Federation of European Accountants
Fédération des Experts comptables Européens

7 September 2010

European Commission
DG Internal Market and Services
B - 1049 Brussels

E-mail: markt-cg-fin-inst@ec.europa.eu

Ref.: CLC/HvD/HB/SH

Dear Sir or Madam,

Re: European Commission Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies

FEE is pleased to provide you below with its comments on the European Commission (EC) Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies (the Green Paper).

We have considered your General and Specific Questions put forward in the Green Paper with great interest and in addition to our main comments hereafter, provide you below in the Appendix with our more detailed responses to your questions.

Main Comment

FEE welcomes this initiative of the European Commission (EC) with the ultimate aim to restore confidence in financial institutions and capital markets following the financial crisis.

FEE has been active in both the broader area of corporate governance and financial institutions for a number of years and has issued various papers in this respect. Therefore, FEE wishes to contribute to this debate by offering the accountancy profession's perspective.

Professional accountants can work in different capacities: as accountants in public practice (in large and smaller accountancy firms), as accountants in business (in SMEs and large enterprises), and as accountants in government and public sector. In all these different areas, their skills and values are instrumental to contribute to making our economies more efficient, transparent, and sustainable.

In particular, professional accountants have many competences which make them suitable to add value to companies' corporate governance. Their expertise can be (and is) provided in a variety

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of ways, all subject to the relevant ethical and independence regulations and other requirements. For instance, their contribution can take either the form of the provision of professional services, or participation in some aspects of the corporate governance system of a company such as the board of directors or the audit committee.

In our view, although the green paper is targeted at all financial institutions, including banks, insurance undertakings and other financial institutions, many of the issues the financial sector has been faced with over the last few years are specific to the highly regulated industry of banking, for instance the specific issue of systemic risk. Consequently, some of the issues raised in the Green Paper, as well as its questions and our response to these issues, are in our opinion mainly relevant to the banking sector only. The issues and responses should not be extrapolated to other industries outside the banking sector, e.g. to the insurance industry, without in-depth analysis and an appropriate impact assessment.

It needs to be noted that, in a number of EU Member States, financial institutions are not organised using standard corporate structures: mutuals, cooperatives, foundations, public entities, etc. are fairly common legal structures not only for special purpose banks but also for mainstream retail and commercial operations. In order to achieve consistency across the whole banking sector such structures (which sometimes do not even have shareholders in the narrow sense) should also be subjected to the same principles and similar standards. EU Member States should also enact laws and regulation that require such entities to have a proper governance structure. Finally, consideration also needs to be given as to whether and, if so, how to include public sector financial institutions into this structure.

As corporate governance matters are often not straightforward to enforce based on laws and regulations, FEE has, along with most other stakeholders, been a long standing supporter of the ‘comply or explain’ approach to corporate governance for all companies, including financial institutions, and comprehensive disclosure in a corporate governance statement.

Some argue that, in light of the financial crisis, following a *‘comply or explain’* approach is no longer appropriate. However, the current approach to regulation, governance codes, guidance, etc., in relation to corporate governance differ significantly from one EU Member State to another. These differences between jurisdictions need to be understood and considered in detail as they often reflect the role and relative stability of the national financial sector and go some way to explain the difficulties in finding common European solutions.

FEE has always been a long standing supporter of setting robust, high quality *principles and benchmarks* for corporate governance at European level and continues to be of the view that a principles-based approach to corporate governance is preferable over a rules-based and legalistic approach.

Were European regulation in the area of corporate governance for financial institutions, or even for listed entities in general, to be chosen as the way forward, the European Commission should be well aware of the consequences in EU Member States. Established national systems which cannot be changed overnight and amendments to particular national circumstances could result in sweeping changes in the corporate governance system in some EU Member States and only minor changes in others and therefore diminish their effect.

Consequently, FEE wholeheartedly subscribes to the statement in the European Commission Staff Working Document accompanying the Green Paper that:

> *"It is rather about adjustments to expand and detail further corporate governance principles where needed, fine-tune the balance between soft and hard law, and ensure a strict monitoring of voluntary practices and adequate enforcement of legislation. The current*

system of checks and balances must be significantly strengthened, duly applied and enforced so that all involved will have a greater awareness of their accountability and liability, without undermining the spirit of entrepreneurship and risk-taking that is necessary to economic growth."

FEE believes this can be achieved by strengthening the corporate governance approach in financial institutions by balancing principles, benchmarks and standards on a European level, supplemented with rules and requirements at national level that allows for a level playing field across Europe. We express this view because rules, monitoring and enforcement are commonplace in the areas of financial reporting and auditing, areas with which we are most familiar, whereas they are less evident when applied in the area of corporate governance. Additionally, it is also about influencing the culture and behaviour in financial institutions which cannot only be achieved via laws and regulations.

Although not fully within the scope of the Green Paper, we wish to stress that preventing or managing events like asset bubbles relate primarily to macro-economic regulation and only secondary to supervision or corporate governance. We therefore recommend including in the discussion on corporate governance and supervision of individual entities a section that deals with macro-economic regulation and intervention activities.

We would also like to stress that due care should be given to the impact on some small and medium-sized financial institutions as they could easily be over-burdened by the proposed requirements.

Further consideration should also be paid to the competitiveness of EU financial institutions in the wider global financial markets. Therefore measures taken should ideally be globally coordinated and EU institutions should not be disadvantaged in the global competition.

FEE is at the full disposal of the European Commission to discuss any of our comments in further detail in order to contribute to the important work of finding the right balance for these corporate governance related issues. This also includes further discussions related to any issues raised in our responses to the detailed questions included in the appendix to this letter.

FEE's ID number on the European Commission's Register of Interest Representatives is 4713568401-18. For further information on FEE's name, country of origin, legal form, size, field of activities and cross-border activity, please refer to footnote 1.[1]

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[1] FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 European Union (EU) Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;

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For further information on this letter, please contact Hilde Blomme at +32 2 285 40 77 or via email at hilde.blomme@fee.be or Lotte Andersen at +32 2 285 40 80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,

Hans van Damme
FEE President

- To represent the European accountancy profession at the international level.

Avenue d'Auderghem 22-28, B-1040 Brussels
Tel: +32 (0)2 285 40 85
Fax : +32 (0)2 231 11 12
secretariat@fee.be
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Appendix: Responses to Questions

Boards of directors

Question 1: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the composition, role and functioning of the board of directors, and to indicate any other measures they believe would be necessary.

Due care should be given to the proper appointment, competences and composition of the board of directors[2] as a whole. It is important that the board of directors works to its full potential and reaches maximum efficiency in its operations.

FEE is of the view that in order for shareholders to be able to place sufficient trust in the non-executive or supervisory directors, they should be informed about their particular competencies in light of the board of directors' composition. This, together with information about the operation of the board as a whole should be disclosed to the shareholders in a transparent way.

