

Review of the Governance of the Bank for International Settlements

Final Report

The Team of Experts ("Experts") is pleased to report on the results of the review of the governance of the Bank for International Settlements (the "Bank" or "BIS"), conducted pursuant to the Bank's terms of reference of 25 May 2004 (see Annex 1). This report is a revised version of our interim report dated 6 September 2004, and takes into account discussions with the Chairman and Vice-Chairman of the BIS Board, as well as the views expressed by Board members in response to the interim report.¹

1. Background

The terms of reference invite the Experts to examine, in general terms "the extent to which the governance of the BIS (including the relationship between Board and Management) is consistent with current principles of sound corporate governance", and state that the review "should take account of the specific features of the BIS as an international organisation and its mission of promoting central bank co-operation and financial stability". The Experts understand the Bank's special features to include the following:

- The Bank's shareholders are drawn exclusively from the *central banks* of sovereign jurisdictions.
- The Bank has two functions: it serves, first, as a *bank for central banks*, now more than at any other time since World War II; and, second, as a *service organisation for central banks* in the field of international monetary and financial cooperation and financial stability. Put differently, the Bank has features of both a bank and a co-operative institution or "club".²
- The Bank has the external form of a business corporation but a unique internal governance structure, under which the governors of its founding member central banks fill a majority of its Board seats. This feature of the Bank's governance is enshrined in the so-called "protected provisions" of its Statutes, whose amendment requires the sanction of the Swiss Government and the agreement of the other signatory Governments to the 1930 Convention respecting the BIS.
- The Bank is an organisation governed by *international law*, although it does not belong to any international or regional system.

Our review of the Bank's governance acknowledges both its banking function and its features as a co-operative institution.³ In this regard, we do not underestimate the value of discretion and informality for the Bank's functions, or the value of the opportunity that the Bank affords central bankers to escape the political pressures facing their home institutions. Thus far in its development, the Bank has adapted remarkably smoothly to the evolving international context in which it operates. But it would

¹ The Report has been prepared with the assistance of the Bank's Legal Service.

² Club features remain an important aspect of the Bank's framework today, in part as a result of the opportunities for contact among central bankers made possible by regular meetings in Basel. A large number of central banks as well as representatives of other financial sector supervisors and international financial organisations attend the Bank's Annual General Meeting in June each year.

³ The will to preserve these basic features is reflected in its rather limited membership. There are 55 member central banks or monetary authorities currently having the right to vote at the annual meeting to be compared with the 184 members of the IMF.

exaggerate to attribute the Bank's entire success to the informality of its governance. The quality of the Bank's management was, and is, surely the principal contributor to its success.

Like its club-like features and basic informality, the Bank's governance practices are an important asset of the organisation. As a prominent international institution, the Bank's governance should not only be without reproach, but must also *be seen* as irreproachable. Transparency and accountability are at the centre of good governance today. The BIS has acknowledged as much by recently making its annual report much more informative. But there are other steps that the Bank might be able to take so as to be seen to apply exemplary governance practices. Exploring what these steps might be is the principal goal of this Report.

Central bank governors, in their capacity of directors of the BIS, have a special responsibility towards the institution. As directors of a corporate structure, they must recognise and respect the interests of the Bank as an institution - interests that are distinct from the interests of the Bank's individual shareholders. In other words, Bank board members have a duty of loyalty to the Bank as well as a duty of accountability to its shareholders. This explains, in particular, the obligation of discretion that the Governors should respect in relation with their central bank staff, taking into account possible conflicts of interest between the Bank and their central bank. This obligation cannot be disregarded merely because the Bank's Statutes do not provide a formal sanction to enforce it (see section 6 (*Conflicts of interest*) below).

One should also not underestimate the "visibility" of the BIS as an institution at which principles of sound corporate governance for the financial sector are agreed. Despite the Bank's unique status, actors in the financial world will look to its example when they attempt to understand and apply these principles. This point holds for central banks as well as private sector banks. Central banking has evolved in recent decades. Many central banks have been given operational independence with respect to monetary policy. The essential complement of this new independence, however, is accountability and sound corporate governance. The media, as well as the markets and academic economists, closely scrutinise international banking activities and institutions. The actions of the BIS could, therefore, influence not only its own image, but by example also the public image of the central banks more generally.

In sum, sound governance practices have different justifications at the BIS than in ordinary corporations, but these justifications are no less weighty. Their main purpose is not to reinforce the confidence of investors, or to allow the Bank to obtain external funding at lower cost. Rather, their purpose is:

- to ensure that responsibility for decision-making at the BIS is allocated in a clear and transparent fashion, and that decision-making authority is exercised subject to appropriate checks and balances;
- to manage potential conflicts of interest; and
- for the BIS to be seen to apply exemplary governance practices.

Therefore, the Experts consider that an important focus of the review should be on the structural aspects of the Bank's governance, i.e. on the relationship between the BIS Board and Management and the responsibilities of each organ, the decision-making process at each level, and the resolution of potential conflicts of interest.

