CCBE RESPONSE TO THE GREEN PAPER ON CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS AND REMUNERATION POLICIES

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CCBE Response to the Green Paper on Corporate Governance in Financial Institutions and Remuneration Policies

The Council of Bars and Law Societies of Europe (CCBE) is the representative organisation of around 1 million European lawyers through its member bars and law societies from 31 full member countries, and 11 further associate and observer countries. The CCBE responds regularly on behalf of its members on policy issues which affect European citizens and lawyers.

The CCBE would like to submit the following comments in response to the Green Paper.

General 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.

Response:

On a preliminary basis, the CCBE would like the concept of financial institution, examined in the Green Paper, to be more precisely defined in order to focus draft reforms or draft recommendations on credit institutions. Indeed, except in the case of AIG in the US, which was very particular as the investment banking operations of the group were affected first, the financial sector crisis which began in 2007 struck primarily and mainly the banking sector, and not the insurance industry nor independent asset management within banks.

Subject to the reservations and conditions set forth below, the CCBE generally supports the solutions proposed by the European Commission regarding the composition, role and functioning of the board of directors, although it considers that the wording of certain issues, which may sometimes be imprecise, makes it difficult to always measure their exact scope.

However, the CCBE insists that considerations on the operation of boards, a collegiate body which by definition meets periodically, should not lead to the ignoring or minimising of the responsibility of permanent executive leaders who are responsible for the daily conduct of the establishment. Risk management should be a concern shared by all stakeholders.

The positions of the CCBE on specific issues addressed by the European Commission are presented hereafter.

1. Specific questions:

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

Response:

Yes. In principle, the CCBE welcomes the limitation of the number of boards for directors. However, this limitation potentially deprives companies of the expertise of an experienced person sitting on many boards due, for instance, to a long career. Event though they do not spent the same amount of time as other directors, they are likely to shed valuable light or make indispensable assessments of situations.

In certain countries in the European Union, company law already limits the number of boards of directors.

The CCBE therefore suggests:

- recommending a limitation of the number of board seats a director may hold in companies established in the European Union (general limit), for example limited to five, specifying that a fixed limit would apply to financial institutions: the same director not being permitted to hold more than three board seats in financial institutions without prior approval of the banking supervisory authority (specific limit), who may allow exceptions based on the actual time required according to the size and complexity of the institution;

- extending such restrictions to all boards in commercial companies in the same Member State, irrespective of their corporate form;
- by exception, placing no limitations on boards seats held in companies belonging to the same group so that they are not be taken into account when assessing the general and specific limitations mentioned above.

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

Response:

No. The CCBE believes that the spread of the current trend of this separation, even if found, in practice, in several countries including the US, should not become mandatory because there is no evidence that financial institutions which opted for this separation have necessarily tackled or better averted the financial crisis of 2007/2009 than institutions which still have the combination of the two terms.

However, the CCBE considers that:

- the choice made by the institution between these two options should be made public, so that shareholders and counterparties of the institution are informed (depositors, creditors, etc.);
- the institution should outline, for example in its annual report, the reason(s) why it has chosen one option over the other.

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?

Response:

Yes. The CCBE believes that the principle of verification of skills and experience of the two main executives of banking institutions exists in European regulations.

The CCBE suggests:

- That recruitment policies meet standards that are sufficiently general in order that the search for more competent directors is not hindered by overly specific and rigid conditions;
- Besides key executives, the appointment of a limited number of directors should be subject to prior approval of the supervisory authority, especially for chairmen of audit committees, risk and remuneration committees, with Member states still having the faculty to extend such control to the extent that its criteria are objective and subject to appeal[1];
- All or some of the other directors on the audit committee or risk committee should meet certain experience or training requirements.

The presence of a minimum number of independent directors in the composition of the board of directors as mentioned in paragraph 1.4 below must be addressed without prejudice. Having independent directors does not automatically mean that they are competent, and the financial crisis which started in 2007 proved to the US that independent directors are not a guarantee of good management since the average amount of independent directors present in the Board of directors of AIG, Lehman Brothers, Merrill Lynch and Bear Stearns rose to 84% in 2007. However, having independent members in unlisted credit institutions, in particular of a mutual nature or linked to local authorities, seems to be recommended to compensate for the lack of control from outside shareholders.

