannot report all its findings concerning mergers and acquisitions to the board or its risk committee but only the ones having a material impact. The FBF thus suggests reporting to the board such findings “as appropriate”.

Principle 8: Risk communication

Point 127

A clarification would be welcomed. The wording could be slightly changed:

“Material risk-related ad hoc information that requires immediate decisions or reactions should be promptly presented to senior management ~~and~~ **or** the board as appropriate”. In fact, if a decision requires an immediate decision, it could be counter-productive to present it promptly to both the senior management and the board.

Point 130

According to this point Banks should avoid organisational “silos”. It should be clearly stated that Chinese wall does not imply the existence of organisational “silos”. Furthermore there is an issue concerning the “sharing of information”. Information relating to clients, personal data, business information, information on units of the bank is not to be wide shared across the bank organisation. Therefore, the FBF would like BIS to clarify what means “avoid organisational “silo” that can impede effective sharing of information across an organisation since footnote 25 is not very clear underlying the case of business line and geographic units being run in isolation.

Principle 9: Compliance

The FBF is in a view that BIS should clarify the role of various functions in the bank. In our point of view:

- The legal function is responsible for saying the rule.
- The compliance function shall transpose the rule into good practice that will guide the business in its operational day to day work (by ensuring the compliancy of the policies, giving advice and controlling the respect of compliance rules).
- The audit function is controlling.
- The risk function is managing all risks that are not compliance risks.

Point 132

The FBF considers that the text is going too far by implying that the compliance function should ensure that the bank observe the spirit as well as the letter of the law. If the FBF agree that in some case there is a “spirit of the law” some laws are clear enough so that there is no need to invoke the spirit of the law. In fact, it could be dangerous in the sense that a clear law should not be interpreted. Compliance might have a true added value when the law require the implementation of a full scheme.

We feel that the words “high standards” put on too much pressure and are not very clear. We are on the opinion that those words should be deleted.

The scope of the compliance should be clearly defined. The FBF has a clear preference for the wording of point 139 (please, see below).

Point 136

The words “”The compliance function is independent from the management” shall be read “the compliance function shall be independent from the business management”. Indeed the Compliance function cannot be independent from the senior management.

Point 136 and 137

The direct access and reporting of the compliance function to the board (points 136 and 137).shall be, as provided for the risk function (point 103), and for the Audit function (point 141) "as appropriate".

Point 138

The FBF agrees that the "areas of special focus by the compliance function include those that could create reputational risk for the bank, including bribery, money laundering, country sanctions." However it should be clearly stated that these areas of special focus should not be excessively extended. The FBF is in favor of a clearly defined scope concerning the compliance function. If the boundaries of the compliance function are not clearly set this could weaken the compliance function. For instance according to this point compliance function include "fair treatment of the consumer and practices raising ethical issues". The FBF consider that this is too vague; the scope of compliance cannot be extended indefinitely. Furthermore some ethical issues are not always considered as compliance issues for the FBF. The banks should have some flexibility and be allowed to manage their social and environmental and social responsibilities independently from the compliance functions.

Principle 10: Internal audit

Point 141 and 142

It is stated that the internal audit function should be accountable to the board. Its reports are provided to the board without management filtering. Given the non-executive mission of the board, is it realistic to provide it with such a volume of information?

Principle 11: Compensation

Point 146

The reference to the CRO and the head of the internal audit function shall be deleted as the power to determine the remuneration of those persons remains with the senior management (CEO).

Principle 12: Disclosure and transparency

Principle 13: The role of supervisors

Point 159

"Supervisors should establish guidance or rules…" There is a great deal of legal uncertainties if the supervisors are enabled to create rules where *"national laws, regulations, codes or listing requirements regarding corporate governance are too generic…"*. Furthermore, regulatory guidance can sometimes be dangerous since the supervisor is both judge and party. We should make sure that the supervisors are not drafting powers toward themselves. It should be clearly stated that the supervisor should not usurp power that belong to other bodies (legislators, etc.).

Point 160 and 165

Supervisors can hear board members individually. This, together with the reference to an "open dialogue" process including the use of very informal communication tools such as mails, phone calls, etc. 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 dizorganisation: this would be counter-productive and would undermine the objectives of the corporate governance principles that banks put in place.

While specialised board committees may be established in order to allow deeper focus in specific areas, it would not make sense for the supervisors to discuss about 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.