1.1. Should the number of boards on which a director may sit be limited (for example, no more than three at once)?

The overarching principle in relation to directors is that each director should be able to devote sufficient time and the necessary attention for each board on which the board member sits, also in times of crisis. This would be consistent with the EC 2005 Recommendation on the role of non-executive or supervisory directors in listed companies[3]. Directors should be prevented from acceptance of too many board appointments with due regard to their other duties and commitment. The aim is that individual's ability to properly perform his/her duties as a whole is not compromised. This should be enforced by the chairman of the board of directors.

The principle should be designed to encourage EU Member States to introduce systems that limit the incentive of directors to be a member of too many boards and hence not comply with the overarching principle. However, FEE considers that regulatory measures in the form of detailed rules at European level would not be appropriate. When implementing the European principles, EU Member States might decide to introduce specific rules on this issue, which is already the case in some national laws or corporate governance codes. Further details to complement the overarching principle could include:

- Requiring that the expected time commitment is clearly specified in the terms of reference for the board of directors, such as the number of meetings, expected contribution of each of the members, participation in committees, etc;
- Highlighting considerations related to proportionality, such as size and complexity of the financial institution and the lines of business it operates in (banking, insurance undertaking, provision of mortgages, funds management, others);
- Setting specific expectations for directors' involvement in general and in times of crisis.

Financial institutions should be required to disclose board positions held in other companies by their non-executive or supervisory directors. A number of companies currently disclose this information in their financial statements as recommended in paragraph 12 of the EC Recommendation on the role of non-executive or supervisory directors in listed companies.

[2] In this response the use of « board » and « board of directors » is considered equivalent and depending on the specific circumstances. The terms should be understood as management board or supervisory board. The specific circumstances will, to some extent, depend on the situation at national level, i.e. whether the system for boards is a one-tier or two-tier system.
[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:EN:PDF

Disclosures should include significant board or equivalent positions held in public sector or not-for-profit bodies.

1.2. Should combining the functions of chairman of the board of directors and chief executive officer be prohibited in financial institutions?

All companies need able management whilst it is important to have an appropriate balance of power in any board system so that no single individual or group has unfettered control of the company.

As recommended in our Discussion Paper on the Financial Reporting and Auditing Aspects of Corporate Governance[4], it is essential that, in a system with a unitary board, the roles of Chairman and Chief Executive should be held by different people, balanced by a strong independent non-executive element. In a two-tier structure the management board should have further members in addition to the Chief Executive who could be the chairman of the management or executive board.

This is consistent with paragraph 3.2 of the 2005 Commission Recommendation on the role of non-executive or supervisory directors of listed companies that recommends separation between the roles of chairman and chief executive in a unitary system. A cooling off period is recommended for both unitary and dual systems.

In exceptional circumstances where the roles are combined, it is recommended that safeguards are put in place. Possible safeguards would include requiring full explanation of:

a) Why the two roles have been combined.
b) Safeguards put in place by the board of directors to ensure that one person does not have too much power.

FEE supports having similar requirements in place for all financial institutions, not just listed companies, in line with the scope of this Green Paper.

1.3. Should recruitment policies specify the duties and profile of directors, including the chairman, ensure that directors have adequate skills, and ensure that the composition of the board of directors is suitably diverse? If so, how?

As previously mentioned, FEE is of the view that in order for shareholders to be able to place sufficient trust in the non-executive or supervisory directors, they should be informed about their particular competencies in the context of the composition of the board of directors. This trust by shareholders can only be achieved if non-executive and supervisory directors are competent and have sufficient time to fulfil their role. The key point is balancing skills and experience so that the financial institutions' board of directors *as a whole* has strong expertise relevant to the activities of the respective financial institution.

Paragraph 11 of the EC Recommendation on the role of non-executive or supervisory directors in listed companies addresses the qualifications of the non-executive or supervisory directors on issues such as proper balance in terms of qualifications in the board of directors, induction programmes for new members, and disclosures of competences upon appointment and yearly review.

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4 http://www.fee.be/fileupload/upload/DP%20Financial%20Reporting%20and%20Auditing%20Aspects%20of%20Corporate%20Governance%2003071532005211529.pdf, July 2003

These requirements all seem appropriate for board of director members of financial institutions, where necessary competences within the board of directors in, for instance, financial services are clearly needed considering the economic impact that these companies have on society in general if their business is put under pressure. In light of this impact, requirements regarding continuous education to maintain the knowledge about the market and its developments could also be considered as a supplement to the already recommended induction programmes for new members of the board.

Where there is a majority or sole shareholder, there is a need for independent and knowledgeable non-executive directors or supervisory board members to ensure the interests of minority shareholders and/or wider stakeholder groups, like creditors, are adequately represented.

1.4. Do you agree that including more women and individuals with different backgrounds in the board of directors could improve the functioning and efficiency of boards of directors?

FEE supports diversity in the board of directors and its committees based on the overall principle of *“the best person for the job”* giving due care to the competences, qualifications and the collective responsibilities of the board of directors, whether or not this entails more differences in gender, background, age, etc. However, it is important to recruit from a sufficiently large and diversified pool of candidates, being substantially wider than an established network of candidates.

In FEE’s opinion quotas of any kind would not be compatible with this overall principle as the primary criterion is that the competences of the board of directors collectively reflect the activities of the financial institution.

The most important element, over and above the composition of the board and its committees, is ensuring that the board is run effectively, functions properly and works efficiently.

1.5. Should a compulsory evaluation of the functioning of the board of directors, carried out by an external evaluator, be put in place? Should the result of this evaluation be made available to supervisory authorities and shareholders?

The EC recommendation on the role of non-executive and supervisory directors in listed companies includes a number of relevant principles under 8. Evaluation of the (supervisory) board and 9. Transparency and communication.

Similar principles would be appropriate for financial institutions within the scope of this Green Paper.

The EC recommendation deals with self-assessment by the board of directors which it proposes should be carried out yearly.

FEE considers that evaluations facilitated by an external evaluator could be relevant. Having such external evaluation carried out on a regular basis, but less frequent than annually, and whenever there is a significant change in the composition of the board of directors would be appropriate.

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The following key characteristics of an external evaluator and the evaluation facilitated by an external evaluator could be relevant:

- Independence of the external evaluator, both of the board of directors and its committees, as well as the financial institution as a whole. Such independence should be disclosed by the financial institutions;
- Evaluation of the performance of the board of directors as a whole and of its committees;
- Facilitation of the evaluation of the performance of individual non-executive board members. The evaluation itself has to be performed by the other board members, assisted by the independent external evaluator, as usually only the board members attend board meetings;
- Annual evaluation of executive board members, the CEO and management as a whole should be performed by the chairman and non-executive board members. This process can be facilitated by an independent external evaluator.

FEE does not see a need to disclose the details of the external evaluation carried out, as it seems sufficient to inform the shareholders, in accordance with the EC recommendation, that the evaluation has been carried out.

To enable enforcement of these principles related to self-assessment and externally facilitated evaluations of the board, regulators should have access to the results of the evaluations carried out.

1.6. Should it be compulsory to set up a risk committee within the board of directors and establish rules regarding the composition and functioning of this committee?

