25 January 2011

Results and main conclusions of the public hearing on the draft

Internal Governance Guidebook

(CP 44)

1. Participants from associations, institutions, supervisory authorities and the European Commission registered for the public hearing on the Internal Governance Guidebook taking place on 15 Dec. 2010 at the CEBS premises in London.

2. After a brief introduction by Bernd Rummel about the transition from CEBS to the European Banking Authority (EBA), Jo Swyngedouw presented the reasoning behind and the content of the Internal Governance Guidebook.

Concept and implementation of the Guidebook

3. Participants were generally supportive of the Guidebook and appreciated that CEBS had developed a comprehensive set of internal governance guidelines which are in line with international standards.

4. Participants asked about the relationship between the Guidebook and the European Commission's legislative initiatives as a follow up to its Green Paper on Corporate Governance that was published in June 2010.

Response: Given the fact that it will take considerable time before any initiatives from the EC in the field of corporate governance for financial institutions become final EU legislative instruments, CEBS intends to go forward with the Guidebook as it stands now, i.e. implementing it by the end of September 2011, without waiting for the EC initiatives. Moreover, in 2009, CEBS conducted a case study analysis of how European banks had implemented former CEBS principles for internal governance and which weaknesses in this respect had been identified during the financial crisis. The report was sent in early 2010 to the European Commission as an input to its work on corporate governance practices within the financial services area. CEBS does not expect any contradictions between the Guidebook and future EC initiatives, but rather elaborations or specifications. The Omnibus I directive states that the EBA may develop such standards in the area of corporate governance. However, CEBS will not decide now on the development of "binding technical standards".

The European Commission from its side replied that proposals for regulatory actions regarding the corporate governance of financial institutions will be published in June 2011. Regulatory proposals will set out principles for some areas, applicable to financial institutions only. Another Green Paper on corporate governance in general will be consulted next year.

5. Participants recommended that not only the Guidebook, but also supervisory practices regarding internal governance be harmonised.

Response: The Guidebook will have to be implemented by both supervisors/legislators and institutions. An implementation plan and an implementation study will aim at harmonising supervisory practices; in addition, other guidelines regarding the supervisory review process and joint risk assessments also deal with the evaluation of internal governance.

Proportionality and scope of the Guidelines

6. Several participants stressed the importance of the proportionality principle. A "one-size-fits-all" approach for internal governance would be counterproductive. Some participants would see benefits in setting explicit thresholds to define which requirements would only apply to larger firms and consequently not to smaller firms.

Response: setting thresholds at EU level is not feasible. CEBS confirmed its overall approach on proportionality, which allows for justified flexibility in the implementation (i.e. alternative appropriate solutions can be proposed by institutions; explaining why one does not comply is not sufficient). Proportionality applies to the supervisory layer (also taking into account national differences e.g. in company laws) and also to the actual implementation by institutions. The principles in bold are the outcome to be achieved; the implementation of the explaining paragraphs is more flexible based on the proportionality principle and a comply or explain approach.

7. In addition, the existence of matrix or business line organisations need to be considered by the Guidebook, to take into account centralised management. Participants asked if the guidelines would be applicable at group level only.

8. The participant from the Central Bank of Ireland stressed the importance of the proportionality principle. The Irish regulation distinguishes between principles which apply to all institutions and principles that only apply to large institutions. Specific Guidelines on the Management Body and Committees and on how group resources can be shared are in place[1].

9. The Croatian and also the Czech National Bank commented that proportionality should also be assessed from the subsidiaries' perspective and that at all subsidiaries a minimum risk management competence is needed. Subsidiaries cannot rely exclusively on group resources. The Czech National

[1] For more information, see http://www.financialregulator.ie, former CP41, Corporate Governance Code for Credit Institutions and Insurance Undertakings.

Bank additionally commented that one must differentiate between subsidiaries and branches.

Response: The Guidebook is directed to all institutions, including subsidiaries. It should be implemented at group and solo level, but the proportionality principle applies also for the implementation of the Guidebook in a group context. Internal governance should be discussed in supervisory colleges.

Transparency

10. Participants questioned that the transparency principles would enable stakeholders to assess the quality of the Risk Management Function.

Response: In addition to the Guidebooks' transparency requirements, CRD Pillar 3 disclosure requirements (*inter alia* regarding risk management) have to be complied with by all institutions. The risk profile of an institution should be transparent.

11. Participants commented that the transparency requirements should only apply to group level (which is the normal approach under Pillar 3) and that the transparency requirements, as currently drafted in the Guidebook (paragraph 169) are difficult to meet in particular by large groups with a high number of subsidiaries. Subsidiaries need to follow group governance standards (see from paragraph 28 onwards), and therefore it would be sufficient to ask for transparency at group level.

Response: CEBS believes, in line with the current draft of the Guidebook, that it is important that minimum of information about the internal governance system of subsidiaries is available. It will consider options on how the transparency requirement can be met within a group context.

Management Body

12. It was asked if there were any specific guidelines directed to the internal audit function of an institution on how to assess the adequacy of the composition of the management body.

Response: Institutions have to lay down a policy on which qualifications for members of the management body are required. This policy needs to consider the risk profile and complexity of the institution. Internal audit will have to check compliance with such internal policy. However, the Guidebook does not contain a detailed process on how this type of audit should be performed.

13. Participants commented that in a subsidiary no independent board members are needed (see paragraph 33 of the Guidebook: "In a subsidiary, an element of strong governance is to have independent members on the management body (e.g. non-executives who are independent of the subsidiary and of its group, and of the controlling shareholder)").

Response: Independent members in the management at subsidiary level are intentionally presented in the Guidebook as an element of strong governance. As for the composition of the management body, also national requirements have to be considered which in some cases are even stricter at subsidiary level compared to what is provided for in the Guidebook (a participant from the Central bank of Ireland explained IE requirements in this respect).

14. Regarding the qualification of members of the management body, it was asked if a specific exam would be required.

Response: The Guidebook does not provide for a specific exam being taken.

15. A participant asked whether "senior management" is not covered.

Response: the Guidebook intentionally uses the term "management body". The management function is not necessarily limited to executive members of the management body.

16. It was suggested to lay out the qualification requirements in more detail.

17. It was raised that lending to directors can cause governance issues.

18. One Participant commented (re paragraph 15) that the requirement to participate in a given number of meetings is difficult to meet, if one has a global board.

Internal control / risk management

19. Participants asked if internal control functions could still be supported by external companies or be outsourced.

Response: Both options would still be possible. Regarding outsourcing, attention was drawn to the specific Outsourcing Guidelines, which remain valid in parallel to Principle 14 of the Guidebook. Reference was also made to the MiFid requirements in this respect. Furthermore, different internal control functions cannot outsource to each other, e.g. the risk control function can not be outsourced to the internal audit function, because the internal audit function is the broadest of all and also controls the risk control function. However, in smaller and less complex institutions, the risk control and compliance functions may be combined.

20. Participants commented that it is important to have one single internal control function overseeing all risks and combining the different risk assessments of risk specific control functions.

Response: This was intended by the guidelines; CEBS will check if the wording is clear enough (cfr. paragraph 124 of the Guidebook).

Other comments

21. Participants welcomed the introduction of principles regarding IT and Business Continuity Management.

22. The Czech National Bank stated that more harmonisation between the governance rules for institutions and insurance companies would be helpful.