The issue of diversity is discussed below in Section 1.4.

1 For some member delegations of the CCBE, the intervention of supervisory authorities should limit itself to the definition of clear criteria that should be fulfilled by the chairmen of the audit, risk and remuneration committees.

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?

Response:

Not necessarily. The CCBE believes it is first and foremost wiser to focus mostly on competence, experience, and reasonably enough on the independence of directors of financial institutions. Whilst the CCBE disapproves of the use of quotas imposed by law or regulations, it encourages diversity in the membership of boards of directors and specifically supports an increase in the number of women among these social bodies provided they meet the experience and skill criteria.

This pragmatic approach is motivated by the will to learn from the 2007/2009 crisis in order to improve the governance of banks and to prevent a new crisis, or provide more help for banks so they that can tackle one better.

First, on a historical level, the *'subprime'* loans phenomenon started with the disorganised increase in the number of new derivatives and the globalization of securitisation transactions, but also with a 'diversity' policy approach already seeking to extend credit to people who previously could not access loans and property (hence the term *'subprime')* - which gave birth to American institutions promoted by the State such as Freddie Mac and Fannie Mae.

Secondly, in spite of the global dimension of the crisis, European, American or Asian directors, as diverse in wealth and training as they were, did not behave differently.

Finally, within the same regions, boards of institutions showing both cultural and linguistic as well as national diversity with French, Flemish and Walloon Belgian, Dutch and Luxembourg nationals, did not handle the crisis any better than more 'uniform' boards among their competitors. Mutual or cooperative institutions or regional banks involving local authorities, whose boards were characterised by a strong regional representation and had many 'out of range' executives from different backgrounds did not stand out from traditional institutions hiring more uniform directors from the financial or technocratic elite.

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? of Directors by an external evaluator? Should the result of this evaluation be made available to supervisory authorities and shareholders?

Response:

No. Regular evaluation of the work of the board and the intervention of outside consultants is increasingly recommended by codes of governance with no binding force.

The CCBE is of the view that regulations should not make the evaluation of the functioning of the board of directors by an external evaluator compulsory. It should simply be an option left to the discretion of the board or its committees, which should be given means to resort to external experts.

Furthermore, the CCBE shares the view that it would be useful to communicate the results of such evaluations to the supervising authorities, should they so request, particularly when these concern financial institutions with securities not traded on a regulated market - there are still many in Europe - not subject to transparency requirements (German *Sparkassen*, Italian regional banks, French mutual groups, etc.).

Ultimately, the CCBE suggests, should there be no explicit request from the supervisory authority, that these evaluations should still be transmitted when a number of directors, defined by regulation, request them.

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?

Response:

Yes. The CCBE supports the creation of a committee, in the board of directors, responsible for risk management and risk monitoring of the institution, while ensuring that it does not weaken all board members' liability. The committee must remain an offshoot of the board working to assist and prepare decisions.

Moreover, the CCBE notes that France will probably introduce in its domestic law the obligation for credit institutions to set up risk committees. Section 7 (g) (*septies*) of the bill on banking and financial regulation currently under discussion at the French Parliament, seeks - through an amendment of the Code de commerce (new Article L.210-10) - to oblige all financial institutions to set up a board committee specialised in risk monitoring. Under this bill, such a committee may only include non-executive directors, i.e. who do not exercise managing functions in the institution and *'at least one member of the committee should provide specific expertise in financial matters or accounting and be independent under the criteria specified and made public by the body responsible for administration or monitoring'*. This committee would also take responsibility for *'ensuring that the company has an adequate analysis and risk measurement scheme and also an adequate supervision and risk control system*'.

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?

Response:

Yes. The CCBE considers it necessary for the audit and risk committees to do their work in conjunction; their mandates are complementary where the real financial situation of a financial institution cannot be given without having the risks associated with its activity identified, valued and properly reflected in the accounts.

Accordingly, it would be appropriate for audit and risk committees to collaborate on their work. On that account, the presence of several members (without necessarily constituting a majority) of each committee at meetings of the other committee is advisable to facilitate sharing of information and risks. However, it is necessary to ensure independence of judgment of members in each committee.

