

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

Via e-mail: baselcommittee@bis.org

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Principles for Enhancing Corporate Governance

We are writing in response to the Basel Committee on Banking Supervision March 16, 2010 invitation to comment on the Principles for Enhancing Corporate Governance. We welcome the opportunity to comment on the draft Principles.

Institutional Shareholder Services ("ISS") is the corporate governance business of MSCI Inc. ISS advises 1,300 institutional investor clients on 40,000 general meetings each year in over 100 global markets. We examine board issues, executive compensation, shareholder rights & takeover defenses, and social and environmental shareholder proposals. Our recommendations are based on ISS' transparent proxy voting policy built on client and industry outreach.

General Remarks and Comments

As a strong proponent of enhanced and coherent corporate governance principles within the banking sector, ISS supports the introduction of the new Principles. During the financial crisis it became evident that many corporate governance deficiencies were present in the banking, insurance, as well as other sectors. ISS therefore welcomes the new guidelines which will assist banking organizations in enhancing their corporate governance framework and also offer supervisors a reference point when assessing the quality of those frameworks. As a general comment, ISS strongly supports the following guidelines:

- The board should approve and oversee the implementation of the bank's overall risk strategy, including its risk tolerance/appetite.
- Senior management should implement appropriate systems for managing the risks - both financial and non-financial - to which the bank is exposed. This includes a comprehensive and independent risk management function and an effective system of internal controls.
- Banks should have an independent risk management function (including a chief risk officer or equivalent) with sufficient authority, stature, independence, resources and access to the board.
- The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.

We notice that the content of the Principles for Enhancing Corporate Governance to a great extent concur with the International Corporate Governance Network (ICGN) Corporate Risk Oversight Principles¹. There is however a slight difference in the objectives, as the ICGN Principles are intended to help investors assess how well a portfolio company's board is effectively overseeing risk management, while the Basel Principles are intended to assist banking organizations in enhancing their corporate governance frameworks. Nevertheless both principles address many of the same key issues, such as for example the roles of responsibility of the board and management. According to the Basel

¹ Please refer to the *ICGN Corporate Risk Oversight Principles*, enclosed to this email.

Principles the board is responsible for approving and overseeing the implementation of the bank's overall risk strategy, including its risk tolerance/appetite, while the senior management is tasked with implementing appropriate systems for managing these risks, including a comprehensive and independent risk management function. We notice that the ICGN Principles also make a clear distinction between risk setting and risk management. Boards are responsible for approving corporate strategy and risk tolerance, while the management is responsible for designing and implementing a risk management system.

There are also noticeable differences between the two sets of Principles, for example, the ICGN Principles focus attention on proactive engagement between the board and active shareholders. To name one specific example the ICGN Principles state that boards should make available to shareowners one or more communication channels for periodic dialogue on governance matters, including the board's role in risk oversight, shareholders should also regularly be invited to express views and concerns regarding strategy and risk oversight.²

Monitoring

While ISS is a strong supporter of the Principles for Enhancing Corporate Governance, we would like to stress that emphasis should not only be put on the material context of the Principles but also on the compliance of the Principles. ISS thus believes that it is important that there are suitable structures for monitoring in place in those markets that implement the Principles. In a recent Study³ released by the European Commission several important types of corporate governance monitoring and enforcements activities were identified. Here we would like to stress the importance of two enforcement bodies: market-wide monitors and shareholders.

Market-Wide Monitors

In the Study to the European Commission, it was concluded that in many markets there are already market-wide monitors⁴ or other specialized institutions, which are responsible for verifying, for example, the availability of information disclosed in corporate governance statements etc. This formal verification of the publication of information is a valuable function of market-wide monitors because it ensures that the information is available to the market. However, soft regulations, such as corporate governance codes, do not guarantee a satisfactory level of disclosure and market players might still face a lack of qualitative and comprehensive governance input which might impede them from making informed decisions.⁵

While the Basel Principles recommend that the governance of banks be adequately transparent to their shareholders and there are a few explicit examples of information that should be made available for shareholders, we feel that the recommendations are fairly open-ended. We note that the ICGN Principles in many cases take the disclosure requirement a step further and specifically state what information should be made available for shareholders, and how often this information should be published.⁶ Thus we remain somewhat concerned that unless there are clear guidelines on what information should be made publicly available, the disclosure level will not be sufficient for

² See *ICGN Corporate Risk Oversight Principles*, pp.7

³ Please refer to the *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*, pp.61, available at

http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf

⁴ Market-wide monitors and enforcement bodies refer to financial market authorities, stock exchanges, trade bodies and professional organizations, and financial press, analysts and academics.

⁵ See *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*, pp.179

⁶ See *ICGN Corporate Risk Oversight Principles*, pp.10

shareholders or other stakeholders to fully evaluate the banks' risk strategy and risk management systems.

Shareholders

The ICGN Principles focus much attention on the need of oversight by shareholders. According to the publication, boards and shareholders have a joint responsibility to engage in substantive and effective communication on corporate risk oversight. Communication models and methods for this should not be any different than for other corporate governance matters. However, the topic of corporate risk oversight is a subject on which boards and investors should specifically engage.⁷

In the Study to the European Commission, ISS noted that during the past couple of years the EU has focused on providing shareholders with sufficient rights while less action has been dedicated to the question of how to encourage shareholders to use their rights. One of the key findings of the Study was that, while there exists a small community of active investors, many shareholders were reluctant to use their rights due to a lack of incentives or because of free-rider problems.⁸ Therefore, merely providing rights to shareholders might not in itself lead to a significant increase of shareholder involvement in monitoring and enforcing corporate governance codes or other best practice reference documents, such as the Basel Principles. However, we still believe that if given access to timely and comprehensive information, active shareholders will be able to make informed decisions and promote good corporate governance through active exercise of shareholder rights.

Final Remarks

Full and quality disclosure is the only market mechanism by which shareholders and other stakeholders will be able to monitor and compare the risk profiles of different banks and the risk processes in place to mitigate these risks. ISS believes that each market should ensure effective oversight of the Principles and believes that the section 'the role of supervisors' could be complemented with a recommendation for supervisors to monitor the amount of information available to shareholders and other stakeholders. While we do not expect supervisors to make judgments about the quality of disclosure, it would be desirable to have a body responsible for verifying that accurate and comprehensive information is easily accessible for shareholders. ISS would also welcome a review process to be undertaken periodically to assess the overall effectiveness of the Principles and a review across markets on the level of compliance with the Principles, as well as the quality of information available to shareholders and other stakeholders.

ISS would like to thank the Basel Committee on Banking Supervision for the opportunity to provide comments on the Principles for Enhancing Corporate Governance and we trust that you will find the above comments and suggestions useful. We remain at your disposal if you would like to discuss our comments in further detail.

Yours sincerely,



Jean-Nicolas Caprasse
European Governance Head



Tomi Lakkonen
Governance Research Analyst

⁷ See *ICGN Corporate Risk Oversight Principles*, pp.3

⁸ See *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*, pp.185