

POSITION PAPER



WSBI-ESBG response to the BCBS consultation on the Guidelines “Corporate governance principles for banks”

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WSBI-ESBG welcomes the opportunity to comment on the Guidelines “Corporate governance principles for banks” (“Guidelines”) issued by the Basel Committee in October 2014.

WSBI-ESBG members all share the objective of improving corporate governance based on the considerations of the authorities, central banks and the Basel Committee. It should contribute to explicitly state the main functions and responsibilities of the board of directors and the senior management. However, WSBI-ESBG considers that the allocation of some functions and responsibilities should be clarified in order to avoid interpretative problems.

WSBI-ESBG would also like to take the opportunity of these comments to illustrate these principles in light of current practices which show the relevance of this renewed Corporate Governance which, although already mostly applied in some countries, could be a very useful source of inspiration for others.

As a preliminary comment, WSBI-ESBG would like to emphasise that the governance structure of its members is diverse (savings banks, cooperative banks, retail banks, mutual associations, foundations). Many savings banks are based on a dualistic governance model, with management functions on one hand and those of control on the other. Each of these functions is assigned to two separate bodies: the executive board, responsible for the management, and the supervisory board, responsible for monitoring the executive board’s management. Each of these bodies is collegial, which limits risk, particularly in management decisions. Moreover, it is impossible to participate in both organs simultaneously. Therefore WSBI-ESBG appreciates that the Guidelines do not advocate for any specific board or governance structure. However, whenever possible the dual system of corporate governance should be given the possibility to implement the principles (see Principle 1).

WSBI-ESBG would also like to highlight that not all parent institutions own 100% of the shares of their subsidiaries. Therefore, the Guidelines should recognise that some parent institutions have limited powers to control whether the subsidiary is compliant with all rules (see Principle 5).

Principle 1: Board’s overall responsibilities

WSBI-ESBG fully supports that a fundamental element of good governance is to be based on **ethical and responsible values**, as stated in the Charter for Responsible Business which was adopted by WSBI-ESBG members in May 2008.

Savings and retail banks carry the following founding principles: transparency, solidarity, proximity, sustainability, responsibility, service and democracy.

To assist a board or committee to fulfil their mandate in accordance with these values, savings and retail banks usually define a set of principles and practices that have been brought together within a code of ethics.

In addition, in some savings and retail banks, any member of the board when taking office has to sign an act of commitment to respect the code of ethics which is based on the following key princi-



ples: to act in conformity with regulatory requirements governing the banking sector as well as with the cooperative or mutual principles. At least, the compliance with regulatory requirements is a part of employment contracts for executive board members in dual-board structures.

We would also like to highlight some aspects which may be problematic in the case of dual systems of corporate governance:

- We believe that the **board's explicit responsibilities** listed in the Guidelines do not completely suit dual-board systems. Some of the responsibilities, e. g. strategies or internal organisation, are carried by senior management in dual-board structures. We therefore believe it would be useful to distinguish between management and oversight functions at this point of the guidelines.
- For instance, according to the consultative document, the board in its oversight function has – in addition to the **selection of the members of senior management** - a duty to select the heads of the control functions. We believe this contradicts the division of functions within a dual board structure, in which senior management is responsible for selecting executive staff below management board level. Hence, the proposed regulation on the selection of management members should reflect the conventions of a dual board structure to a larger extent.

As for the accountability and the **responsibility of board and senior management**, according to the consultative document, members of senior management are to be held accountable for their actions, based on predefined sanctions, should they not fulfil the requirements and expectations of the board. We believe the sanctions required in such an event are already defined by the existing laws and regulations under civil, administrative and – if need be – criminal law, from our perspective. Against this background, we believe it is unnecessary and difficult to establish any internal-company sanctions. Therefore, we consider that, in no. 44, the part “and enumerate the consequences if those actions were not aligned with the board's performance expectations” is not necessary. Should the sanctions mentioned in the consultative document merely refer to the performance-based remuneration of the management, a clarification in the text would be welcomed.

Turning to the **whistleblowing process**, not all indications provided by employees through the whistleblowing process require the board's acknowledgement or action. From our perspective, it should be made clear that the competent office collecting employees' notices (for instance, the Compliance office) is authorised to evaluate the incoming information, and to decide on further measures to be taken. Involvement of the board should only be required in the case of potential major violations of regulations.

