Comparison between European Commission proposals and TI recommendations on corporate governance in financial institutions

The following table lists the European Commission proposals on prudential supervision of credit institutions as outlined in the draft directive published in July 2011. We focus here only on the sections relating to governance and remuneration (Articles 86-90). We note where the proposals echo TI recommendations contained in our submission to the Commission consultation on corporate governance and remuneration in financial institutions (September 2010). Finally, we enumerate those recommendations that have not been taken up in the draft directive.

Article 86 – Governance Arrangements		
	EC proposal	TI recommendations
1	Member States shall ensure that the management body defines and oversees the implementation of the governance arrangements that ensure effective and prudent management of an institution, including the segregation of duties in the organisation and the prevention of conflicts of interest. Those arrangements shall comply with the following principles: (a) the management body shall have the overall responsibility for the institution, including approving and overseeing the implementation of the institution's strategic objectives, risk strategy and internal governance; (b) the management body shall be responsible for providing effective oversight of senior management; (c) the chairman of the management body of an institution shall not exercise simultaneously the functions of a chief executive officer within the same institution, unless justified and authorised by competent authorities.	*Transparency International believes that the* ***board of directors is one of the major elements of a successful corporate governance system****. The board provides oversight and takes leadership on strategic and key operational issues and is considered as having the 'duty of care' for a company by setting the 'tone at the top' and promoting a corporate governance framework that covers all levels of the organisation and types of risks. To reinforce and operationalise this alignment, the active engagement of the board in good governance systems is essential.* *the overall accountability for risk management policy should remain with the board in its entirety.*

	Competent authorities shall ensure that the management body monitors and periodically assesses the effectiveness of the institution’s governance arrangements and takes appropriate steps to address any deficiencies.	
2	Competent authorities shall ensure that institutions establish a nomination committee composed of members of the management body who do not perform any executive function in the institution concerned. The nomination committee shall carry out the following: (a) identify and recommend, for the approval of the management body in its supervisory function candidates to fill management body vacancies. In doing so, the nomination committee shall evaluate the balance of knowledge, skills, diversity and experience of the management body, prepare a description of the roles and capabilities for a particular appointment, and assess the time commitment expected; (b) periodically assess the structure, size, composition and performance of the management body, and make recommendations to the management body in its supervisory function with regard to any changes; (c) periodically assess the knowledge, skills and experience of individual members of the management body and of the management body collectively, and report this to the management body in its supervisory function; (d) periodically review the policy of the management body for selection and appointment of senior management and make recommendations to the management body. In performing its duties, the nomination committee shall be able to use any forms of resources it deems appropriate, including external advice, and shall receive	*It is of fundamental importance that members of the board have a general knowledge of the working and risks and rewards of financial products and services that are offered by their institution to customers.*

	appropriate funding from the institution to this effect. Competent authorities may authorise an institution not to establish a separate nomination committee taking into account the nature, scale and complexity of the institution's activities. Where, under national law, the management body does not have any competence in the process of appointment of its members, this paragraph shall not apply.	
Article 87- Management Body		
1	Competent authorities shall require that all members of the management body of any institution shall at all times be of sufficiently good repute, possess sufficient knowledge, skills and experience and commit sufficient time to perform their duties. Members of the management body shall, in particular, fulfil the following requirements: (a) Members of the management body shall commit sufficient time to perform their functions in the institution. They shall not combine at the same time more than one of the following combinations: (i) one executive directorship with two non-executive directorships; (ii) four non-executive directorships. Executive or non-executive directorships held within the same group shall count as one single directorship. Competent authorities may authorise a member of the management body of an institution to combine more directorships than permitted, if this does not prevent the member from committing sufficient time to perform its functions in the institution, taking into account individual circumstances and the nature, scale and complexity of the institution's activities.	

	(b) The management body shall possess adequate collective knowledge, skills and experience to be able to understand the institution's activities***, including the main risks.*** [our italics] (c) Each member of the management body shall act with honesty, integrity and independence of mind to effectively challenge the decisions of the senior management where necessary.	*Several members of Board should have a strong risk management background in order to make clear that the ability to manage risks is of paramount importance to the company and is a hallmark of strong leadership skills.* *Provide committed and consistent leadership ('tone from the top') that makes performance with integrity the foundation of the corporation;*
2	Competent authorities shall require institutions to devote adequate human and financial resources to the induction and training of members of the management body.	
3	Competent authorities shall require institutions to take into account diversity as one of the criteria for selection of members of the management body. In particular, institutions shall put in place a policy promoting gender, age, geographical, educational and professional diversity on the management body.	
4	Competent authorities shall use the information collected in accordance with the criteria for disclosure established in Article 422 of Regulation [inserted by OP] to benchmark diversity practices. The competent authorities shall provide EBA with that information. EBA shall use this information to benchmark diversity practices at Union level.	
5	EBA shall develop draft regulatory technical standards to specify the following: (a) the notion of sufficient time commitment of a member of the management body to perform his functions, in relation to the individual circumstances and the nature, scale and complexity of activities of the institution which competent authorities must take into account when they authorise a member of the management body of an institution to	