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

Response:

No. The CCBE believes that every director must be capable of being heard at shareholders' meetings and taking responsibilities. It is not necessary or desirable to create a special responsibility, as it would have at least two disadvantages: (i) It would seem to alleviate the responsibility of other directors and (ii) it would exclude potential quality candidates without any certainty that imposing such a public trial would significantly improve risk management.

The risk committee, an offshoot of the Board, is responsible before the Board. The chairman of the board of directors seems, therefore, to be the appropriate member to answer most questions.

Finally, the CCBE deems that there is no proof that the shareholders' meeting is the best suited forum to address the issue of risks, at least in listed institutions. Aside from the complexity of the issue, it should be emphasised that the individual interest of shareholders - which entails a shorter-term approach evidenced by the rotation of titles on the market and their average holding period - sometimes diverges from that of financial institutions regarding risks in the medium or the long term. The desire to maintain or restore stock market prices may contradict that of controlling risks if arbitration bodies on these issues are not clearly identified and differentiated.

However, the CCBE favours that auditors are required to answer questions they are asked during shareholders' meetings. It is not right that in several Member States of the EU the accounting auditors of a company cannot be questioned by its shareholders.

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

Response:

The board of directors should be petitioned in advance and should have the last word in risk issues. The general guidelines in terms of risks fall within the competence of the board, as is the case for strategic guidelines. Nevertheless, the board cannot and should not be the body responsible for defining the specific risk profiles for each financial product: this task, due to its complexity and need for daily updating, directly falls to operational managers, who in turn are controlled by the board of directors.

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

Response:

No. The CCBE does not support the establishment of a *'risk control declaration'*, especially since neither the content nor the liability system of this declaration are identified. However, the CCBE supports that financial institutions send a report on their development model and risk strategy to the supervisory authority.

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

Response:

Yes, but not for all new financial products. The development of financial products must necessarily go through a prior internal validation procedure which must nevertheless be adapted to the nature and amount of financial products so as not to unduly hinder on-going business.

In the CCBE's view, two processes of validation of new financial products ('newness' being evaluated having regard to both the institution and the market) might be considered:

- Prior approval of the board of directors should be limited to financial products which show significant risks (expressed as a percentage of equity) for the financial institution after review by the risk committee. Validation of these financial products should then be submitted to shareholders and to the market in the annual report;
- In other cases, the development of financial products should be validated in advance by the *'compliance'* department of the credit institution for most standardised products or products with limited risks for the institution. In this regard, it would seem appropriate that the 'compliance' department should on this occasion gather professionals of different disciplines in the institution (finance, legal, taxes, general inspection, etc.) to take advantage of the complementarity of different stakeholders and understand all the risks associated with the financial product concerned.

More importantly, the CCBE supports that the regulator should be informed when new financial products are created, acquired, invested in equity or marketed by the institution so that, where appropriate, the regulator can impose higher prudential equity constraints.

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?

Response:

Yes. The CCBE supports that the board of directors discuss the need to solicit the supervisory authority and appoint, should the case arise, one of its members to proceed with such information when a case of implementation of the duty of information arises. In the case of directors who wanted to solicit the supervisory authority, but were outvoted, they should still be able to notify it, while giving detailed reasons on why the majority of the board has adopted a different analysis and by informing the chair of the board of this approach. In any event, such duty of information should not exempt external auditors from their own 'duty of alert' as stated in paragraph 3.1.

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')?

Response:

Rather than supporting the creation of a new legal obligation which would be too general and have litigation consequences that are difficult to measure, the CCBE supports the principle that the board should be required to take into account the interests of depositors and stakeholders when defining the institution's strategy which will be publicised.

2. Risk-related functions

General 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.

Response:

The CCBE agrees with the European Commission that the failure of risk management functions in financial institutions is a key reason behind the financial crisis. The CCBE therefore supports the reinforcement of these functions within financial institutions, which must obviously have the means and authority needed for their actions.

The position of the CCBE on specific issues addressed by the European Commission are presented hereafter.

Specific questions:

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?