2. Sound corporate governance principles

The terms of reference refer to "current principles of sound corporate governance". It is for the Experts to identify the pertinent principles, taking into account the "special character of the BIS", as described above. As is underlined in the Preamble to the *2004 OECD Principles of Corporate Governance* (the "*2004 OECD Principles*"), "there is no single model of good corporate governance", but there are obviously principles that could inspire the governance of any institution, either public or private.

One appropriate source of principles are those adopted by the Basel Committee on Banking Supervision on "Enhancing Corporate Governance for Banking Organisations" in September 1999 (the "*Basel Principles*"). The *Basel Principles* adopt the following definition of "corporate governance" from the *1999 OECD Principles of Corporate Governance*:

“a set of relationships between a company's management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.”

The *Basel Principles* define corporate governance as involving “the manner in which the business and affairs of individual institutions are governed by their boards of directors and senior management” and mention a number of principles. It seems possible to identify the following principles among those mentioned in the *Basel Principles*, such as:

- a clear assignment of responsibilities and decision-making authorities;
- the establishment of a mechanism for the interaction and cooperation among the board of directors, senior management and the auditors; and
- appropriate information flows and conducting corporate governance in a transparent manner.

Another possible source of sound corporate governance principles is the *2004 OECD Principles*. Section VI (*The Responsibilities of the Board*) contains a number of principles, including the following:

- the Board should fulfil certain key functions, including:
 1. reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives, monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures;
 2. monitoring the effectiveness of the company's governance practices and making changes as needed;
 3. selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning; and
 4. monitoring and managing potential conflicts of interest of management, board members and shareholders; and
- Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interests of the company and the shareholders.

Certain of the principles quoted above may not be directly applicable to the BIS. Further, the special character of the BIS may raise governance issues that are not addressed by these principles. Nevertheless, they provide a useful frame of reference when considering corporate governance at the BIS.

3. Two broad governance models

Before moving to the governance-related issues, it may be helpful to consider the two main governance models that have been developed over time, both in public companies and in non-profit organisations - namely the one-tier and the two-tier board model - and to see what lessons might be drawn from these models for governance at the BIS.

It is common knowledge that some countries, such as the United States and the United Kingdom, rely on one-tier boards while others, such as Germany, stick to the two-tier board system. The division between one-tier and two-tier boards runs through continental Europe. The essence of the two-tier system is that the supervisory board is strictly separated from the management board (i.e., no member of the management board, including its chairman, may sit at the same time on the supervisory board). The members of the management board are appointed and dismissed by the supervisory board, while the members of the supervisory board are elected and removed by the shareholders. In addition, the supervisory board has some co-responsibility for important decisions in the company. But day-to-day management is strictly reserved for the management board. In contrast, the one-tier board does without such formal divisions and restrictions, though more recently a division between executive and non-executive directors within the same board has become common practice. From a comparative law

perspective, a clear tendency toward convergence is discernible. In the one-tier system, forms and methods of breaking up the homogeneity of the board are apparent; in particular, there are recommendations against having the same person as CEO and chairman of the board. Conversely, in the two-tier board systems the practical interplay between the two boards is becoming closer.⁴ The Statutes of the BIS have some elements of a one-tier board system. This is apparent from Article 38(4), which provides that the President “will carry out the policy decided upon by the Board”. On the other hand, the same provision also states that the President “will control the administration of the Bank”, and in practice the Bank has elements of a two-tier board system.

Actual experience with the two governance models, the one-tier and two-tier board, has not shown conclusive evidence for preferring either of the two models. It seems that the models have not only developed in a “path-dependent” way, but that each may be better suited for certain organisations: the two-tier model has a clearer division between management and control, and the one-tier model has information advantages and is more flexible. In the end, the question of whether to choose the one or the other of the two models may also depend on particular preferences and national and cultural backgrounds. This is why modern developments - both in a number of EU member states such as France and Italy and also at the EU level as shown by the Company Law and Corporate Governance Action Plan of the European Commission of May 21, 2003 - are more likely to grant the enterprises themselves the free choice between the two models.⁵ Furthermore, in various countries, companies are permitted to modify in their by-laws the model they choose. In other words, both in theory and in practice, there is a certain spectrum between a “pure” one-tier board model on the one hand and a “pure” two-tier board model on the other. Within this spectrum, it is for the enterprise itself to determine (subject to domestic company law) how it wishes to distribute decision-making responsibilities between board and management. The important point is that any such distribution of responsibilities be clear.

With this in mind, the report now considers the extent to which the governance of the BIS as defined in its Statutes is consistent with current principles of sound corporate governance and, to the extent there is any deviation, the enhancements in governance that could be achieved by amending the non-protected provisions of the Statutes or revising the practices followed by the BIS. Section 4 addresses the issues arising from the structural relationship between the BIS Board and Management. Section 5 briefly considers the question of Board and Management committees. Section 6 looks at potential conflicts of interest.