As it is especially important that financial institutions focus on risk management, FEE supports a mandatory requirement to set up a risk committee within the board of directors of financial institutions which are subject to significant systemic risks. Systemic risks appear to have been an important cause of the financial crisis together with a combination of various other issues which are mostly relevant for banks. Proportionate and less comprehensive measures should apply for financial institutions subject to less systemic risks. One may consider a risk organ both on the level of executive management as well as a risk committee of the (supervisory) board.

FEE recommends that the principles applicable to such a committee are similar to the principles already recommended for other board committees in the EC recommendation on the role of non-executive or supervisory directors in listed companies – nomination committee, remuneration committee and audit committee. This entails that principles in the following areas would also apply to the risk committee:

- Presence of non-executive or supervisory directors and the number of independent directors: FEE considers that most members of the risk committee should be independent. However, it might not be necessary that all members of the risk committee are independent. For instance, although not independent, the CRO (Chief Risk Officer) of the parent company could usefully be member of the risk committee of a subsidiary financial institution;
- Organisation, including flexibility in setting up the risk committee: Flexibility in setting up the risk committee should be allowed as the whole board of directors would take on this key agenda in many cases if sufficiently qualified, with or without the assistance of independent risk experts;
- Role of the risk committee vis-à-vis the board of directors: similar principles as for other board committees should apply, as the board of directors remains fully responsible;
- Appointment, qualifications and commitment of the members of the risk committee: similar principles as for other board committees should apply, including requirements related to

specific expertise with risk management issues and development of terms of reference for the risk committee.

In addition, FEE supports having clear and well-defined recruitment policies that facilitate identification and election of the right candidates for the board of directors and its committees, giving due consideration to the principles for qualifications and competences set out in the EC Recommendation and as highlighted above.

1.7. Should it be compulsory for one or more members of the audit committee to be part of the risk committee and vice versa?

As set out in the EC recommendation the primary purpose of the committees should be to increase the efficiency of the (supervisory) board by making sure that decisions are based on due consideration and to help organise its work with a view to ensuring that the decisions it takes are free of material conflicts of interest. The board of directors should ensure continuous, clear and uninhibited exchange of views and positions between its committees, including the risk committee. This could be supported by the combined membership of the risk committee and the audit committee of the key liaison person which seems to be an effective way to ensure this desired level of communication.

However, it is also important that the risk committee has an appropriate mix of competent executive and non-executive directors to ensure that the board of directors collectively complies with the overall principle of efficiency of its work.

1.8. Should the chairman of the risk committee report to the general meeting?

The EC Recommendation on the role of non-executive or supervisory directors in listed companies acknowledges that the committees of the board make recommendations aimed at preparing the decisions to be taken by the board itself.

FEE supports this approach and finds it appropriate also for financial institutions as it underlines that the board of directors has sole statutory decision-making authority and is collectively accountable for the performance of its duties. In this way the full responsibility remains, in principle, with the entire board of directors. The committees of the board, including the risk committee, are preparatory committees that undertake certain tasks on behalf of the board, but the board of directors cannot, in principle, delegate ultimate responsibility to such committees.

The risk committee’s role and responsibilities, included in its terms of reference, should be agreed with the board of directors. Each company is unique and, therefore, the committee’s terms of reference need to suit the circumstances of the particular company subject to a fundamental core of responsibilities applicable to committees for all financial institutions.

Therefore, FEE considers that procedures requiring the chair of the risk committee to report directly to the shareholders would weaken the position and role of the board of directors vis-à-vis the shareholders. However, although not encouraged, it could be considered to allow for reporting by the chair of the risk committee to the general meeting in very exceptional circumstances only.

With regards to reporting by the risk committee, the board of directors should be responsible for ensuring that shareholders are properly informed regarding the affairs of the financial institution, its strategic approach, and the management of risks and conflicts of interest. These principles are equally relevant for reporting on the activities of the risk committee. This would be in line with the

recommended reporting by other board committees stated in the EC recommendation on the role of non-executive or supervisory directors in listed companies. For comments related to the content of such a risk statement, please refer to our response to question 1.10 below.

1.9. What should be the role of the board of directors in a financial institution's risk profile and strategy?

We refer to our response to question 1.6. The board of directors retains full responsibility for setting and approving the risk profile and strategy of the financial institution and continues to be accountable for this key function.

The board of directors also retains the responsibility for monitoring adherence to the strategy and ensuring that it remains comprehensive and reflects changes in the business model. In general, the board needs to be aware of the business model of the financial institution in considering whether that business model remains fit for purpose in the overall business environment.

1.10. Should a risk control declaration be put in place and published?

Scope of a risk control declaration/risk statement

According to the EC Green Paper, the approval of the risk strategy and profile in a public document should be published by the financial institution in a *"Risk Control Declaration"*. The Staff Working Document refers to a *"Risk Statement"* containing information about the risk appetite determination *"to show the market how rigorous and robust the risk management framework is"*. For the purpose of this response, FEE assumes that the Green Paper and the Staff Working Document refer to one and the same document, hereafter named "Risk Statement".

A decision on whether to introduce such a risk statement should be preceded by a comprehensive cost-benefit analysis on the need for such a statement as a significant amount of information on risk-related issues is already available in the public domain. Consideration should be given to the different needs of users, which could be the board of directors, the supervisors or the public. If considered appropriate, further discussions as to the content of a risk statement should be carried out.

In considering whether there is a scope for a Risk Statement, issues related to the proportionality of its possible content, level of detail, length, etc. should be addressed.

Contents

The EC Green Paper and the Staff Working Document provide suggestions for the content of the Risk Statement with references to, for instance:

1. Risk strategy and profile including the risk management governance system and how the system corresponds to the typology of risk to be managed.
2. Risk appetite determination:
    - show how rigorous and robust the risk management framework is together with the parameters of the risk management system;
    - reflect the type of financial services/products together with its geographical exposure.
3. Available risk architecture that reconciles bottom-up business, risk management practices and output with target risk appetite.
4. The board's understanding of current business risks in a changing market place as well as new risks, its monitoring and responses to changes.

5. Quantitative disclosures:
   - Benchmarks (respective levels of permissible aggregate exposures) for the implementation and monitoring of the risk, including deviations;
   - Effective aggregate amounts of exposure for the different financial products and regions (including off-balance sheet exposures), including deviations.

The EC Green Paper highlights that the information in the risk statement could be presented in a standardised minimum content and/ or format.

FEE sees a need for an agreed and adequate framework, benchmarks or standards for the contents of this risk statement. Such a framework would facilitate consistent application for the benefits of the information needs that the statement is responsive to. When considering the content of a framework, based on the suggestions made in the Green Paper, as summarised above, it should be recognised that part of this information is already available, mainly in the financial statements and in the annual report of the financial institutions.

In the context of the financial statements and the annual report the following legal and regulatory requirements already apply for disclosures on risk related issues:

- Article 46 of the Fourth Directive requires a description of the principal risks and uncertainties the entity faces. This review shall be a balanced and comprehensive analysis of the developments and performance of the company's business consistent with the size and complexity of the business;
- Paragraph 125 of IAS 1[5] requires the entity to disclose information about the assumptions it makes about the future and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of their nature and their carrying amount as at the end of the reporting period;
- Paragraphs 33-35 of IFRS 7[6] require qualitative and quantitative disclosures, including disclosures regarding risk exposures, objectives, policies and processes for managing risk and the methods used to measure the risk;
- Basel II and other regulatory requirements require various disclosures of risk-related information.