Response:

A first line of thought might be for the chief risk officer to be subject to special approval from the supervisory authority, like the CEO and CFO who are often subject to approval under the 'four eyes' principle. This particular approval granted to the chief risk officer would allow the supervisory authority to impose conditions of experience and expertise, in addition to existing measures allowing him/her to verify that adequate procedures and resources are allocated to internal risk management.

This regulatory approval by the chief risk officer would be supplemented by a direct relationship with the supervisory authority which could at any time question him/her like 'managing directors' under banking regulations. The chief risk officer may finally have a duty to alert the supervisory authority.

These two measures would increase the authority and the independence of judgment of the chief risk officer within the institution. Pressure and self-censorship would be mitigated or offset by the interference of the supervisory authority in the relationship between the chief risk officer and his/her employer.

A more radical line of thought would be to attach the chief risk officer directly to the risk committee of the board of directors of the financial institution. Moreover, it would be desirable for the chief risk officer to be the permanent guest of this committee to keep members informed about the risks of the institution. The chief risk officer would have the right to be heard by the risk committee.

The chief risk officer would have no hierarchical relationship with the senior or financial management of the establishment, thus creating a parallel hierarchy in order to come to terms with the conflict of interests which is sometimes considered as improper between the risk-taker (the CEO) who would decide over the career of the person whose mission it is to manage risks (chief risk officer).

The CCBE is of the view that this option would have two advantages and one disadvantage. On the one hand, consistency would benefit from it since the risk committee, hence the board of Directors, would be granted practical means to exercise its mission of the control and monitoring of risks, and on the other hand, it would strengthen the power of risk management when facing up to the general management of the institution. However, in so-doing, the main drawback of this scheme is that the power structure of financial institutions could become significantly disrupted as the general management may be too often challenged by the introduction of a diarchy or a form of 'cohabitation' to the detriment of the activity of the establishment. Setting up risk management as a counterbalancing power to the general management could challenge the very purpose of credit or insurance institutions - taking or insuring against risks.

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?

Response:

See 2.3 below.

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

Response:

Yes, the risk committee established within the board of directors of financial institutions should be able to hear the chief risk officer, regardless of his/her reporting relationship to the general management. Conversely, the chief risk officer should also be obliged to inform the general management, and if necessary the risk committee, in deciding in particular on any possible litigation which would oppose him/her to the financial direction of the institution.

The CCBE notes that in the current practice of French financial institutions, it is already common for risk management to directly alert the chairman of the board of directors and to have a special risk committee set up to institutionalise such form of communication by making it more current and collegiate.

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?

Response:

Since the Green Paper does not give criteria or aims for judging the speed and quality of information provided by computer systems, nor the actual way in which these might be defined, taking into account the different situations of every institutions, it is difficult to answer this question. In principle, the complexity of financial products plus the globalisation of financial flows demand efficient and regularly updated IT infrastructures to be set up in financial institutions, ensuring both best risk management and the automatic detection of unusual risks. Nevertheless, it is also important to ensure that information remains clear and usable and that the abundance of unsorted information does not affect the board being properly informed.

Moreover, large international financial clusters often have geographically remote managers, and deadlines for the organisation of boards of directors meetings are sometimes inadequate. It therefore seems desirable to organise information and real-time notification systems (if necessary through video-conference, conference calls, etc.) informing managers without delay on major developments for the risks of their institutions. In an emergency, one or more directors might want to organise a board of directors meeting.

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

Response:

No. In the CCBE's view, it is not desirable to require that only executive directors report on the adequacy of internal control systems - a better solution would be to focus on prior approval by all directors with one copy sent to the supervisory authority.

An equivalent rule applies in France and Germany, where Company law requires companies whose financial securities are traded on a regulated market to attach to the annual report of the board of directors (or executive board) a special report detailing internal control and risk management procedures implemented by the company, among others. The CCBE would support the application of this obligation within the Member States.

The enhancing of the contents of this report might be envisaged to include an assessment of the quality of internal controls, comprising the consistency of risk measurement, supervision and management systems, capable of suggesting, where needed, complementary actions. This report should be circulated not only to the risk committee, but also to supervisory authorities.

3. External auditors

General 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.