4. Relationship between BIS Board and Management

There are two areas which in our view need to be considered as a priority; first, reducing the number of top positions at the BIS from three to two; and second, clarifying the responsibilities of the Board.

4.1 Number of top positions

(a) Issues

In most organisations there are usually two top positions - Chairman of the Board and CEO. The Chairman is responsible for setting the agenda for Board meetings and acting as a channel for communication between Board and Management. The CEO is responsible for the management of the

⁴ For details, see Klaus J. Hopt, *The German Two-Tier Board: Experience, Theories, Reforms*, in: Klaus J. Hopt et al., eds., *COMPARATIVE CORPORATE GOVERNANCE*, Oxford 1998, p. 227-258; Paul Davies, *Board Structure in the UK and Germany: Convergence or Continuing Divergence?*, *INTERNATIONAL AND COMPARATIVE CORPORATE LAW JOURNAL* 2 (2000) 435-456. However it should be mentioned that under bank supervisory aspects there are arguments for a two-tier system. In Switzerland and in Belgium, for example, the banking law provides for a kind of supervision of powers that is not necessary for normal stock corporations.

⁵ In Belgium, for example, there is an intermediate structure available for banks that permits a one-tier board to delegate to a “Direction” committee (composed of board members) powers that go further than the day-to-day competences (“gestion journalière”) of management, in order to realise the so-called “autonomie bancaire” i.e. autonomy for banking operations. In Italy, companies may choose among more than two models.

organisation, either individually or as chairman of a management board.⁶ At the BIS, however, there are three top statutory positions, Chairman, President and General Manager, and the President also currently occupies the position of Chairman of the Board. This raises the following issues:

- (i) Articles 38 and 40 of the Bank's Statutes indicate that the person with overall executive responsibility for administration of the Bank is the President. However, since 1948 the position has been occupied by a Board Member on a part-time basis, and most of his executive responsibilities have in practice been exercised by the General Manager. There is, therefore, a divergence between the Statutes, in which the President is the *de jure* CEO, and the situation in practice, in which the General Manager is the *de facto* CEO. This creates a lack of transparency as to who is actually responsible for the management function.
- (ii) The position of CEO should be a full-time position, and thus cannot be performed by any Board Member who is not available on a full-time basis. Further, Article 38(5) of the Statutes provides that the President "shall not hold any other office which, in the judgment of the Board, might interfere with his duties as President."
- (iii) The current arrangement makes the President appear responsible for the executive decisions of the General Manager, most of which he cannot monitor closely. It also leaves the Board with a poorly defined relationship to the General Manager. Unlike the President, the General Manager has no statutory right to participate in the Board's deliberations (although he does so in practice), and the Board has no clearly defined obligation to monitor the General Manager.

(b) Recommendations and options

We recommend that the three current positions of Chairman, President and General Manager be reduced to two, Chairman and CEO. We express no view on the titles of these two positions, which is a presentational rather than functional issue. In practice, the executive responsibilities of the President under the Statutes would be transferred to the General Manager, and any remaining functions of the President would be exercised by the Chairman. In other words, the current functions of the President under the Statutes would be apportioned between the Chairman and the CEO. We also recommend that the CEO be responsible to the Board as a whole for the management of the Bank, not to the Chairman of the Board. In our view, these recommendations can only be implemented by amending the Bank's Statutes.

A number of consequential changes would need to be considered in connection with this process.

First, it would be important to retain appropriate checks and balances on the exercise of executive authority following the reduction of the current top positions from three to two. "Vertical checks" would require certain major executive decisions to be approved at Board level. "Horizontal checks" would require certain major executive decisions to be taken by more than one person at Management level.

Second, the Statutes would need to clarify whether the CEO had the right to attend all Board meetings, or alternatively, attended by invitation only. In our view, the CEO should, in principle, be entitled by the Statutes to attend Board meetings (as the General Manager does at present), although there may be circumstances in which the Board wishes to meet in the absence of the CEO. The Board may also wish to consider whether to extend the right of attendance to certain other members of Management.

Third, the respective roles of the Board and the CEO in the appointment of Heads of Department and other officers of similar rank would need to be clarified. Article 40(2) currently provides that the occupants of these positions shall be "appointed by the Board on recommendations made by the President of the Bank after consultation with the General Manager". It is for the Board to decide the extent to which it wishes to be involved in these appointments. It may, for example, wish to limit its involvement to the appointment of the Heads of Department and possibly also the General Counsel. If so, the expression "other officers of similar rank" would no longer be required. It would also need to be

⁶ For organisations that use a one-tier board, the CEO may also occupy the position of Chairman, although this practice has recently been criticized from a corporate governance perspective on the basis that the functions of Chairman and CEO are distinct.

decided whether the occupants of the positions should be appointed: (i) by the Board following consultation with the CEO; or (ii) by the Board on the recommendation of the CEO.

