



Brussels 6th January 2015
VH/MM/B18

**EACB Note
on
BCBS Guidelines on Corporate Governance Principles for Banks**

The members of the European Association of Cooperative Banks (EACB) support the aim of the Basel Committee to enhance sound corporate governance practices at banking organizations. It is certainly useful to determine a set of enhanced principles for best practices, in order to avoid the adverse effects of deficiencies in banks' corporate governance which may contribute, among other factors, to financial crisis.

General

We appreciate that the paper emphasizes proportionality and differences in governance approaches and points out that it does not advocate any specific board or governance structure and that shareholder rights and national legislations have to be respected. These elements are of particular relevance for cooperative banks, which dispose of governance and groups structures, which significantly differ from those of joint stock companies, as they have very high numbers of shareholder members and where, in most cases, the principle "one member, one vote" prevails. While there can be no denying that the Basel Committee's guidelines should also be applied to cooperative banks, these relevant differences will have to be respected.

We underline that cooperative banks have better weathered the financial crisis than joint-stock banks, noticeably thanks to their specific governance based on:

- the dispersion of risks between many more or less independent entities ;
- the checks and balances between professional bankers and elected directors and chairmen;
- members who are customer and owners with direct interest in the sound management of the bank;
- one man one vote principle;
- simple and local business based on proximity and intimate knowledge of the field ;
- long term strategy aimed at the financing of the economy and the development of territories, rather than short term profit.

We appreciate that the Committee is aware that there are limits to the application of certain principles and we would like to highlight as possible sources of restrictions corporate, labour and other national law outside the regulatory or supervisory framework. In this respect, an important degree of discretion will have to be granted to national authorities and a "legal change" as mentioned in para. 12 (Jurisdictional differences) will not always be possible.

The voice of 3.700 local and retail banks, 56 million members, 215 million customers

EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels

Tel: (+32 2) 230 11 24 • Fax (+32 2) 230 06 49 • Enterprise 0896.081.149 • lobbying register 4172526951-19
www.eacb.coop • e-mail : secretariat@eacb.coop



Moreover, the EACB would like to draw the attention of the BCBS to the fact that the governance framework for institutions in Europe was comprehensively amended with the introduction of CRR and CRD IV as of January 2014. We believe that these rules are in line with Principle 11 and that no additional market standards or standalone regulations are required.

Drafting

➤ Senior management/board of directors

We believe that the use of the terms “senior management”, “board of directors” and “board” is not very consistent and causes confusion, especially when to be applied in jurisdictions with a dualistic model. Therefore, we would recommend to use the term “management body” for general principles throughout the text and to single out respectively whether the executive (managing/executive board), the supervisory function (supervisory board), or a director/staff level below the board (senior management) is meant (see also principle 5). In addition we would recommend clarifying what is meant by the term senior management, i.e. whether this is the management just below the management body or the management body itself.

We also have the impression that the paper is too much geared towards one-tier models. Certain elements and proposals do not seem conclusive if applied to two-tier governance models, where the systems of checks and balances are different. Especially before this background some of the suggested solutions seem overly formal and could even be counter-productive if applied in two-tier systems (e.g. exclusion of chair of supervisory board from certain board committees).

➤ Management body

The term “management body” should be defined as “an institution's body or bodies, which are appointed in accordance with national law, which are empowered to set the institution's strategy, objectives and overall direction, and which oversee and monitor management decision-making, and include the persons who effectively direct the business of the institution;” (CRD 4 directive, article 3 (7)).

Indeed, in some jurisdictions directors may have both supervisory and management roles. In that case, the difference with persons who exclusively have managing powers is that these latter “operate the bank’s business on a day-to-day basis” as referred in BCBS documents at point 2. The CRD 4 directive also defines these 'senior management' as “those natural persons who exercise executive functions within an institution and who are responsible, and accountable to the management body, for the day-to-day management of the institution;” (CRD 4 article 3(9)). The *summa divisio* should be between the “management body” and the “day-to-day management” of the bank.