The content of the risk statement should take note of the information already included in the financial statements, and should only contain information that is not already published. FEE is aware that criticism has been expressed stating that the financial statements contain too much complex and overly detailed information on this issue. There is a resultant risk that users will not find the information useful when attempting to make decisions based thereon.

The issue is IFRS 7 and appears to be related to presentation of the comprehensive risk-related information, which might result in the principal risks being less clearly disclosed. It should be noted that the presentation of information is first and foremost the responsibility of management and those charged with governance (board of directors, etc.) of the financial institution. As financial institutions gain more experience with the implementation of IFRS 7, the application is likely to be improved.

The Committee of European Securities Regulators (CESR) and the Committee of European Banking Supervisors (CEBS), which both analysed the application of IFRS 7 in 2008 and 2009, concluded that there is room for improvement regarding these disclosures. In addition, when

[5] IAS 1 Presentation of Financial Statements
[6] IFRS 7 Financial Instruments: Disclosures

comparing disclosures on this issue in 2008 and 2009 financial statements, CEBS concluded that improvements were made in 2009, although more could still be done[7]. In this context, FEE would highlight that the financial statements are subject to supervision and enforcement. Appropriate actions can therefore be expected to be taken if supervisors and enforcers see non-compliance with IFRS requirements in the financial statements.

Further practical guidance on how to apply the disclosure requirements of risk-related financial information as far as its presentation, aggregation, prominence, level of comprehensiveness, etc. is concerned, would be considered useful. For further analysis, it can be highlighted that CESR and CEBS have provided some additional guidance on these issues in the above mentioned reports, which could be relevant to consider further and discuss with the relevant parties.

In addition, with regard to the content of the report of the risk committee the recommendations made by the UK Walker Review[8] could be considered, keeping in mind that the risk statement should include information that is not already publicly available elsewhere, such as in the financial statements.

Publication

As discussed above, information on risk is already produced and published by financial institutions around Europe based on regulatory requirements. However, it should be noted that not all information is necessarily published and does not have to be published, as some information is produced for internal purposes only, whilst other information is produced with the aim of meeting specific information needs of regulators or other users.

The various user groups of information on risk related issues of a financial institution as well as the information provided to them include:

- The financial institution itself, its board of directors, audit committee, risk committee and others: Internal reporting on risk management in accordance with internal corporate governance codes and other agreed procedures for internal reporting, long-form audit reports and other reporting from the auditor to the financial institution, etc.
- Regulators of financial institutions: Regulatory reporting based on international, European or national requirements, such as Basel II, Solvency requirements, CESR, CEBS and CEIOPS requirements and recommendations and national law requirements, etc.
- Users, investors, public: Financial statements including regulatory reporting required, audit opinion, analysts' briefings, investor relations' presentations, etc.

The proposed risk statement is intended to be published by the financial institution, and as such the aim of this published document therefore appears to be to fulfil some user information needs that are currently not met. In addition, the EC Green Paper refers to arguments presented as to whether or not to include the risk statement in the financial statements.

When publishing information there is always a risk of too much information being available, which is not necessarily helpful to the decision-making process of users, which has already been presented as criticism on IFRS 7 as mentioned above.

Therefore, FEE strongly encourages further analysis of the information needs of such a risk statement, with particular emphasis on which kind of information on risk-related issues for

[7] CESR analysis on *"Application of Disclosure Requirements Related to Financial Instruments in the 2008 Financial Statements"* http://www.cesr.eu/popup2.php?id=6156 and the latest report on disclosures from CEBS on *"Assessment of banks' transparency in their 2009 audited annual reports"* http://www.c-ebs.org/documents/Publications/Other-Publications/Others/2010/Transparency_2009AR.aspx

[8] http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf, recommendation 27

financial institutions that is currently not in the public domain. Especially, due considerations should be given as to whether or not inclusion of the risk statement in the financial statements would respond to the criticism on the comprehensiveness and usefulness of the current presentation of financial statements.

If further analysis shows that users would like more information (currently not available) in such a risk statement, whether inside or outside the financial statements, FEE supports the publication of a risk statement with considerations regarding the content as discussed above.

Further analysis in relation to the user needs should also reveal whether the information needs are currently more based on requests for additional information not readily available from regulators and supervisors. Such further analysis might show that the information needs of regulators and of other users are not the same and the reporting, including the possible involvement of the auditors, should therefore be differentiated to meet the needs of the respective user groups. It might be the case that the additional information on risk is only relevant for the benefit of the regulators and does not necessarily need to be publicly available.

Level of auditor's involvement

Finally, as further discussed in our response to Section 3 below, the level of involvement of the external auditors in this risk statement, if any, could be considered. The level of involvement should be further analysed as the range of this involvement could vary from no involvement at all to the auditor providing reasonable assurance on the entire content of the risk statement. As discussed above and in section 3, FEE considers a thorough cost-benefit analysis is needed, covering both the content of the risk statement and the level of the auditor's involvement before making any final decisions on this issue.

Further detailed work on these determining factors would be relevant in order to find the right balance for the content and credibility of this risk statement.

1.11. Should an approval procedure be established for the board of directors to approve new financial products?

A detailed rules-based procedure for approving new financial products would not be appropriate as the issue is not solely the risk profile of a product at its inception, but also the changes in its risk profile during its lifetime. Certain new products will bear more significant risks than others. Detailed rules on how much an existing product needs to have changed so that it meets the definition of a new product could be difficult to apply in practice.

Therefore, FEE considers a more effective and practical approach is for the board of directors to establish clear procedures for new product authorisation, product amendments and monitoring of the changes in their risk profile. This process would include appropriate involvement of the risk committee.

1.12. Should an obligation be established for the board of directors to inform the supervisory authorities of any material risks they are aware of?

FEE supports clear and frank communication channels between the financial institution and its supervisor. This includes information about the risk management approach and on subsequent significant, particularly adverse, changes to material risks. It should also be considered whether it is appropriate to report all gross inherent risks or only net risks after consideration of mitigating factors. However, any procedures in this respect should remain principles-based and take account of existing monthly or quarterly regulatory reporting obligations.

1.13. Should a specific duty be established for the board of directors to take into account the interests of depositors and other stakeholders during the decision-making procedure ('duty of care')?

The board of directors of any company must *have regard to*, not necessarily *take into account*, the best interests of the company and the long-term interests of its shareholders. In doing so the board of directors of a financial institution would also protect the key interest of depositors in the banking sector and policy holders in the insurance industry. However, the interests of depositors and policy holders, respectively, should not be singled out specifically beyond having regard to the interests of the financial institution itself and the ones of all other stakeholders.

The financial institution as a whole already has specific duties as a result of being part of a highly regulated industry where the focus is on acting in the public interest. As such the financial institution as a whole has to address its reputational risk as the business of the financial institution is highly sensitive if incidents occur that can affect its reputation.