Principle 2: Board qualifications and composition

Generally speaking, **independent members** are part of savings and retail banks' boards. However the requirement to have a sufficient number of independent directors in the nomination committee may be considered as exceeding what is foreseen in some jurisdictions, in particular in the European



Union. We are also of the opinion that requiring that the risk committee must have a majority of independent directors goes too far.

An important point entails that the requirement to establish a **nomination committee** (or similar body) should depend on the size and internal organisation of a company, as well as the nature, scope, complexity and risk potential of a company's business activities, and should not be mandatory for all institutions. We consider that the text should be amended accordingly, in consideration of the principle of proportionality and of different jurisdictions (as mentioned in no. 48, footnote 12).

Another feature of the majority of our members' boards is based on the **diversity of their members**, from diverse socio-professional circles who are representatives of local communities and employees. Some of the characteristics of these boards are as follows:

- Savings banks' boards are mainly composed of managers/administrators representing members and are therefore representatives of diverse areas where savings banks are located. Moreover, they live on the territory of their savings bank and are also frequently engaged in professional activity, which allows them to keep a strong link with the socio-economic fabric of the region and with the members that they represent and listen to their expectations.
- In addition, it is important to highlight that the board of savings banks includes not only shareholder representatives of the private or social economy sector, but may also include representatives of local authorities or of employees. This indicates another specificity of the governance of savings banks, which is bringing together different stakeholders on its board, and pledging a foundation in their territories.
- Finally, within the boards of some savings banks (in particular in France), employees are represented twice: once by member employees, and once by the assembly of the employees.

In practice, for savings and retail banks - like any other credit institution - a **control mechanism of the reputation, experiences and competences of the members of the board** of the savings and retail banks is set up and run by the national competent authority.

The **training of board members** is obviously an essential component of effective and balanced governance. This training is sometimes ensured by a dedicated entity in savings banks (e.g. the National Federation of Savings Banks for the BPCE Group in France).

Moreover, amongst the topics of concern for a savings bank's board (which have been defined for instance in France by the decree implementing the banking law dating from July 2013) are:

- ❖ System of Governance (role and responsibility of the board, ...)
- ❖ Presentation of the savings banks (history, markets, key figures, organisation, ...)
- ❖ Accounting and financial information (balance sheet, asset-liability management, accounting result, budget, ...)



- ❖ Strategic planning and its implementation (business and financial results, strategic project from 2014 to 2017, ...)
- ❖ Internal control and risk management, ethics (supervisory bodies, nature of risks and implementation of internal control, internal organisation plan, ...)
- ❖ Legal and regulatory requirements (Basel III, supervisory bodies, ...)
- ❖ Banking Markets and Financial Markets (Different financial markets, the role of financial markets ...)

Principle 3: Board's own structure and practices

With regards to **evaluation**, a self-assessment process is being carried out in boards of savings and retail banks. The aim is to assess the functioning of the board, to bring out the strengths, the areas for improvement and to derive action plans to improve the effectiveness of the boards in the performance of their missions.

This approach:

- Contributes to a more efficient functioning of the body (better understanding of the responsibilities, more efficient teamwork, better delineation of tasks ...);
- Strengthens the relationship of trust within the company;
- Strengthens dialogue and transparency by allowing each member to express his point of view; and
- Can help to alleviate or anticipate problems.

The evaluation covers the following topics:

- ✓ Composition and functioning of the board;
- ✓ Quality and clarity of the documents submitted to the board;
- ✓ Quality of the transmission of information in session;
- ✓ Quality of deliberations and animation of meetings;
- ✓ Completion of the tasks entrusted to the board;
- ✓ Assessment of the commitment within the board;
- ✓ Deepening of work themes;
- ✓ Understanding of work themes;
- ✓ Quality of the work relationship between the supervisory board and the management board in case of dual system.

In savings and retail banks, each **specialised committee of the board** has a specific regulation adopted by the board which defines the composition and missions of the committee, its operating procedures as well as its investigation means.