Response:

As part of their mandates, external auditors identify significant risks that financial institutions may face and therefore have a good knowledge of the conduct of their activities. Accordingly, the CCBE believes that external auditors should share this information with supervisory authorities and the board of directors.

The positions of the CCBE on specific issues addressed by the European Commission are presented hereafter.

Specific questions:

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

Response:

Yes. It is desirable to have the equivalent of a 'duty of alert', binding court auditors to the competent courts, for external auditors and the supervisory authority. This duty should apply in all circumstances, and financial auditors should solicit the supervisory authority without delay once they are aware of a factor justifying the intervention of the supervisory authority, without waiting for the review of annual accounts.

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?

Response:

Yes, towards the board of directors initially and if necessary to supervisory authorities if justified by the seriousness of the situation and the lack of solutions offered by the board.

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

Response:

The concept of 'risk-related financial information' should be defined more precisely. The CCBE does not support such a measure, if it refers to the description of current or future 'risk factors' in the financial documents or literature of listed institutions. In contrast, for periodic communications similar to the report on internal controls, which report retrospectively, the CCBE supports the idea that they should be reviewed by auditors, who will have to ask for, if necessary, changes or additions based on information available to them because of their audit of the institution's accounts throughout the year.

4. Supervisory authorities

General 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.

Response:

As indicated in sections 1.1, 1.3, 1.5, 1.10, 1.11 and 1.12, the CCBE supports granting new powers to supervisory authorities. Without overestimating the preventive power of supervisory authorities or the pitfalls of excessive legislation penalising institutions throughout Europe if there is no global harmonisation, the CCBE agrees with the European Commission that it is necessary to increase the involvement of supervisory authorities and most importantly to improve the coordination of these authorities.

The positions of the CCBE on specific issues addressed by the European Commission are presented hereafter.

Specific questions:

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

Response:

See the proposed enhancements referred to above.

The Larosière report of 25th February 2009 on financial supervision in Europe was approved by the European Commission and by the 27 Heads of States and Governments of the Union at the European Council on 19th and 20th March 2009, and serves as the basis for the definition of a European legislation on financial supervision. Rather than assigning all supervisory charges to the European Central Bank - a goal rejected by one Member State - the report supports a middle ground promoting better coordination for supervisory authorities in several dedicated authorities.

In this context, the CCBE welcomes initiatives by the European Commission to reform, fundamentally, the current architecture of committees for financial services, which includes creating:

- A 'European Council on Systemic Risk' ('ECSR') controlling and analysing the risks for the stability of the overall European financial system (macro-prudential supervision), issuing early warnings and recommendations in case of predictable systemic risks and, if necessary, making recommendations for action to address these risks; and
- A European system for financial supervision composed of the 'European Banking Authority', the 'European Insurance and Occupational Pensions Authority' and the 'European Securities and Markets Authority' to supervise financial institutions themselves (micro-prudential supervision) with a tight network of national financial supervisory authorities.

Finally, the CCBE suggests, on the other hand, that broader powers should be granted to supervisory authorities, their managers should be heard regularly by the European or national parliaments on a case–by-case basis and more transparent and swifter remedies should be set up to allow institutions to challenge the conformity of their decisions with the applicable regulations.

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?

Response:

The CCBE considers that supervisory authorities should be able to ensure that the board of directors carries out its risk management functions since these authorities have been carrying out the same checks in the internal services responsible for this mission within institutions.

In practice, the control of the functioning of the board of directors by the supervisory authorities directly concerning risk management could be (i) a permanent right of information from the moment that the board would have to submit to such authorities the report on internal controls referred to in Section 2.5 and (ii) an occasional right of information under which the supervisory authority may direct any information inquiries on the financial institution's risk level to the board of directors or the chief risk officer.

Eventually, the CCBE suggests that supervisors should be able to bring civil actions against negligent or wrongdoing directors for the payment of damages by these directors to the financial institution for which they were responsible ('ut singuli' actions).

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?

Response:

The CCBE believes that it is obviously desirable that directors of financial institutions have the necessary skills and judgment to carry out their mandate, the selection of directors also needing to be made in accordance with the principle of diversity discussed in Section 1.4. The increasing complexity of financial activities and their influence on other sectors of economic activity legitimise paying special attention to directors of financial institutions.