Therefore the glossary should be modified accordingly: the board of directors cannot be defined as the structure that exclusively supervises management, because it may have



both supervisory and management task, but no “day-to-day management of the institution”

➤ Board governance structure

The drafting of the beginning of point 16 is also confusing: *“Owing to these differences, this document does not advocate any specific board or governance structure. The term board of directors is used as a way to refer to the oversight function and the term senior management as a way to refer to the management function in general. These terms should be interpreted throughout the document in accordance with the applicable law within each jurisdiction”*. This drafting is ambiguous and should be modified.

The key point is to abide by the principle set in point 16 of the BCBS document : “The application of corporate governance standards in any jurisdiction is naturally expected to be pursued in a manner consistent with applicable national laws, regulations and codes (e.g. taking into consideration the existence of oversight boards in some jurisdictions)”.

Independent Directors (Principle 2 and 3)

All in all, we believe that the guidance regarding independent directors could unintentionally be too far reaching.

The role of independence in governance is assumed as primal cornerstone and is not challenged: “The board must be suitable to carry out its responsibilities and have a composition that facilitates effective oversight. For that purpose, the board should be comprised of a sufficient number of independent directors” (para. 45).

However, this role is far from being obvious. For instance, it can be remembered how the presence of so-called “independent directors” has not been by itself a guarantee of sound governance in the past. If, the independent directors do not have the appropriate culture and distort the incentive system of the organisation, on the contrary, some of them may even emerge as a new class of professional directors, often former CEOs, “salaried” with attendance fees, and that are not really “independent” from the CEOs of companies. This is particularly sensitive especially for one-tier systems. It seems difficult to support that a director may have no interest whatsoever in the company and not suffer in any way from the company’s bankruptcy.

The historical basis of boards of directors is instead in many cases constituted of the main shareholders who have a direct interest in an efficient management of a company.

The very fundament of cooperative banks is that they have been created by their customers for their customers, who are in most cases eventually the owners of the bank. Therefore, the governance of cooperative banks is based on the involvement of customer-owners, the members, in the governance of the bank. This model has proved very efficient due to the direct and obvious interest of members in the good management of the bank, both as owners and as customers and depositors.



The directors of the management board, in one-tier systems, and of the supervisory board, in two-tier systems, of a cooperative bank are independent because they have been elected by the members, are not subject to the will of the management, and because they are often depositors and customers of the bank.

➤ Independent Directors – the definition

The definition in the glossary, which is identical to the one of the FSB's "Thematic review on risk governance", requires an independent director "not to have any management responsibilities with the bank and not to be under any undue influence, internal or external, what would impede his exercise of objective judgment".

In cooperative groups, where local institutions are the major shareholders of central institutions and specialized institutions, this could mean that managing directors of local banks, when sitting on the board of the central institution of their group or network would not be considered "independent", since they may have management responsibilities in other parts of the group. This would exclude her/him from the status of "independent director" and could create difficulties.

An important issue remains also what constitutes "undue influence". In this respect, the FSB review reveals quite a bandwidth of possibilities. It has to be underlined, that often, although not for every cooperative bank, board members are also members of the cooperative, hold shares and do business with the cooperative. The idea is that as customers they should have a good insight and understanding of the bank and a strong interest in its services. Moreover, the capital involvement as shareholder in cooperative banks is never significant. We therefore underline the importance to maintain a definition of independence as the current one, which gives sufficient flexibility. By no means should "undue influence" be defined along a list of formal criteria, as due to the variety of governance structures this might lead to undue and uneven restrictions. There should be a dedicated assessment to identify in individual cases whether a member of the board is independent or not. Independence of the members of the management board should rather be subject to declaration/self evaluation with regards to his/her connection to the respective credit institution and subsequent internal evaluation by the credit institution.

In particular, the paper should also avoid misleading proposals, and should explicitly clarify that members of the management board recruited from the shareholder/customer base should not be considered dependent, influenced, or under conflict of interest *per se* (see from para. 79). Reflecting the shareholder structure and the business model, it should be allowed to boards and committees (see from para. 67) to recruit among their shareholders/customers.

Although not for every case, often a condition for the election to the board of a cooperative bank consists in being a shareholder member or a member holding certificates or any other type of capital instrument issued by the cooperative.