The overall task of the regulators is to make sure that financial markets and financial institutions within these markets are run properly and interests of depositors and policy holders, respectively, are protected.

Risk-related functions

Question 2: Interested parties are invited to express whether they are in favour of the proposed solutions regarding the risk management function, and to indicate any other measures they believe would be necessary.

FEE agrees that poor or weak risk management in financial institutions undoubtedly contributed to the severe impact of the financial crisis. Therefore, FEE supports strengthening the risk-related functions in financial institutions. However, for the reasons discussed above, FEE considers that a principles-based approach to corporate governance including risk management is preferable to a rules-based approach.

As propagated in the FEE Discussion Paper: *"Risk Management and Internal Control in the EU"*[9] emphasis should be placed on an overall need for more research and learning from experience to direct developments in risk management and internal control appropriately. It needs to be widely recognised that profits are, in large part, the reward for successful risk-taking. Therefore the purpose of risk management and internal control is to manage risk, including upside risk, appropriately rather than to eliminate it.

[9] http://www.fee.be/publications/default.asp?library_ref=4&content_ref=351, March 2005

As of 2006, the Fourth and Seventh Directives require a description of internal control and risk management systems which presuppose the identification of high level criteria for use by companies in order to facilitate consistent reporting. Additional European regulatory initiatives in light of the financial crisis could be considered, if the application of the requirements in the directives is found to be inadequate.

2.1. How can the status of the chief risk officer be enhanced? Should the status of the chief risk officer be at least equivalent to that of the chief financial officer?

Risk management is the key focus area in financial institutions, primarily banks. The financial crisis revealed significant deficiencies in risk management in the financial institutions that were put under pressure.

Increased focus on risk management in financial institutions, primarily banks, therefore appears to be an appropriate response to these deficiencies. In this context, FEE supports having the Chief Risk Officer (CRO) as a mandatory executive position. Considering the role of (financial) risks in financial institutions, the status of the Chief Risk Officer should be equivalent to that of the Chief Financial Officer (CFO), putting similar reporting lines in place for the Chief Risk Officer to report to the risk committee (as explained in our response to question 1.6 above) as is in place for the chief financial officer when reporting to the audit committee.

For the role of the Chief Risk Officer, FEE finds the recommendation made in the Walker Review[10] regarding this particular position relevant for consideration at European level. Walker Recommendation 24 states the following:

> *"In support of board-level risk governance, a [BOFI] board should be served by a CRO who should participate in the risk management and oversight process at the highest level on an enterprise-wide basis and have a status of total independence from individual business units. Alongside an internal reporting line to the CEO or CFO, the CRO should report to the board risk committee, with direct access to the chairman of the committee in the event of need. The tenure and independence of the CRO should be underpinned by a provision that removal from office would require the prior agreement of the board. The remuneration of the CRO should be subject to approval by the chairman or chairman of the board remuneration committee."*

2.2. How can the communication system between the risk management function and the board of directors be improved? Should a procedure for referring conflicts/problems to the hierarchy for resolution be set up?

As discussed in our response to question 1.6, FEE supports the establishment of a risk committee in financial institutions. In addition, as mentioned in our response to question 2.1, the Chief Risk Officer should report to the risk committee regularly and in times of specific needs and pressure and crisis, which should be set out in the terms of reference for the risk committee. The various types of information that the risk committee expects to receive from the Chief Risk Officer should be included in the terms of reference, including records from discussions in the forms of minutes from risk-related meetings and any procedures for referring conflicts, problems or issues to the corporate governance hierarchy for resolution.

Communication from the risk committee to the board of directors should be specifically addressed in the terms of reference for the board of directors and for the risk committee.

[10] http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf

The monitoring of compliance and evaluation of the efficiency of the communication should be done regularly as part of the self-assessment and/or externally facilitated evaluation of the functioning of the board of directors and its committees, as discussed in question 1.5 above.

2.3. Should the chief risk officer be able to report directly to the board of directors, including the risk committee?

If a risk committee is established the reporting lines should ensure that the risk committee has all relevant information to be able to make sound and sustainable decisions in support of the decisions to be made by the board of directors.

In general, it seems appropriate to have similar structures in relation to the reporting lines in place for the Chief Risk Officer as those relating to the chief financial officer when reporting to the audit committee.

2.4. Should IT tools be upgraded in order to improve the quality and speed at which information concerning significant risks is transmitted to the board of directors?

The development and upgrading of IT tools will require consideration in the particular circumstances of each financial institution. The development and upgrading of IT tools would be consequential to amendments of regulatory matters and it is inherent that regulatory changes would require upgrading of IT tools to continue to ensure the quality of the information transmitted to the board of directors. The development of IT tools, however, does not seem to be an area that is suitable for regulation at European level.

2.5. Should executives be required to approve a report on the adequacy of internal control systems?

European shareholders do not necessarily need further rights through company law or the provision of additional corporate governance measures to bring improvements in risk management and internal control for financial institutions. There are already viable mechanisms in EU Member States where shareholders have effective powers through company law to bring about change and influence those charged with governance.

Reports on the adequacy of internal control systems seem to be similar to the reporting required under the US Sarbanes Oxley Act. However, FEE remains unconvinced about the usefulness of introducing published effectiveness conclusions on internal control over financial reporting across the EU in the same way as required by Section 404 of the Sarbanes-Oxley Act.

Considering the European context, in substance and as discussed in our response to question 1.10 above, disclosures regarding risk and internal control are already required in various ways:

- IFRS already requires substantive disclosures regarding risk management;
- Article 41 of the Statutory Audit Directive requires the following for public interest entities:
    - The audit committee shall *“monitor the effectiveness of the company's internal control, internal audit where applicable, and risk management systems”;*
    - The statutory auditor or audit firm shall *“report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process.”*

Avenue d’Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
Association International reconnue par Arrêté Royal en date du 30 décembre 1986

- In this Green Paper, the European Commission is discussing whether to introduce a new *“Risk statement”* commenting on the risk strategy, profile and risk appetite in financial institutions.

With these requirements already in place for listed companies and public interest entities, respectively, and with the new initiative of a *“Risk Statement”* for financial institutions, any further reports commenting on internal control systems for financial institutions appear only to be necessary for those financial institutions that are not-listed companies or public interest entities. In this regard, the efficiency and cost-benefits of reporting in general should be kept in mind.

External auditors

Question 3: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of external auditors, and to indicate any other measures they believe would be necessary.

The current role of external auditors is primarily in the context of the statutory audit which is aimed at enhancing the degree of confidence in the financial statements of the entity for intended users which is achieved by the expression of an opinion by the auditor on whether the financial statements present fairly, in all material respects, the financial position, the financial performance and the cash flows of the entity in accordance with an applicable financial reporting framework.

The primary function of external auditors in the current model is not to assess the corporate governance of financial institutions but to consider corporate governance structures and policies in the context of their audit of the financial statements. In obtaining an understanding of the business, external auditors consider these corporate governance structures and policies as part of their work leading to the expression of an opinion on the financial statements. However, the auditors do not automatically and formally report on this aspect to the board of directors or management.