In practice, two options are possible to verify the technical and professional skills of directors:

- Prior to taking office, the relevant supervisory authority should be consulted on the identity of directors whose appointment to the audit and risk committee is considered in accordance with the objective criteria of competence and experience;
- While in office, each director should also receive mandatory training for the different professions or financial products of the financial institution.

However, the CCBE highlights that 'behavioural characteristics' that are too subjective, are not reliable eligibility criteria for management positions.

5. Shareholders

General 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?

Response:

While the monitoring of financial institutions by shareholders may appear theoretical, given past events and the increasing complexity of financial relations, the CCBE believes that it must remain a priority, not least because as providers of capital, shareholders are the first to back the stability and solvency of institutions. For this reason, they should enjoy greater safeguarded rights while granting supervisory authorities counterbalancing powers taking into account the fact that some shareholders (investment funds, large institutional shareholders, etc.) may encourage reckless risk taking.

The position of the CCBE on specific issues addressed by the European Commission are presented hereafter.

Specific questions:

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

Response:

No. In the CCBE's view, the transparency of policies and voting practices of institutional investors in shareholders' meetings of financial institutions should not be mandatory because it is not likely to improve the financial soundness or governance of institutions. These issues must be left to the discretion of shareholders and freedom of vote must be preserved from pressure, deadlines and other regulatory constraints. However, national initiatives aimed at fostering such transparency without making it mandatory, in the interest of shareholders' equal access to information, raise no objection from the CCBE.

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.

Response:

No. As much as greater transparency can help to improve the market's judgment on the functioning and governance of an institution, the imposition of constraints constituting almost imperative mandates controlled by associations or lobbies without democratic legitimacy could lead to restricting the access of institutions to capital markets by discouraging investors at a crucial point in their recovery.

However, the CCBE does not disagree with initiatives like the British Stewardship Code which encourages institutional investors to comply with certain non-regulatory recommendations or to explain their possible reasons for not complying.

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' 27?

Response:

The CCBE believes that the identification of shareholders should be encouraged as long as it is accepted by the ultimate shareholders (except in cases of fraud under existing stock market provisions of course), including in the case of a loan or title-stripping giving rise to *'empty voting'.*

Several EU Member States have methods of identification, such as the UK and France. They partially satisfy listed companies' wish to better understand and inform their shareholders, but the CCBE considers that *'empty voting'* is a point apart.

In addition, particular care should be taken not to restrict the liquidity of securities or raise the costs already imposed on financial issuers whose securities are traded on a regulated market. Finally, the CCBE would like to point out that market regulations on crossing thresholds already identifies major shareholders of financial institutions whose securities are admitted to trading on a regulated market.

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

Response:

Some Member States allow companies to grant double voting rights, depending on the length of time that shares are held, with a view to promoting the commitment of long-term shareholders, who are often more concerned about risks in the medium or long term than short-term shareholders. The participation of shareholders of financial institutions in their governance is thought to be promoted while helping to foster a long-term vision with a more cautious development. This measure would not be sufficient in itself to ensure a more stable and better informed commitment from shareholders, since some hold shares for third parties and may not in fact benefit from them, e.g. due to the changes in their titleholders.

6. Effective implementation of corporate governance principles

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

Response:

Corporate governance principles are usually a set of rules, often collected in codes of best practice not directly binding in law, but which form a convergence of practices - which some call *'soft law'.*

The CCBE is committed to the idea that these corporate governance principles, which sometimes change according to trends or events that are too exceptional or too recent to be covered under sweeping general rules, should not be systematically integrated into law. Only strictly necessary measures should become binding and the contractual and responsive nature of the modern economy should be preferred to the temptation of a managed economy. In this context, the CCBE suggests

reviewing existing recommendations arising from 'soft law', and identifying recommendations (i) not implemented by financial institutions and (ii) which could help to prevent or minimise the crisis which started in 2007. This practical approach could lead to implementing certain more restrictive regulatory reforms.

The CCBE considers that the harmonisation of corporate governance principles among Member States could enhance the convergence of practices and create international standards for corporate governance.