Fourth, Article 38(3) currently provides that the President is elected by the Board for a maximum term of three years, which may be renewed. This term is arguably too short. It may be appropriate to provide for a five year term of office for the Chairman, the CEO, and possibly other members of Management.⁷

Annex 2 to this report contains some suggestions as to how these issues could be addressed. In particular, it reviews the existing functions of the President under the Statutes and contains proposals as to how they could be apportioned between the Chairman and the CEO. For convenience, Annex 2 also touches on Article 26 (*Administration of the Bank*) and Article 36 (*Dealings with Third Parties*), but our comments in relation to those provisions are subject to the Board's views on the appropriate distribution of responsibilities between Board and Management (see Section 4.2 below).

4.2 Board responsibilities

The general framework for the Board's composition and responsibilities is laid down in Articles 27 and 26 of the Statutes respectively. All Board Member positions (other than the position of President, if he is also a Board member) are non-executive, and all Board Members carry out their responsibilities on a part-time basis.

The composition of the Board is prescribed by Article 27 of the Statutes, which is a protected Article. It is not part of the mission of the Experts to examine these rules, which go back to the foundation of the BIS. They appear to have the flexibility to accommodate the representation of the different constituencies of the BIS, according to decisions to be taken by the Board itself.

As regards the responsibilities of the Board, it was noted in Section 3 above that between the pure one-tier board model and the pure two-tier board model, there is a range of possibilities as to how decision-making responsibility can be distributed between Board and Management. Under the BIS Statutes, the only general provision dealing with the responsibilities of the Board is Article 26, which states that "The administration of the Bank shall be vested in the Board". The Statutes also provide for a number of specific responsibilities of the Board, most of which may be considered to fall within one of the following five categories:

- Decisions on the capital of the Bank and on shareholding (e.g. Art. 6 to 9, 14 and in 18 (A)) as well as regarding the General Meeting, accounts and profits and liquidation of the Bank (see Chapters V to VII);
- Decisions regarding financial operations of the Bank (e.g. Art. 19 to 21, 23 and 25);
- External representation of the Bank (e.g. Art. 36 and 37);
- Appointment of top positions of Management and departmental organisation (e.g. Art. 40 and 41); and
- Appointment of executive and advisory committees (e.g. Art. 42 and 43).

(a) Issues

Article 26 states that "The administration of the Bank shall be vested in the Board". This reference to "administration" is open to misunderstanding, in particular if it is compared with Article 38 clause (4): "The President of the Bank ... will control the administration of the Bank". It is strange that the President, who is elected by the Board, should also control the "administration" of the Bank and thereby seemingly the Board. The word "administration" seems to be used in two different ways, first, to refer to the policy and supervisory functions exercised by the Board, and second, to refer to the executive functions of the CEO. This is not ideal from a corporate governance perspective, as it confuses the responsibilities of the Board with the responsibilities of Management.

⁷ It should be noted that Article 27 (a protected Article) provides that elected Directors shall remain in office for three years but may be re-elected. Therefore, any statutory provision with respect to the term of office for the Chairman would need to be consistent with this Article.

Article 36 (*Dealings with third parties*) states that “The Board shall represent the Bank in its dealings with third parties and shall have the exclusive right of entering into engagements on behalf of the Bank”. In practice, it is the Management and staff (and not the Board) of the Bank who represent the Bank in its dealings with third parties, although the Board determines how such authority is to be exercised as part of its supervisory functions. Article 36 is therefore arguably inconsistent with the current responsibilities of the Board.

(b) Recommendation and options

We recommend that Article 26 be amended by replacing the word “administration” with a phrase that more accurately reflects the existing responsibilities of the Board. The revised provision could read:

“The Board decides upon the strategic and policy direction of the Bank, supervises the management, and fulfills the specific tasks given to it by these Statutes.”

Alternatively, it could read:

“The Board approves (but may also determine on its own initiative) the strategic and policy direction of the Bank, supervises the management, and fulfills the specific tasks given to it by these Statutes.”

The latter wording would recognise the fact that the initiative to change the strategic or policy direction of the Bank may (and indeed has in the past) come from Management.

It is for the BIS Board to determine whether the distribution of responsibilities between Board and Management as suggested by the revised Article 26 and as currently implemented in practice is broadly satisfactory. In clarifying its responsibilities, and taking account of the part-time availability of its members, the Board may wish to consider adjusting the existing distribution of responsibilities with a view to focusing on supervision of Management and the strategic direction of the Bank. If so, consequential changes to the Bank’s decision-making structure along the lines discussed in Section 4.1(b) above might need to be considered in order to retain an appropriate system of checks and balances. This process would also be helpful to align the actual responsibilities of Management to its accountability for operational decisions.

Before taking a view on whether the present distribution of responsibilities between Board and Management is satisfactory, the Board should consider the changes that would arise from our recommendation to reduce the number of the Bank’s top positions from three to two: i.e., to a Chairman of the Board and a CEO. In particular, we mentioned that it would be important to retain appropriate checks and balances on the exercise of executive authority following any such change. Vertical checks would require certain executive decisions to be approved at Board level, possibly through the Chairman. We do not recommend adding new vertical checks to those already in place, as this would add to the problem of the legal responsibility of a Board whose members are only available part-time. In practice, it is hard to imagine that before major decisions are taken, the CEO would not consult the Chairman of the Board. This practice could, however, be reinforced through an obligation on the CEO to inform the Chairman of important issues, thus giving the Chairman an opportunity to determine whether a discussion at Board level is appropriate.