As far as risk-related information is concerned, the audit opinion of external auditors already covers the disclosures on the different types of risks arising from financial instruments as made in the notes to the financial statements following IAS 1 and IFRS 7 and including certain quantitative and qualitative disclosures as mentioned in our response to question 1.10.

If there is a clear public interest for enhancement of the role of the external auditor coming from regulators, investors and other stakeholders, external auditors can be involved with corporate governance matters and additional qualitative risk-related and risk management information and issues as prepared by banks and other financial institutions. Factors to keep in mind include:

- The decision should be preceded by a comprehensive cost-benefit analysis on such enhanced auditor’s involvement;
- Consideration should be given to the different needs of various categories of users, which could be the board of directors, the supervisors or the public;
- External auditors’ involvement with corporate governance and risk-related matters cannot exceed the responsibilities assumed by management and the board of directors;
- There are inherent limitations to the external auditor’s involvement in this respect, especially in case of forward looking information;
- External auditors can ordinarily not be involved with the risk appetite or risk strategy as determined by the board of directors of the financial institution;
- There is a need for an agreed and adequate framework, benchmarks, or standards for auditors to be involved and to base their opinion or conclusion on;

- The provision of services by external auditors can be in different forms including an audit, a review, another assurance engagement, a consistency check, agreed upon procedures, etc. In this respect, we refer to Chapter 5 in the FEE Discussion Paper for "The Auditor's Role Regarding Providing Assurance on Corporate Governance Statements"[11];
- The assignment could be carried out either by the statutory auditor or another independent and suitably qualified practitioner, depending on whether the work on corporate governance or risk-related information is a statutory engagement or in other jurisdictions is included in the annual report or is published separately;
- Although external auditors must be held appropriately responsible for their work and opinions issued, this should be to no greater extent than is reasonable by bringing in the notion of limitation of auditors' liability or safe harbour limitations. At a minimum, it should be ensured that auditors are not responsible for differences between estimates and risk metrics on one hand and actual outcomes on the other unless clear professional negligence is proven.

There is a genuine need to consider all the different factors as indicated above and this demonstrates that it is very important to find the right balance before any final decisions are made on the way forward regarding the auditor's involvement.

In line with previously publicised positions by the European Commission and the responses to question 2.5 above, FEE remains unconvinced about the benefits of introducing published effectiveness conclusions on internal control, including risk management as required by Sections 302 and 404 of the US Sarbanes-Oxley Act into financial reporting across the EU as they do not appear to have prevented the financial crisis from happening in the US.

Finally, reference is made to Section 3.7 on "The role of auditors" in the Green Paper where the following is stated: "*However, conflicts of interest could arise as audit firms are remunerated by the same companies who mandate them to audit their financial accounts*."

The European Commission is of course aware that following the transposition of the Statutory Audit Directive in every EU Member State, the appointment of statutory auditors or audit firms should be based on its Article 37 which stipulates that:

> *"1. The statutory auditor or audit firm shall be appointed by the general meeting of shareholders or members of the audited entity.*
>
> *2. Member States may allow alternative systems or modalities for the appointment of the statutory auditor or audit firms, provided that those systems or modalities are designed to ensure the independence of the statutory auditor or audit firm from the executive members of the administrative body or from the managerial body of the audited entity."*

As statutory auditors are in practice either nominated by the general assembly, the supervisory board or its audit committee, their independence of the executive management of the financial institution should be ensured upon appointment. The involvement of regulatory supervisors in the financial sector further reinforces this independence requirement.

Moreover, based on Article 22 of the Statutory Audit Directive on independence and objectivity, Member States shall ensure that, when carrying out a statutory audit, statutory auditors and/or the audit firms are independent of the audited entity and are not involved in the decision-making of the audited entity. This is in practice ensured by compliance with a code of ethics, either based on the European Commission Recommendation of 16 May 2002 on Statutory Auditors' Independence in the EU: A Set of Fundamental Principles, the IFAC Code of Ethics or national codes of ethics.

[11] http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1167, November 2009

Article 42 of the Statutory Audit Directive requires that the audit committee in public interest entities reviews and monitors the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity.

Furthermore, Article 32 of the statutory audit directive requires the public oversight system to have the ultimate responsibility for the oversight of the adoption of standards on professional ethics (which include the compliance with independence standards), internal quality control of audit firms and auditing.

All these European requirements function as significant safeguards and have already been put in place in response to the possible threat of conflict of interest and lack of independence in regard of auditor's remuneration. Accordingly, there is no need to add to these requirements.

3.1. Should cooperation between external auditors and supervisory authorities be deepened? If so, how?

As referred to in the Green Paper, Article 53 of the EU Directive of 14 June 2006 (2006/48/EC) relating to the taking up and pursuit of the business of credit institutions already requires that auditors of financial institutions alert the competent authorities whenever they become aware of certain facts which are liable to have a serious effect on the financial situation of an institution.

FEE has not performed work to determine whether this requirement has been effectively enforced in practice in EU Member States. Therefore, as a first step, FEE would strongly recommend the EC to check the enforcement of Article 53 of Directive 2006/48/EC in every EU Member State rather than to add additional regulations with the risk that these might not be consistently implemented and enforced at the EU Member State level.

However, FEE is aware that the current laws, regulations, and approach to corporate governance in financial institutions as well as the interaction of external auditors with supervisory authorities differ significantly from one EU Member State to another. Measures that are taken to deepen the communication and cooperation between auditors and supervisory authorities will result in sweeping changes in some EU Member States and virtually none in other EU Member States where such cooperation is already in place.

In this respect, it should be noted that the role of supervisory authorities is geared towards the financial market as a whole as well as to the supervision of individual financial institutions. The role of external auditors is primarily related to reporting on those individual financial institutions which are their audit clients. The focus for supervisory authorities is therefore wider compared to the scope of the work of external auditors. Supervisory authorities should identify and report on global risk factors and systemic risks in the financial markets such as potential risks with Icelandic or Greek banks whereas external auditors should be occupied with the risks their clients face. A fruitful exchange of information between the two groups could be beneficial to both, as indicated by the European Commission in the Green Paper.

In considering the cooperation between external auditors and supervisory authorities, it is important to get an appropriate balance of rights and obligations between the different parties involved. More specifically, the effectiveness of such cooperation will differ depending on how the existing communication and cooperation between auditors and the securities regulator, the financial services industry regulator and other authorities is exercised, as each authority has different interests in risk management, liquidity, solvency, etc.

The cooperation between external auditors and supervisory authorities should in practice be extended to also include management and/or those charged with governance of the financial institution audit client and be a three-way communication:

- Generally, meetings should involve the supervisory authorities, the financial institution client and the external auditor together, although the possibility of a private meeting between the supervisory authorities and the external auditor in justified cases should be provided for.
- Three-way communication means that the cooperation and sharing of information is not only from the financial institution and the auditor's side up to the supervisory authorities but also from the supervisory authorities to the financial institution and the auditors.
- In practice, three-parties exchanges could take place between the supervisory authorities, the financial institution client and the external auditor after the latter's interim work at the client, focusing mainly on macro-economic and systemic issues. Subsequent to the year-end audit, a second exchange of views could be envisioned focusing on the significant issues facing the financial institution audit client.