Since the board member may also be a client and a holder of capital instruments of the cooperative, the proposed definition of "independent director" would make it highly



difficult for board members of many cooperative banks, current or future, to comply with the independence criteria proposed. This would contrast with the checks and balances between professional day-to-day managers and directors/members elected by members which have proved very effective.

Therefore, we would recommend supplementing the definition of "independent director" with the following:

"For the avoidance of doubt, when applying these guidelines in cooperative groups/networks, the independent directors shall not be denied their independence when they are:

1. Board members who are also clients and shareholder members of the cooperative or members of the cooperative holding certificates or any other type of capital instrument issued by the cooperative; and
2. Board members in any cooperative of a group of cooperatives and who are also board members, directors, managing directors or members of the senior management in another cooperative of the group;"

➤ *Independent directors - nomination*

Furthermore, we disagree, with the proposals which require the nomination of independent directors, especially in Principle 2 and 3. Those principles, amongst others, require that:

- the boards are comprised of a certain number of independent directors (Nr. 45),
- the nomination committee should be composed of a number of independent board members (Nr. 52),
- the members of the audit committee should be entirely independent (Nr. 67),
- the majority of the members of the risk committee should be independent (Nr. 70);

We are not convinced that this high amount of independent board members will really lead to a better oversight and control. While we strongly advocate for an independence of mind and character of the board members, we would not believe that there is a lack of independence due to involvement in the management of affiliated banks. We also believe that this issue has to be treated differently in monistic and dualistic structures.

Periodic review of the structure of the board of directors (Principle 3)

The guidelines state that the Board of directors should periodically review its own "structure". We would appreciate a clarification of this notion of "Board's own structure": The implementation of this principle recommending a periodic review of the "structure" of the Board should be construed so as not to interfere in prevailing legislation. Indeed, the choice of the form of management is set by the legal statutes and only a general meeting



of members or shareholders would "review" the existing structure. The role of the Board is to consider the structure and propose to the general assembly the relevant changes.

Taken in a broader sense, the evaluation of its own structure by the Board would be to organize the sharing of responsibilities/roles of the various bodies of the Board, committees and the chairman of the Board. In addition, this principle seems to only take into account monistic models and not take regard of dualistic models. In the latter ones the chair of the management board is an executive board member while all the non-executive board members are members of the *supervisory board*. This would be in line with national company law. In fact, under some jurisdictions banks are obliged to have both a board of directors and a supervisory board.

Qualities of the chair of the board (Principle 3)

The Basel Committee states in its guidelines (Nr. 60) that, to promote checks and balances, chairman of the Board should be a non-executive Board member and not serve as chair of any Board committee. We understand that the aim of this provision is to strengthen the protection of the independence of the debates within the committees that advise the Board. However, we have doubts about the efficiency of this procedure, which could lead to duplications of discussions. In particular, it should be possible for the to allocate responsibilities of committees with staffing responsibility (e.g. the nomination or remuneration committee) to the board's chair.

Moreover, we do not believe that such restrictive rule should be implemented in banks of all sizes.

With respect to para. 60-61 of the draft guidelines, the guidelines should not aim at promoting one specific governance structure or model among the different models that are available under applicable laws in each jurisdiction.

In some jurisdictions, for instance in France, company law permits banks to be organised either with: (i) a board of directors (*directoire*) and a supervisory board (*conseil de surveillance*) as per the dualistic model; or (ii) a board of directors (*conseil d'administration*) and one or more managing directors (*directeur général and directeur général délégué*), generally not members of the board.

In the latter case, the powers of the board of directors (*conseil d'administration*), which are provided for under national companies law, include executive powers. In this case, it would therefore be impossible to implement measures as those indicated in para. 61 of the draft guidelines, since such measures would be contrary to national company law.

Moreover, from a more general perspective we do not see any need to restrict in this way the role of the chair in a dualistic system of supervisory board/management board.



Audit and Risk Committee (Principle 3)

According to the draft guidelines, the audit committee has the power to monitor the implementation, by the management body, of the remedial measures which are required because of flaws in the internal control identified in the audit report. We do not believe that the powers of an audit committee should be defined to this degree of detail.