The Board may wish to consider additional means of assuring its ability to carry out its supervisory responsibilities, given the part-time availability of its members. This is particularly relevant if the Board decides not to change the existing distribution of responsibilities between Board and Management. One possible option would be for the Board to meet more frequently, perhaps by video conference. Specific tasks could also be delegated to one or more committees of the Board (see section 5 below). Our suggested amendments to Article 42 (*Board Committees*) contained in Annex 2 might facilitate this.

We also recommend that Article 36 (*Dealings with Third Parties*) be revised, so that it is consistent with the existing responsibilities of the Board.

Finally, the headline “Management” to Chapter IV of the Statutes is open to misunderstanding, as this Chapter deals with the responsibilities of the Board as well as Management. To make this clear from the very beginning, we would recommend that it be amended so that it states “Board and Management”.

5. Board and Management Committees

The structure and functions of the main committees at both Board and Management level are to a large extent dependent on how decision making responsibilities are divided between Board and Management. The following comments are offered in this respect.

5.1 Board Committees

Article 43 of the Bank's Statutes provides that "the Board may appoint advisory committees chosen wholly or partly from persons not concerned in the Bank's management". The two main advisory committees of the Board are the Consultative Committee and the Audit Committee. The membership of each committee is currently the same (namely the Board Members appointed by the *ex-officio* directors, together with the President of the Swiss National Bank). Both committees are chaired by the Vice-Chairman of the Board.

The *Audit Committee* provides a channel of communication between the Bank's internal and external auditors, on the one hand, and the Board, on the other. The structure and responsibilities of this committee are clearly defined in a charter. Article 2(1) of the Charter states that the committee "shall be composed of three or more members chosen among members of the Board of Directors", and emphasises that all members "shall be independent of BIS management." This rightly excludes BIS Management and staff from membership of the Committee.

The *Consultative Committee* has no established terms of reference. We understand that the committee deals with certain topics of an administrative character that involve extended consideration and discussions (e.g. budget, health insurance, pensions etc). It would be helpful to clarify its structure and responsibilities in a formal Board document. As part of this exercise, it could perhaps be considered whether the current range of responsibilities of the committee is appropriate for the BIS, or whether there would be merit in creating Board committees with responsibilities for specific issues.

The Consultative Committee currently meets the day before the meeting of the Board. While this is an improvement over the previous practice of meeting on the same day as the Board meeting, it still leaves a short time lag between each meeting, and thus little opportunity for the deliberations of the committee to be considered by other members of the Board. The possibility for the Consultative Committee to meet one or two weeks before the Board meeting, perhaps by teleconference or videoconference, should be examined.

5.2 Management Committees

As discussed above, under the Statutes the President has executive responsibility for the management of the Bank. In practice, however, most of his executive responsibilities are exercised by the General Manager, who is assisted in this task by a number of committees.

The most important of these committees is the executive committee (ExCo), comprising the General Manager (who chairs the committee), the Deputy General Manager, department heads, and several other members of senior management. ExCo meets daily to co-ordinate the on-going management of the various business lines of the Bank. It also meets at least once a month (as "extended ExCo") with an established agenda, briefing notes and background material to deal with bank-wide management issues that require advance staff preparation. Another important management committee is the Finance Committee (FiCo), also chaired by the General Manager, which meets at least once a month to provide strategic direction and establish broad parameters for the Bank's risk management and banking operations.⁸ There are also a number of other management committees established for specific purposes, whose composition and responsibilities are determined by the General Manager.

ExCo does not have a formal charter or terms of reference. Under a governance structure characterised by a delegation of responsibilities from Board to Management along the lines of a two-tier board model, ExCo would become a management committee, and its composition and powers would need to be reflected in the Statutes. If the structure was closer to a one-tier model, ExCo would in any event require a charter or terms of reference.

⁸ FiCo's original terms of reference are described in a note to members of staff of 14 June 1995.

It has already been mentioned in Section 4.1 that following any reduction of the number of the Bank's top positions from three to two, it will be necessary to retain appropriate checks and balances on the exercise of executive authority. "Vertical checks" were discussed in Section 4.2. Possible "horizontal checks" could involve certain major executive decisions being taken by more than one person at Management level. One horizontal check would be for certain particularly important matters to require the approval of both the CEO and the Deputy CEO (i.e. the "four eyes" principle). By way of illustration, European Union banking law provides that at least two individuals must effectively direct the business of the bank.⁹ Another approach would be to strengthen the functions of ExCo, which is referred to in the Bank's most recent annual report as one of its three most important decision-making bodies. As mentioned above, ExCo currently assists the General Manager in the exercise of his responsibilities and, in the case of a divergence of views on a specific matter, the General Manager's view prevails. There are ways in which the functions of ExCo could be strengthened. For example, ExCo's terms of reference could provide that the CEO is required to consult ExCo on certain particularly important matters.¹⁰

A key issue in relation to both suggestions would be to define the types of matter that require the involvement of other members of Management, be it the Deputy CEO, or more broadly, ExCo. An obvious possibility would be to identify matters for which the approval of the President is currently necessary, such as conducting certain types of banking operations, or granting credit beyond ordinary limits.