3.2. Should their duty of information towards the board of directors and/or supervisory authorities on possible serious matters discovered in the performance of their duties be increased?

In considering the duty of information of external auditors towards the board of directors and/or supervisory authorities on possible serious matters discovered in the performance of the external auditors' duties, it is again all about getting an appropriate balance of rights and obligations between the parties involved. A number of considerations should be taken into account before undertaking such action:

- In the absence of unusual circumstances which would require immediate reporting to the regulator, the auditor should first and foremost inform company's management and its board of directors. In the absence of any time limitations imposed by reporting requirements or other reasons, management should be allowed a reasonable period of time to rectify the matters discovered, providing the issue is addressed without undue delay.
- In case where further action towards the supervisory authorities is considered appropriate and necessary, great care should be taken by the supervisory authorities to avoid that such matters become 'semi-public' due to disproportionate action or overreaction by the supervisory authorities or regulators in their financial markets as a whole.

3.3. Should external auditors' control be extended to risk-related financial information?

Reference is made to our general comments on increased auditor's involvement (which is not necessarily understood as control) under Question 3, especially in relation to the careful consideration of the need for users' interest, for a cost-benefit analysis, for a framework or standards as a basis for the auditor's opinion or conclusion and for a limitation of the auditor's liability.

As also stated above, the auditor's audit responsibilities related to risk-related financial information are currently related to such information disclosed in the financial statements following the application of IFRS 7 on Financial Instruments: Disclosures.

The issues with IFRS 7 appear to be related to how risk-related information is presented, for instance the overload of information, which might result in the principal risks being less clearly disclosed. It should be noted that the presentation of information is first and foremost a responsibility of management and those charged with governance (board of directors, etc.) of the

financial institution. As financial institutions gain more experience with the implementation of IFRS 7, it would be expected that its application has improved, as mentioned in our response to question 1.10 above.

As far as the external auditor's involvement is concerned, as already hinted in our general response to Question 3, a number of different types of risk-related financial information can be identified:

- Quantitative and qualitative information disclosures about existing risk exposures in accordance with IFRS 7 are included in the notes to the financial statements. As highlighted in our response to question 1.10 above, these are covered by the audit opinion of the external auditor as part of the audit opinion on the financial statements. The auditors opinion could also be extended to cover additional clearly defined regulatory requirements, such as Basel II disclosures, if so required at national level;
- Other additional qualitative risk-related information and risk management issues, disclosures are normally not included in the financial statements of the financial institution. An enhancement of the role of the external auditor on these types of disclosures could be considered in further detail. Apart from the different forms of auditor's involvement as referred to above in our general response to Question 3, certain factors should be considered in deciding whether to involve the auditor and on which disclosures to seek his involvement, as referred to in Section 5.5 of the FEE Discussion Paper of "The Auditor's Role Regarding Providing Assurance on Corporate Governance Statements"[12];
- Disclosures on risk appetite, risk strategy and risk policy as determined by the board of directors of the financial institution and which are currently not required to be included, e.g. neither by IAS 1 nor IFRS 7, should remain outside the scope of the financial statements. External auditors can ordinarily not be involved with such disclosures.

A number of different target audiences can be identified for additional external auditor's involvement with and reporting on risk-related financial information as follows:

- Private reporting to those charged with governance, including executive management, board of directors, audit committee and risk committee;
- Reporting to supervisory authorities:
- Public reporting to the shareholders and the public at large.

The level of possible external auditor's involvement will depend on the type of risk-related financial information and the target audience.

As already discussed above, there is a clear merit in further detailed discussions about the level and form of auditor's involvement and the disclosures to which any such involvement would relate, which is closely linked to the content of the risk statement as mentioned in our response to question 1.10 above.

[12] http://www.fee.be/publications/default.asp?library_ref=4&content_ref=1167, November 2009

<u>**Supervisory authorities**</u>

Question 4: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of supervisory authorities, and to indicate any other measures they believe would be necessary.

4.1. Should the role of supervisory authorities in the internal governance of financial institutions be redefined and strengthened?

4.2. Should supervisory authorities be given the power and duty to check the correct functioning of the board of directors and the risk management function? How can this be put into practice?

4.3. Should the eligibility criteria ('fit and proper test') be extended to cover the technical and professional skills, as well as the individual qualities, of future directors? How can this be achieved in practice?

The responsibility of supervisory authorities in general and in times of crisis is to properly regulate and supervise financial institutions. Supervisors should be given appropriate powers to fulfil that responsibility on an ongoing basis. High quality supervision can only be done if supervisors have and also apply such powers and have the necessary and appropriate human and financial resources. The aim of all stakeholders, including the supervisors, is the same: high quality information to enable the various stakeholders to make well-informed and sustainable decisions in each of their areas.

The Green Paper and the Staff Working Document suggest various initiatives to improve the role of supervisors of financial institutions. In general, FEE finds these initiatives appropriate for further considerations on improving financial supervision. If supervision of financial institutions were to be improved, as envisaged in the Green Paper, it is of great importance that supervisors keep their monitoring and supervisory role and do not carry out a role taking up management responsibilities.

Any initiatives should take into consideration that the purpose of supervision of individual entities differs from the aim of macro-economic regulation, which also underlines the different responsibilities of management and supervisors respectively.

FEE is aware that the current laws, regulation and approach in relation to the role of supervisory authorities in the internal governance of financial institutions differ significantly from one EU Member State to another. In general, a level playing field for supervision should be the aim, although the differences in starting points should be taken into account when redefining and strengthening the role of supervisors. Enhancement would then also address cross-border considerations and harmonisation. Those competent authorities that are now in charge of assessing the technical and professional skills as well as the individual qualities of future directors should work together with the other competent regulatory authorities.

In this context, FEE emphasises the importance of a good and constructive open dialogue between financial institutions and their supervisor as well as between financial institutions, their supervisors and their auditors as discussed in Section 3 above, as this allows for even better quality in the supervision carried out.

Shareholders

Question 5: Interested parties are invited to express their view on whether they consider that shareholder control of financial institutions is still realistic. If so, how in their opinion would it be possible to improve shareholder engagement in practice?

5.1. Should disclosure of institutional investors' voting practices and policies be compulsory? How often?

5.2. Should institutional investors be obliged to adhere to a code of best practice (national or international) such as, for example, the code of the International Corporate Governance Network (ICGN)? This code requires signatories to develop and publish their investment and voting policies, to take measures to avoid conflicts of interest and to use their voting rights in a responsible way.

5.3. Should the identification of shareholders be facilitated in order to encourage dialogue between companies and their shareholders and reduce the risk of abuse connected to 'empty voting'[13]?