With regards to specialised committees, the Guidelines should be adjusted as follows:



- The requirement to establish board Committees (audit committee, risk committee, compensation committee or other board committees) should depend on the size and internal organisation of a company, as well as the nature, scope, complexity and risk potential of a company's business activities and should not be mandatory for all institutions.
- Concerning the invitation to establish by the board certain specialised committees, “unless it can be proved to the supervisor that it can keep fulfilling its objectives without such committees”, this should allow a minimal structure of joint committees: audit-risk and appointments-remuneration. In this regard the constraint that the audit committee and risk committee must be distinct from other committees should be eliminated. In order to streamline organisational structures for non-systematically important institutions the option of joint audit and risk committee and also of a joint nomination and compensation committee should be provided.
- A reference to the involvement of the appointments committee in the process of recurrent assessment of the suitability of directors and board members should be included.
- Paragraph 68 establishes that the audit committee is responsible for, among other things, the revision of third-party opinions in the design and effectiveness of the overall risk governance framework and internal control system. However, we consider that this function could fall into the scope of the risk committee, in particular in relation to the overall risk governance framework. Therefore, in absence of clarification it could be an overlapping of functions. Even though the Guidelines state that both committees should meet periodically to exchange information, a clarification would be appreciated in order prevent double responsibility.
- As far as the requirement that the chairman cannot be president of any committee is concerned, this should be limited to mandatory committees, but not extended to other committees which are created by the board.
- The consultative paper proposes that the audit and risk committees should each have a chair who is independent, and who is not the chair of the board or any other committee. However, we believe that the chair of the board or a committee should be permitted to chair another committee. This would bring the advantage of gaining an extensive overview of critical issues to be discussed and monitored, and would facilitate the flow of information between committees. This would be particularly important to the chair of the board in exercising his/her central function. From our perspective, any attempt to derogate the chair's central functions would contradict the overall objective of enhanced control over the management board, and would simultaneously contradict European requirements for cross-links between different committees, including overlapping activities of committee members and chairs. Accordingly, No. 60 should be revised in this respect, too.

With regards to **conflicts of interest within the board** and the new requirement which consists of having written conflicts of interest policy of the board, it should be determined whether the policy should be disclosed in any way.



Principle 5: Governance of group structures

The Guidelines determine that the board of the parent company in a group structure should have sufficient resources to monitor compliance of subsidiaries with all applicable legal, regulatory and governance requirements (paragraph 95). We believe that the intention of the provision is right; some regulations in place already require institutions to comply with the rules on group level. Accordingly, we can assume that the parent company must have the duty to monitor and control the compliance of all entities with all related provisions. However, we see significant challenges arising in practice should this requirement mean holding the parent institution liable for the level of compliance of all entities. Such absolute control would be almost impossible to achieve in practice both from an administrative and operational point of view.

How much governance is exercised on group level could be better achieved through establishing a proper system of controls or specific reporting obligations to the board and senior management of the subsidiary – which takes into account the differences in the group. As an illustration, we believe that a parent company controlling the subsidiaries through holding 100% of shares is significantly different to a parent institution consolidating the subsidiaries through de facto exercising a controlling influence. The power of the parent institution to impact decisions of the subsidiaries differs significantly in the latter cases. Please note the Article by Sabine Lautenschläger for this view, Vice-Chair of the Supervisory Board of the Single Supervisory Mechanism (SSM) in the European Central Bank (ECB)¹.

In addition, it would be beneficial if the way the subsidiaries must manage their adaptation to the corporate governance structure of the Group could be clarified.

Principle 6: Risk management

WSBI-ESBG considers that an overall review of the allocation of risk functions and responsibilities should be considered in order to reach an understandable delimitation between the responsibilities and functions of the board of directors (or the risk committee) and the **responsibilities and functions of the Chief Risk Officer (CRO)** or senior management.