6. Conflicts of Interest

Board Members of the BIS face potential conflicts of interest, just as the directors of any company in the private sector do. However, these conflicts differ from analogous conflicts among the directors of private companies in two fundamental ways. First, the mix of potential conflicts at the Bank is strongly weighted toward institutional rather than personal conflicts, in contrast to the mix at a typical private company. Second, the Bank's unique status as an organisation of central banks - and the idiosyncratic governance structure that results - shapes potential responses to the problem of conflicts of interest in ways that differ from those that are open to the typical company in the private sector.

Personal conflicts of interest

It appears that personal conflicts of interests are not a primary concern at Board level. The Bank's board members live in the public eye and, as senior bank officials, work in an exceptionally rigorous ethical environment. The appearance of a personal conflict of interest, should it arise at all, is likely to be exceedingly rare.

Institutional conflicts of interest

The Bank differs from conventional companies in the range of potential institutional conflicts of interest that it might support. Most Board Members are governors or senior officials of central banks. The country of a central bank whose governor is a Board Member may have political interests at odds with the Bank's objectives - and possibly at odds with the objectives of other member central banks represented on the Board. Central banks represented on the Board may also be contractual counterparties and/or competitors of the BIS on the financial markets. Further, the laws of the home jurisdiction of a Board Member may impose legal duties on the Board Member that are in conflict with his fiduciary duties to the BIS. For example, a Board Member has a duty of confidentiality with respect to non-public information about the BIS to which he obtains access by virtue of his position as a Board Member. However, in some jurisdictions, freedom of information legislation gives members of the public wide-ranging access to public documents. The scope of this legislation differs from jurisdiction

⁹ See Article 6(2) of the Banking Consolidation Directive (2000/12/EC).

¹⁰ ExCo's terms of reference could also provide that ExCo's approval is required for certain matters. This approach however, is not easy to reconcile with the principle that the CEO remain personally accountable to the Board for all executive decisions.

to jurisdiction, and in many cases confidential BIS documents retained by the Board Member in the archives of the central bank concerned may not be protected from disclosure under domestic law. This situation is partly due to the fact that, unlike Bretton Woods institutions, such as the IMF and the World Bank, the BIS does not automatically benefit from legal immunities in each of its member countries.

Possible responses to conflicts of interest

The principal tool employed by the Board to regulate potential conflicts of interest is the recently-adopted “Code of Conduct for Members of the Board of Directors.” This Code resembles the codes adopted by other international institutions to regulate the conduct of board members¹¹ with two significant exceptions: first, it limits the obligations of Board members to the Bank to actions that are consistent with the duties and obligations of Board members to their home central banks;¹² and, second, it avoids any mention of particular actions that Board members must take when potential conflicts arise, other than consulting with the Chairman or Vice-Chairman of the Board. Thus the approach adopted by the Code is to resolve institutional conflicts of interest ex ante by giving priority to duties and obligations owed by Board members to home central banks over conflicting duties owed by Board members to the BIS.

In our view the existing Code of Conduct governing the Bank’s Board members is subject to three possible criticisms:

- it fails to distinguish explicitly between personal and institutional conflicts of interest;
- it fails to elaborate adequately on the duties of a Board member upon discovering a real or apparent personal conflict of interest. For instance, there is no requirement that Board members refrain from participating in any Bank decision or operation in which they have a personal conflict of interest; and
- it fails to elaborate adequately on the consequences of an apparent institutional conflict of interest. There is, for example, no affirmative duty to refrain from disclosing Bank information when the risk is significant that it will be used to the detriment of the Bank. Nor is there an obligation that Board members recuse themselves (i.e. withdraw) from decisions or operations in which they have an apparent institutional conflict of interest.

We appreciate that as the Code has only recently been adopted, there may be practical considerations against re-opening discussion on the document. Nevertheless, it would be appropriate if the Code could be clarified on these points. We are also conscious that as regards institutional conflicts of interest, there may be a limit to what a code of conduct can achieve. In this respect, it would be desirable for individual national jurisdictions to recognise the special legal status of the BIS under domestic law and grant the Bank legal immunities similar to those enjoyed by the IMF and World Bank.

