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Secretariat, Basel Committee,

Bank for International Settlements

CH-4002 Basel, Switzerland

Dear Sir/Madam

I am writing, in my personal capacity, to comment on the Draft Guidance on Corporate Governance. I have been involved in bank supervision and regulation and as a board member of a D-SIFI and Chair of its risk committee, and I recently was the Project Director for the Group of Thirty Report entitled 'A New Paradigm, Financial Institution Boards and Supervisors'. There are many things in the Consultative Document I agree with. I have two comments in areas that I believe require modification. In each of the two areas I provide suggestions for redrafting.

First, the document does not adequately distinguish between the role of boards and management in Principles 1 and 4, and the statement of board responsibilities is too broad. Often, the language used is notably stronger in the case of the board, vis a vis the language used to describe management responsibilities, and the responsibilities placed on the board go beyond what their responsibilities actually are, or could reasonably be. Boards that are too involved in management's responsibilities can themselves be a source of problem. The concept of board oversight and effective challenge are missing from the document. Five examples follow that should be corrected:

- Paragraph 20, which is the key initial paragraph stating board responsibilities, says that "the board has ultimate responsibility for the bank's business strategy and financial soundness, key personnel decisions, internal organisation and governance structure and practices, and risk management and compliance obligations". In fact its responsibilities for internal organisation, governance structure and practices, and risk management and compliance are shared with management, and the board's responsibilities in those areas are for effective oversight. The wording should be amended to say "the board has ultimate responsibility for...key senior personnel decisions, and for effective oversight of internal organisation.....risk management and compliance".

- The use of the word 'ensure' in para 21, and other paragraphs and the footnote that accompanies it is misplaced. Other documents, including those of the G30, only use the word ensure in much more focussed ways. This paper says that "Throughout this document, the phrase 'the board should ensure' is used to convey the Committee's view that a board of directors has ultimate responsibility for the bank's adoption of the necessary processes, policies, procedures, controls and hiring of sufficient staff to achieve the function or objective described." This again is an area where the board's responsibility is for effective oversight and challenge and for satisfying itself about various matters. I believe that this description of the boards responsibility needs to be altered to remove or severely circumscribe the use of the word 'ensure', and the use of concepts such as ultimate responsibility for all procedures, controls, and hiring of sufficient staff. Instead the concept of effective oversight should be introduced into the text.

- Paragraph 22 indicates that the board is to "monitor the bank's adherence to the RAS, risk policies and risk limits". Taken literally, this implies the board would be totally supplanting many roles in management and the various lines of defence. The relevant section in Principle 4 on senior management responsibility does not include a responsibility to adhere to and monitor adherence to limits. Rather it says only that senior management should report limit breaches to the board. Wording should be introduced such as " the board should monitor the bank's adherence to the RAS, and regularly satisfy itself as to compliance with risk policies and risk limits". That would allow the board to rely on the various lines of defence, provided it conducted various activities periodically to validate and verify that reliance.

- Similarly, paragraph 42 says that the board " should ensure that the risk management compliance and audit functions are properly resourced and effective". The board does need to oversee these functions, and satisfy itself about the resourcing and effectiveness of these functions based on effective oversight, challenge, focus and periodic independent reviews and benchmarking, together with its own observations. Again, the use of the ensure concept and wording is not appropriate. Rather, the notions above, which describe effective oversight and reliance based on reasonable inquiry, should be introduced into the text. Also, senior management in Principle 4 should have a parallel, strongly worded, requirement for proper resourcing and effective operation of these functions.

- Paragraph 44 indicates that the board should "ensure that senior management knowledge and expertise remain appropriate..." Again the 'ensure' concept is inappropriate. The wording of the parallel responsibility on senior management in Principle 4 should be strengthened.

My second comment relates to the section covering the responsibilities of supervisors. The document does not adequately recognise the challenges that supervisors face in interacting effectively with boards and in assessing corporate governance. Nor does it recognise that traditional supervisory methodologies need to be adapted to be able to assess board effectiveness. In that sense the document is not balanced in putting demands on both supervisors and boards to 'up their game'. The issue of supervisory capacity is referred to almost in passing in Paragraph 163. It deserves a separate paragraph or section.

- A short section should be added along the lines of that contained in the G30 New Paradigm document. This should indicate that supervisors should attract and develop staff with the necessary skillset to deal effectively with governance issues. They should develop and use a methodology for assessing governance that recognises how boards operate and the complex judgements involved in assessing board effectiveness. They should involve senior staff in these judgements particularly for large complex institutions, and should strive for comparable treatment of institutions. They should also consider establishing internal centers of excellence to assist front-line teams in supervisory assessments of governance, and to help supervisors remain current with governance trends.

- Paragraph 165 covers supervisors' communication with boards. Much of this is welcome and would go a long way to enhancing effectiveness of the relationship. The paragraph indicates that "Supervisors may also provide insights to the bank on its operations relative to its peers, market developments and emerging systemic risks". Many board members have indicated that they find these insights very valuable in performing their responsibilities. This should be elevated to a requirement on supervisors by making this something that the BCBS thinks "should" be done.

- The document should do more to promote two-way communication, including more from supervisors to boards, who can benefit from supervisory insights. Often supervisory communications to banks do not adequately highlight issues that should be of more concern to boards. In Paragraph 165 wording should be added to indicate that "in those interactions supervisors should be prepared to share their insights on the bank and discuss supervisory findings that supervisors believe are particularly important to board members".

Sincerely yours,

Nick LePan