The requirement to establish an exclusive CRO – at management board level – in larger and complex institutions is already included in the guidelines. According to the principle of proportionality, this requirement should not apply to smaller banks with less complex or lower risk business activities, we believe. For such banks alternative solutions can be appropriate, either a senior manager that carries other responsibilities besides the risk management function or an executive below manage-

¹ Lautenschläger, Sabine and Ketessidis, Adam (2011): Führung von gruppenangehörigen Banken und ihre Beaufsichtigung. In: Hopt, Klaus J. and Wohlmannstetter, Gottfried (Ed.), Handbuch Corporate Governance von Banken, München. https://www.frankfurt-main-finance.de/fileadmin/user_upload/media/Lautenschlaeger_Ketessidis_Fuehrung_von_gruppenangehoerigen_Banken_und_ihre_Beaufsichtigung.pdf (available in German).



ment board level. The term “CRO” is used throughout the guidelines, leaving the impression that an exclusive management board member with overall responsibility for the bank’s risk management is required for all institutions. We therefore recommend replacing the term “CRO” with the expression “head of the risk management function” in general.

Therefore, we believe that it should be clarified whether or not the CRO has to consider all the risks of the entity and the group, with overall or ultimate responsibility for the bank’s risk management. In this regard, a detailed list of functions and responsibilities of the risk committee and the CRO would be welcomed.

As for changes to the position of CRO, the requirement of an approval from the supervisory body in the case of changes to the position of CRO, as well as the supervisory body’s review and approval requirement of the CRO’s performance, compensation and budget, should - in our view - be mitigated into a requirement to merely inform the supervisory body of such an instance. In addition, the requirement to publicly disclose the removal of the CRO – and to discuss the reasons for the removal – should not apply to non-systemically important institutions.

Principle 7: Risk measurement

We consider the requirement stipulated to measure “hard-to-quantify risks” as contradictory. We approve of the fact that an institution has to be aware of, and monitor, reputation risk. However, we do not believe that this sort of risk can be measured by valid methodologies, and thus recommend the deletion of this part of the requirement.

Principle 9: Compliance

Finally, WSBI-ESBG considers that the board of directors is responsible for establishing compliance policies, as set in paragraph 40: *“The board should approve compliance policies that are communicated to all staff. The compliance function should ensure that the compliance policies are observed and report to senior management and, as appropriate, to the board on how the bank is managing its compliance risk. The function should also have sufficient authority, stature, independence, resources and access to the board”*.

Consequently, we believe that following changes should be proposed in Principle 9 in order to avoid misinterpretations regarding the allocation of responsibility:

Paragraph 133: *“The ~~bank’s senior management~~ board of directors is responsible for establishing a written compliance approach and policies that contain the basic principles to be followed by the ~~board~~, senior management and staff, and explains the main processes by which compliance risks are to be identified and managed through all levels of the organisation. Clarity and transparency may be promoted by making a distinction between general standards for all staff members and rules that only apply to specific groups of staff.”*



Paragraph 135: *“The compliance function should advise the board and senior management on compliance laws, rules and standards, including keeping them informed of developments in the area. It should also help educate staff about compliance issues, act as a contact point within the bank for compliance queries from staff members, and provide guidance, **according to second line of defence**, to staff on the appropriate implementation of compliance laws, rules and standards in the form of policies and procedures and other documents such as compliance manuals, internal codes of conduct and practice guidelines.”*

In addition, we do not consider it necessary to establish the proposed separate **reporting of the compliance function** to the board. Instead, the information in reports submitted to the management body should be structured in a way appropriate and comprehensible to the supervisory body. Therefore the following amendment should be made:

Paragraph 136: *“The compliance function is independent from management and provides ~~separate~~ reporting to the board on the bank’s efforts in the above areas and on how the bank is managing its compliance risk.”*



About WSBI (World Savings and Retail Banking Institute)

WSBI brings together savings and retail banks in all continents and represents the interests of 6,200 financial institutions. As a global organization, WSBI focuses on issues of global importance affecting the banking industry. It supports the aims of the G20 in achieving sustainable, inclusive and balanced growth and job creation around the world, whether in industrialised or less developed countries. WSBI favours an inclusive form of globalization that is just and fair, supporting international efforts to advance financial access and financial usage for everyone. It supports a diversified range of financial services that responsibly meet customers' transaction, saving and borrowing needs. To these ends, WSBI recognizes that there are always lessons to be learned from savings and retail banks from different environments and economic circumstances. It therefore fosters the exchange of experience and best practices, among its members and supports their advancement as sound, well-governed and inclusive financial institutions.



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About ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,480 billion and non-bank loans of €3,950 billion (31 December 2012).



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