7. Concluding Observations

While the Experts consider that the Board should revisit the conflict of interest issues in due course, they unanimously recommend that the Board act soon to correct the most serious discrepancies between the Bank’s Statutes and its current governance practices. In particular, the Statutes now prescribe a kind of “super CEO role” for the President, while in fact the real CEO role is currently performed by the General Manager, who is equipped with much more modest powers. Moreover, the Statutes charge the Bank’s Board (as well as its President) with the Bank’s administration, when in fact it is the General Manager who “administers” the Bank within the ordinary English sense of the

¹¹ See, e.g., World Bank, Code of Conduct for Board Officials; International Monetary Fund, Code of Conduct for Members of the Executive Board of the International Monetary Fund; Basel Committee on Bank Supervision, Enhancing Corporate Governance for Bank Supervision (Part III: “Sound corporate governance practices”).

¹² For example, ¶2 of the Code states that Board members must carry out their tasks and duties “to the best of their ability and judgment, consistent with their responsibilities to their home central banks.” A similar statement is embedded in the Code’s prolegomena.

word. In the view of the Experts, the only way to remedy these discrepancies between Statutes and practice is to amend the Statutes.

The necessary amendments should, first, reduce the number of the Bank's top positions from three to two: i.e., to a CEO and a Chairman of the Board. Correlatively, the President's functions and powers as currently described in the Statutes should be reapportioned between the CEO and the Chairman of the Board (see Annex 2). Second, Articles 26 and 36 should be amended to eliminate any suggestion that the BIS Board is an administrative body exercising day-to-day management of the BIS, as opposed to a classic board of directors performing supervisory, strategic, and appointment responsibilities.

If the Bank were to disclose that its *de facto* governance practices differed significantly from the practices mandated by its Statutes, yet neither amended its Statutes nor changed its practices to address the discrepancies, the Bank would in effect be announcing that it had abandoned its own Statutes as the foundation of its governance. This outcome would run counter to universally recognised norms of sound corporate governance and could damage the reputation of the BIS as an institution at which these norms are agreed. Failure to act could also indirectly damage the reputation of the central banks represented on the Bank's Board, as they have the ultimate responsibility for the Bank's governance.

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Annex 1 (Terms of Reference)

Annex 2 (Suggested revisions/annotations to Article 26 and Articles 36 to 43)

Annex 1

Review of the governance of the Bank for International Settlements (BIS)

Terms of Reference

The basic texts of the BIS, including its Statutes, have not been substantially altered since the Bank was established in 1930, while corporate governance principles have developed considerably since then. In the meantime, the governance practices of the BIS and the scope of its activities have evolved significantly. Thus, it appears timely and appropriate to review the extent to which the governance of the BIS (including the relationship between Board and Management) is consistent with current principles of sound corporate governance. This review should take account of the specific features of the BIS as an international organisation and its mission of promoting central bank co-operation and financial stability.

In particular, the following questions should be considered in a report to be prepared jointly by the Bank's services and selected external experts:

1. To what extent is the governance of the BIS, as defined in its Statutes, consistent with current principles of sound corporate governance?
2. To what extent are the actual governance practices of the BIS consistent with current principles of sound corporate governance?
3. If any deviation is noted under either question (1) or (2), to what extent is it warranted given the special character of the BIS?
4. What enhancements in governance could be achieved either by amending the provisions of the Statutes that are not subject to the special amendment procedure set out in Article 58, or revising the practices followed by the BIS, or both?

The Bank is actively retaining leading experts in the fields of corporate governance and international cooperation of central banks. Special attention is being given to their immediate availability, with a view to obtaining an outline of the report in time for the Board meeting of 28 June 2004, together with an estimated time frame for its completion. The objective is to submit an interim report to the President in September 2004 in preparation for a preliminary discussion among Board members.

Annex 2

Review of the Governance of the Bank for International Settlements

Suggested revisions/annotations to Article 26 and Articles 36 to 43

Existing provisions	Suggested Revisions/Annotations
<p><i>Art. 26.</i> The administration of the Bank shall be vested in the Board.</p>	<p><i>Art. 26.</i> The Board decides upon the strategic and policy direction of the Bank, supervises the management, and fulfills the specific tasks given to it by these Statutes.</p> <p><i>Alternatively:</i></p> <p><i>Art. 26.</i> The Board approves (but may also determine on its own initiative) the strategic and policy direction of the Bank, supervises the management, and fulfills the specific tasks given to it by these Statutes.</p>
<p><i>Art. 27 (Composition of the Board).</i></p>	<p><i>This is a protected article.</i></p>
<p><i>Art. 28 to Art. 35 (Board proceedings).</i></p>	<p><i>No change, except perhaps to para. 35(2), which currently provides that copies of or extracts of board minutes for the purpose of production in a court of justice must be certified by the General Manager.</i></p>
<p><i>Art. 36.</i> The Board shall represent the Bank in its dealings with third parties and shall have the exclusive right of entering into engagements on behalf of the Bank. It may, however, delegate this right to the Chairman of the Board, to another member or other members of the Board, to the President of the Bank or to a member or members of the permanent staff of the Bank, provided that it defines the powers of each person to whom it delegates this right.</p>	<p><i>Reference to the President to be deleted. Possibly other changes to reflect how the Bank is represented in practice in its dealings with third parties.</i></p>
<p><i>Art. 37.</i> The Bank shall be legally committed <i>vis-à-vis</i> third parties either by the signature of the President of the Bank, or by the signatures of two members of the Board or of two members of the staff of the Bank who have been duly authorised by the Board to sign on its behalf.</p>	<p><i>Possibilities include:</i></p> <p><i>(1) single signature of the Chairman;</i></p> <p><i>(2) single signature of the CEO; or</i></p> <p><i>(3) a requirement for two signatures.</i></p>
<p><i>Art. 38(1).</i> The Board shall elect from among its members a Chairman and one or more Vice-Chairmen, one of whom shall preside at meetings of the Board in the absence of the Chairman.</p>	<p><i>No change to para. 38(1), but we would suggest moving the text of the current Article 39 to a new para. 38(2).</i></p>