Specific questions:

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

Response:

The CCBE disagrees with an increase in directors' liability. The existing schemes are already substantial in most Member States (subject to our proposal in Section 4.2) and it seems that it is the judicial or supervisory authorities which need more practical strengthening in the way they apply these schemes.

Two pitfalls must be avoided. First, an excessive increase in the role played by the judicial process in the business world is not necessary, as the many disputes in the US involving managers - which have existed for many years - have not strengthened financial institutions. Secondly, nor is the proliferating of systematic aversions within boards of directors of financial institutions for any form of risk which would result in restricting credit or insurance necessary to finance the economy required. The widespread adoption of an accentuated form of directors' liability does not therefore seem desirable, and a more pragmatic case-by-case approach should be favoured by promoting improved skills, greater transparency, and stricter control for external auditors and supervisory authorities and finally with remuneration rates taking into account the medium and long terms.

However, the CCBE deems it desirable to strengthen the means for directors to be properly informed of the status of the financial institution.

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?

Response:

The CCBE understands that the Commission is due to publish a consultation on sanctions applicable to directors. The CCBE therefore reserves its response to question 6.2 until after the publication of the consultation.

7. Remuneration

General 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.

Response:

Directive 2003/71/EC of the European Parliament and the Council of 4th November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and European Regulation (EC) No. 809/2004 of the Commission implementing this Directive have increased the transparency requirement of these elements of directors' remuneration. This transparency is certainly essential in the fight against possible excesses.

In the CCBE's view, any action by the EU in terms of remuneration should show the same concern for transparency.

In the search for efficiency, restrictions on excessive remunerations, allocated outside the normal remuneration framework, should be insisted on. Especially in difficult economic circumstances for listed companies, the overall 'deferred' *remunerations ('golden parachutes',* 'golden handshakes', 'top-up pensions', etc.) are highly criticised. The CCBE also wishes to draw the attention of the Commission on remuneration paid to directors when taking office (also called *'welcome bonus'* or

'golden hellos') which are often neglected by the legislation. Annual fixed and variable remuneration is even more justified since it is long-term and not based on the end of a mandate or contract.

In this context, fixed and variable brackets of shares for annual remuneration, limiting the amount and conditions for deferred remuneration (with a performance condition) and limiting non-competition clauses and other compensation for retirement, could be considered. Furthermore, '*welcome bonuses*' should also be subject to transparency measures prior to taking office.

The position of the CCBE on specific issues addressed by the European Commission are presented hereafter.

Specific questions:

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?

Response:

Each director's remuneration should obviously reflect the situation of the group and the characteristics and qualities of the directors concerned. It is therefore not necessary to set a single, rigid rule, but it might be possible to consider recommendations about the relationship between the fixed part of remuneration and the variable part.

Alternatively, it would be possible to establish quick and clear information obligations towards shareholders in case of extraordinary remuneration.

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?

Response:

No. The Green Paper does not explain the 'problems related to directors' stock options', which makes it difficult to answer the question, but in principle the CCBE does not believe that removing directors' call options would address any potential abuses in financial institutions observed in recent years. Instead, it is important for directors to be interested in companies' results over time while also taking risks.

This being said, call options or subscription to call options seem to be more desirable with regards to shares granted free of charge, which - at least in France - enjoy virtually identical tax benefits without requiring payment of the purchase or subscription price by the director. Whatever the market price is at the time shares are granted, shares allocated free of charge are always attractive, whereas if the purchase or subscription option price is higher than the market price, the director will not take it. Thus, one of the disadvantages of options - the risk of encouraging directors to focus on the short term - would be relatively reduced.

Similarly, it seems important that options should be exercised only after a certain period of time and should no longer be available for certain cases of a director leaving in controversial circumstances.

Finally, the risk element might be reduced by obliging directors to keep a significant part of shares granted to them for several years after exercising their 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?

Response:

The link between the tax treatment of options and the level of risk-taking by financial institutions is controversial. As noted above in Section 7.2, the CCBE is firstly in favour of fighting against the potential harmful impact of options through an incentive, or even eventually an obligation, to keep options for a long time or to exercise options later. In this way, issues of medium and long term are also taken into account. Subject to this, the CCBE would approve if national laws convey this long term approach in their tax systems.