Moreover, some prerogatives appear to be already in the remit of the risk committee. For instance, the accounting statements and reports, the risks related to internal or external fraud, or compliance with accounting rules are all under the scope of the permanent control framework, thus of the risk committee.

The risk committee established is also responsible for direct supervision of both the implementation of policies and procedures of risk, and the risk monitoring. We believe that it is sufficient if the risk committee is destined to assist the Board in this task.

All in all we believe that this raises the question of the relationship between the supervisory functions of the individual committees and the Board as a whole. Especially in dualistic systems, where there is a supervisory board apart from the management board, it seems not necessary to enhance the role of those subcommittees to such extent.

Thus, in this context, we find that such a division of tasks of Internal Control bodies between risk and audit committee may reveal inefficient. On the one hand, this scheme is redundant, especially if there is a need to schedule periodic meetings between these committees to corroborate their respective opinion (para. 74). On the other hand, it is difficult to assume that such a division would guarantee better risk oversight. At a supervisory level audit and risks findings are complementary and need to be viewed simultaneously within a comprehensive approach for a full factual knowledge decision.

We believe that the establishment of audit and risk and other Committees within a board is more a matter of proportionality and depending on the size, risk profile and complexity of the institution, its business model and activities than the consultation paper suggests. Moreover, we believe that this question requires a more differentiated approach in the case of two-tier models: for small institutions with two-tier models we do not see the need for a mandatory establishment of such board committees, nor do we believe that the creation of such committees should be strongly recommended. We therefore suggest to adjust the sentence "For other banks it remains strongly recommended" (para. 67, 70) accordingly.

Conflict of interest

It seems hardly feasible to implement a detailed, written "*conflicts of interest policy*" (para. 82) for the board. It is in fact not practical to list situations that may give rise to conflicts of interest when serving as a board member. Such examples could not be complete and may even result misleading for the board. It should rather be left to the



responsibility and awareness of board members to closely monitor the best interest of the institution to identify and avoid possible areas and sources of conflict.

Governance of group structure (Principle 5)

In particular in jurisdictions with a dualistic model it would be confusing to create group wide responsibilities for "the board" without differentiating which function is meant (as pointed out above under "Drafting"). For instance, to "establish a group structure" should be explicitly in the competence of the parent company's executive directors endowed with guidance and oversee functions. Any crossover between executive, and oversight/supervisory function in group structures should be avoided.

Moreover, when parent companies "prescribe" corporate risk policies (para. 123) for subsidiary management, there may arise conflicts with the principle that a subsidiary is to adjust group policies under certain circumstances (para. 96/97). The guidelines should clarify how such conflict shall be solved.

Risk Management (Principle 6)

Periodic interactions between Chief Risk officer (CRO) and the Risk committee are to be considered as an effective practice for the independent information of the board of directors. This implies that the CRO has to gather and provide information to directors on the risk situation vs. the set of risk limits of the Bank, according to the risk appetite strategy.

However, the oversight on the CRO by the Risk committee appears inappropriate (para. 71) as board members must be independent from operational function. Besides, this proposal is not symmetric towards other Internal audit functions (Head of Internal Audit, Compliance officer), thus questioning their actual independence.

Risk Communication (Principle 8)

When referring to the possibility for the board to determine that additional information is needed (para. 126), it should also be clearly indicated that the "board" would also be entitled to determine that less information is sufficient.

Under para. 126, the scope of the accuracy of the information delivered to the Risk committee is to be clarified. If accuracy stands for "liability" (instead of "adequacy"), the sense of the word is then likely to question the independence of Internal Control function (Chief Risk officer, Head of Internal Audit, Head, Compliance officer).

Finally, the proposal to avoid "organisational silos" is too vague at this stage and appears unintelligible.



Disclosure and transparency (Principle 12)

We do not see the need also for non-listed banks to disclose the recruitment approach and policy (para. 154).

Contact:

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (v.heegemann@eacb.coop)
- Mr. Marco Mancino, Adviser, Banking Regulation (m.mancino@eacb.coop)