Existing provisions	Suggested Revisions/Annotations
<p><i>Art. 38(2).</i> The Board shall elect a President of the Bank. If the President of the Bank is not Chairman of the Board nor a member thereof, he shall nevertheless be entitled to attend all meetings of the Board, to speak, to make proposals to the Board and, if he so desires, to have his opinions specially recorded in the minutes.</p>	<p><i>Delete. We would suggest including matters relating to the appointment of the CEO in a new Article 39. The current text of Article 39 would be included in the new para. 38(2).</i></p>
<p><i>Art. 38(3).</i> The appointments referred to in this Article shall be made for a maximum of three years and may be renewed.</p>	<p><i>No change. The three year period for appointments is a consequence of Article 27 (a protected Article), which provides that elected Directors shall remain in office for three years.</i></p>
<p><i>Art. 38(4).</i> The President of the Bank will carry out the policy decided upon by the Board and will control the administration of the Bank.</p>	<p><i>Delete. We would suggest a similar provision with respect to the CEO in a new para. 39(2).</i></p>
<p><i>Art. 38(5).</i> He shall not hold any other office which, in the judgement of the Board, might interfere with his duties as President.</p>	<p><i>Delete. We would suggest a similar provision with respect to the CEO in a new para. 39(3).</i></p>
<p><i>Art. 39.</i> At the meeting at which the Board elects its Chairman, the Chair shall be taken by the oldest member of the Board present.</p>	<p><i>Delete and replace with the following:</i></p> <p><i>Art. 39(1).</i> The Board shall appoint a CEO [and Deputy CEO] on the proposal of the Chairman of the Board. This appointment shall be made for a maximum of [five] years and may be renewed.</p> <p><i>Art. 39(2).</i> The CEO will carry out the policy decided upon by the Board and will be responsible to the Board for the administration of the Bank.</p> <p><i>Art. 39(3).</i> The CEO shall not hold any other office which, in the judgement of the Board, might interfere with his duties as CEO.</p> <p><i>Art. 39(4).</i> Unless otherwise determined by the Board by way of exception, the CEO shall be entitled to attend all meetings of the Board, to speak, to make proposals to the Board and, if he so desires, to have his opinions specially recorded in the minutes.</p>
<p><i>Art. 40(1).</i> A General Manager and a Deputy General Manager shall be appointed by the Board on the proposal of the Chairman of the Board. The General Manager will be responsible to the President of the Bank for the operations of the Bank and will be the chief of its operating staff.</p>	<p><i>Delete (see new proposed para. 39(1) and para. 39(2)).</i></p>

Existing provisions	Suggested Revisions/Annotations
<p><i>Art. 40(2).</i> The Heads of Departments and any other officers of similar rank shall be appointed by the Board on recommendations made by the President of the Bank after consultation with the General Manager.</p>	<p><i>Art. 40(1).</i> The [Deputy CEO,] Heads of Departments and [either] [any other officers of similar rank] [or] [the General Counsel] shall be appointed by the Board on recommendations made by [either] [the Chairman of the Board after consultation with the CEO] [or] [the CEO].</p>
<p><i>Art. 40(3).</i> The remainder of the staff shall be appointed by the General Manager with the approval of the President of the Bank.</p>	<p><i>Art. 40(2).</i> The remainder of the staff shall be appointed by the CEO [with the approval of the Chairman of the Board].</p>
<p><i>Art. 41.</i> The departmental organisation of the Bank shall be determined by the Board.</p>	<p><i>No change.</i></p>
<p><i>Art. 42(1).</i> The Board may, if it thinks fit, appoint from among its members an Executive Committee to assist the President of the Bank in the administration of the Bank.</p>	<p><i>Art. 42.</i> The Board may, if it thinks fit, appoint from among its members one or more committees to assist the Board in carrying out its responsibilities.</p>
<p><i>Art. 42(2).</i> The President of the Bank shall be a member of this Committee.</p>	<p><i>Delete.</i></p>
<p><i>Art. 43.</i> The Board may appoint Advisory Committees chosen wholly or partly from persons not concerned in the Bank's management.</p>	<p><i>No change.</i></p>

Note: The above table only considers possible changes to the Bank's Statutes. Corresponding changes may also need to be made to other texts such as the bank's home and host country agreements and certain Board documents.