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?

Response:

Practice has shown that shareholders of many listed companies approve of 'deferred remuneration' which are - for example in French law - subject to approval by the *Assemblée Générale*. The CCBE believes that shareholders' control, even when prescribed by regulations, is quite limited in practice. It is desirable for directors and key executives as a whole but not beyond them.

Similarly, the CCBE does not believe that the role of employees would prevent possible abuses. On the contrary, the involvement of employees may lead to serious tensions and even paralyse social dialogue.

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?

Response:

It is first necessary to distinguish severance pay in general law - e.g. for the loss occurred because of leaving conditions or the length of contractual or predetermined 'golden parachutes'. The CCBE believes that it is indeed necessary to regulate 'deferred remunerations' - which include not only golden parachutes, but also other compensations granted to directors when leaving, such as *'golden handshakes'* and 'top-up pensions' - by making these subject to a shareholders' general meeting. Community law could establish it as a principle and let Member States determine the voting requirements and the exact scope of the system.

In France, it is recommended that these measures do not exceed more than two years of salary while in the UK a shareholders' vote is required if it exceeds more than two years.

It must also reward directors' performance, assessed by objective criteria. '*Golden parachutes*' should not be granted simply because the company did not go bankrupt - the same suggestion applies to any direct or indirect remuneration condition for directors and managers of financial institutions, which ought to be suspended or reduced by the institution in exceptional circumstances broader than mere bankruptcy. Conversely, it should be granted to a reasonable extent. The criterion or criteria retained should relate to the performance of the company as well as the manager concerned, assessed with regard to the performance of the industry.

General 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?

Specific questions:

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

Response:

The CCBE considers it impossible to formulate a response in principle on the matter - a case-by-case approach should be preferred. Indeed, it might be appropriate to distinguish between:

- Directors in office whose mismanagement has exposed the financial institution to significant losses imposing the use of public funds. In such cases, the CCBE would agree that these directors should not receive any variable remuneration until full repayment of public funds, but as long as these public funds in question come from a Member State and not the Union, it seems that it falls to the Member State and its substantive law to decide;
- Newly appointed directors who are not the reason of the loss of the financial institution. Variable remuneration may constitute an incentive tool to have them make the financial institution recover.

Finally, the CCBE highlights that the issue of variable remuneration of directors should not overshadow the need to control the variable remuneration of operational personnel either, and more precisely that of market participants which should not escape from their liability.

8. Conflicts of interest

General 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.

Response:

The CCBE believes that the crisis has revealed several types of conflicts of interest which must indeed be combatted better. The various national supervisory authorities should consult one another in order to harmonise their definition of conflict of interest. For example, rating agencies should be discouraged from giving advice and other chargeable services to the institutions they rate, and individual careers alternating between public authorities and banking institutions should be better regulated.

Specific questions:

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?

Response:

Please see the preliminary answer above. Furthermore, the CCBE believes that greater control of investment activities undertaken by financial institutions for their own account could prevent some conflicts of interest. The CCBE notes that legislations being adopted in the United States is designed to limit or confine own-account activities.

Commercial or investment banks could also be obliged to disclose their interests which potentially conflict with that of one of their clients or a financial product they distribute, in response to operations involving Goldman Sachs in the US. Eventually, to ensure a better separation of public and supervisory authorities from the financial institutions they are responsible for monitoring, persons could only pass from the state sector to the private sector (and vice versa) - which creates a potential conflict of interest - only after a reasonable period fixed by regulations. These principles could be harmonised at European level.

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?

Response:

Yes. The CCBE believes it is appropriate to harmonise and simplify rules on the matter as long as the specifics related to differences in financial and banking development in each Member State are taken into account. The complexity and increasing number of measures to toughen regulation recently may contribute to legal and financial insecurity. It is necessary to adopt simpler schemes by ensuring that EU supervisory authorities take an increasingly consolidated and comprehensive approach tailored to the pan-European nature of a growing number of businesses. As indicated above, the CCBE suggests that the various European supervisory authorities should be required to conduct a collegiate review of existing schemes within a short time and set up a reform focusing on the spread of the rules which seem to be the best way to combat financial insecurity.