5.4. Which other measures could encourage shareholders to engage in financial institutions' corporate governance?

Regulation of shareholders via "hard law" appears to be quite difficult in practice as shareholders usually use their rights to buy and sell shares whenever they consider it appropriate to optimise the return on their investment, also keeping the rules regarding insider trading in mind.

Therefore, "soft law" appears to be more feasible in this area and the principle of *"comply or explain"* may be the best approach in this context.

However, one must recognise that shareholders are not a homogenous group and the choice of approach would need to distinguish between controlling, significant interest, major holding (institutional) shareholders and small holding shareholders, as they have different investment strategies, roles and responsibilities.

The general approach to shareholders should be *"active engagement of shareholders"* and in this context it could be worthwhile underlining in a code of best practice the basic principle that when shareholders acquire shares, they obtain rights but in fact also certain obligations as is the case with every asset, for instance the disclosure obligation of shareholding for major institutional investors, as further explained at the end of this section.

In addition, any code of best practice should clearly promote transparency, both for investment policies, structure of voting, as well as other matters. Initiatives such as internet voting and the use of other IT technology that facilitate active engagement of shareholders are clearly very useful initiatives in this context.

It could be considered to require shareholders to comply with a code of best practice for the financial institution that they invest in. It is most likely that shareholders will only do so if they perceive the code as acceptable and practical. In such circumstances, all significant institutional investors will wish to comply but it appears not to be feasible to require active engagement of all shareholders regardless of any commitment to a code of best practice.

[13] Vote by a shareholder with no corresponding financial interest in the company for which they are voting, with potentially negative consequences for the integrity of the corporate governance of listed companies and the markets on which their shares are traded.

In particular, the full shareholder's structure of financial institutions should be transparent and this principle should be supported. Anonymity for small shareholders can be acceptable keeping in mind that the overall principle is active engagement of shareholders, which can only be done if the financial institution is aware of the identity of its shareholders.

Effective implementation of corporate governance principles

Question 6: Interested parties are invited to express their opinion on which methods would be effective in strengthening implementation of corporate governance principles?

6.1. Is it necessary to increase the accountability of members of the board of directors?

6.2. Should the civil and criminal liability of directors be reinforced, bearing in mind that the rules governing criminal proceedings are not harmonised at European level?

Based on the arguments presented, FEE is not convinced that boards of directors as a whole are not sufficiently accountable now. FEE recognises that there are major differences between EU Member States in this area, but would emphasise that it is not clear from the analysis carried out so far, which areas are considered as more problematic and how such issues can be addressed in an effective and practical manner.

Therefore, FEE would recommend that more evidence is gathered as to whether or not corporate governance codes have been properly implemented and applied by financial institutions across Europe with resulting changes in cultural and behavioural attitudes. If evidence supports the hypothesis that corporate governance codes are not working as intended, a debate should be initiated as to why this is the case. As highlighted in Section 5 above, proper enforcement supported by relevant actions taken by supervisors is equally important.

Remuneration

Question 7: Interested parties are invited to express their views on how to enhance the consistency and effectiveness of EU action on remuneration for directors of listed companies.

7.1. What could be the content and form, binding or non-binding, of possible additional measures at EU level on remuneration for directors of listed companies?

7.2. Do you consider that problems related to directors' stock options should be addressed? If so, how? Is it necessary to regulate at Community level, or even prohibit the granting of stock options?

7.3. Whilst respecting Member States' competence where relevant, do you think that the favourable tax treatment of stock options and other similar remuneration existing in certain Member States helps encourage excessive risk-taking? If so, should this issue be discussed at EU level?

7.4. Do you think that the role of shareholders, and also that of employees and their representatives, should be strengthened in establishing remuneration policy?

7.5. What is your opinion of severance packages (so-called 'golden parachutes')? Is it necessary to regulate at Community level, or even prohibit the granting of such

packages? If so, how? Should they be awarded only to remunerate effective performance of directors?

Question 7a: Interested parties are also invited to express their views on whether additional measures are needed with regard to the structure and governance of remuneration policies in the financial services. If so, what could be the content of these measures?

7.6. Do you think that the variable component of remuneration in financial institutions which have received public funding should be reduced or suspended?

Major attention has been devoted to the consequences of the remuneration policies of financial institutions, especially in relation to the size of bonuses distributed. It is important that attention is paid not only to the size of bonuses but also to the generation of sustainable value through realising the business strategy within preset and appropriate risk boundaries. This could be of more benefit to the financial institution as a whole.

Where the board of directors plays a role in the remuneration process, this role should be performed in an objective and professional way. This is underlined in the EC recommendations on the role of non-executive or supervisory directors in listed companies and on remuneration of directors in listed companies[14]. These EC recommendations recommend that the board establishes a remuneration committee with this purpose. A similar structure for financial institutions in the scope of this Green Paper could be relevant to consider, as it underlines an objective approach to remuneration, having a sustainable future for the entity in mind.

Regarding the remuneration itself, it seems most relevant to find a proper balance between regulation and recommendations, as only some aspects of remuneration, such as general remuneration policy principles, would be appropriate for regulation.

The main objective should be to have the principles set out in a remuneration policy and to ensure that these remuneration policies are transparent to all stakeholders. In this context, active engagement of shareholders should be considered. Involvement of employees has to be considered with caution as this could result in promotion of the self-interest of this particular group of stakeholders.

Especially for financial institutions, the remuneration policies should take proper account of the risks associated with the business and the function of the individuals. It is particularly important that the remuneration policy is in line with effective risk management and does not encourage excessive risk exposure. In addition, it should be combined with effective governance of its application. The main focus should be on long-term incentives, not short-term ones reflecting the risk appetite of the entity itself. Remuneration of non-executives and executives would not be based on the same model, as these two groups should have different risk profiles. The 2009 EC recommendation on remuneration policies in the financial services sector sets out relevant principles in this context[15].

The variable part of remuneration could, to some extent, be based on stock options as this increases the relevant decision-making horizon. However, remuneration policies with such content need to be reasonably structured and defined by principles rather than rules.

[14] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF
[15] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0022:0027:EN:PDF

<u>Conflicts of interest</u>

Question 8: Interested parties are invited to express whether they agree with the Commission's observation that, in spite of current requirements for transparency with regard to conflicts of interest, surveillance of conflicts of interest by the markets alone is not always possible or effective.

8.1. What could be the content of possible additional measures at EU level to reinforce the combating and prevention of conflicts of interest in the financial services sector?

8.2. Do you agree with the view that, while taking into account the different existing legal and economic models, it is necessary to harmonise the content and detail of Community rules on conflicts of interest to ensure that the various financial institutions are subject to similar rules, in accordance with which they must apply the provisions of MiFID, the CRD, the UCITS Directive or Solvency 2?

Conflicts of interest exist in all business relationships and markets. Transparency and appropriate disclosures can, to a limited extent, address problems surrounding it but cannot prevent conflicts of interest arising.

These principles should take into account proper due processes for checks and balances and transparency of all business transactions, including those with affiliates and other related parties.

Currently, conflicts of interests occur in very different situations in different EU Member States. This situation warrants different solutions and any initiative regarding this should therefore entail principles that take these various starting points into consideration.

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
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