	combine more directorships than permitted as referred to in paragraph 1(a); (b) the notion of adequate collective knowledge, skills and experience of the management body as referred to in paragraph 1(b); (c) the notions of honesty, integrity and independence of mind of a member of the management body as referred to in paragraph 1(c); (d) the notion of adequate human and financial resources devoted to the induction and training of members of the management body as referred to in paragraph 2; (e) the notion of diversity to be taken into account for the selection of members of the management body as referred to in paragraph 3. Power is delegated to the Commission to adopt the regulatory technical standards referred to in the first subparagraph in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010. EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2015	
Article 88 - Remuneration policies		
1	The application of Articles 88(2) to 91 shall be ensured by competent authorities for institutions at group, parent company and subsidiary levels, including those established in offshore financial centres	
2	Competent authorities shall ensure that, when establishing and applying the total remuneration policies, inclusive of salaries and discretionary pension benefits, for categories of staff including senior management, risk takers, staff engaged in control functions and any employee receiving total remuneration that takes them into the same remuneration bracket as senior management and risk takers, whose professional activities have a material impact	

	on their risk profile, institutions comply with the following principles in a way and to the extent that is appropriate to their size, internal organisation and the nature, the scope and the complexity of their activities:	
	(a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk-taking that exceeds the level of tolerated risk of the institution;	*Reduce appetite for high-risk transactions… by restructuring employee compensation to reward responsible, sustainable long-term performance*
	(b) the remuneration policy is in line with the business strategy, objectives, values and long-term interests of the institution, and incorporates measures to avoid conflicts of interest;	*Design compensation systems so that management and employees are paid not just for performance, but for performance with integrity*
	(c) the management body, in its supervisory function, of the institution adopts and periodically reviews the general principles of the remuneration policy and is responsible for its implementation;	
	(d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;	*Board and senior executive remuneration and benefits packages should be …determined by independent, non-executive directors.*
	(e) staff engaged in control functions are independent from the business units they oversee, have appropriate authority, and are remunerated in accordance with the achievement of the objectives linked to their functions, independent of the performance of the business areas they control;	*Firms should also set up a framework to protect the risk manager from any kind of pressure.*
	(f) the remuneration of the senior officers in the risk management and compliance functions is directly overseen by the remuneration committee referred to in Article 91 or, if such a committee has not been established, by the management body in its supervisory function.	

Article 90 - Variable elements of remuneration		
1a	where remuneration is performance related, the total amount of remuneration is based on a combination of the assessment of the performance of the individual and of the business unit concerned and of the overall results of the institution and when assessing individual performance, financial and non-financial criteria are taken into account;	*Board and senior executive remuneration and benefits packages should be tied to sustainable performance…*
1b	the assessment of the performance is set in a multi-year framework in order to ensure that the assessment process is based on longer-term performance and that the actual payment of performance-based components of remuneration is spread over a period which takes account of the underlying business cycle of the credit institution and its business risks;	*Board and senior executive remuneration and benefits packages should be tied to sustainable performance…*
1j	A substantial portion, and in any event at least 50 %, of any variable remuneration shall consist of an appropriate balance of the following: (i) shares or equivalent ownership interests, subject to the legal structure of the institution concerned or share-linked instruments or equivalent noncash instruments, in case of a non-listed institution;	*Board Remuneration should be linked to long-term performance…*
1k	a substantial portion, and in any event at least 40 %, of the variable remuneration component is deferred over a period which is not less than three to 5 years and is correctly aligned with the nature of the business, its risks and the activities of the member of staff in question.	*…through deferred payment…*

<u>Unmet Recommendations</u>

<u>Whistleblowing</u>
Secure channels are provided for employees to seek advice or voice concerns (whistle blowing) without fear of intimidation or retaliation

<u>Education and training</u>
Foster employee and business partner awareness, knowledge and commitment through stimulating, systematic education and training;

<u>Risk management</u>
The board should also report at a minimum on annual basis, to their shareholders (and to the public) on the continuing measures they are adopting to strengthen both risk

management at the executive level and board governance of all aspects of risk management. The general meeting would be the forum where the board would explain and defend before shareholders their risk management policy.

A risk control declaration should be put in place and published. There should further be a specific board-level declaration on risk management policy.

The Chief Risk Officer [CRO] must be able to report directly to the board.

There should be clear lines of communication and accountability between risk management and the board, either through a board-level risk committee, senior board personnel engaged with risk management, a periodic review of a company's risk profile or an approval procedure for all risk management activity.

Importantly, there should be clear procedures of internal dispute settlement regarding risk-related decisions.

Reporting

Mandatory reporting disclosure should include non-financial risk such as environmental and integrity standards, including anti-bribery programmes (integrated reporting).

Shareholders

Shareholder participation in corporate governance should be streamlined through transparent procedures. TI advocates the protection of owners' rights and facilitation of their participation in company meetings including voting on changes to the company's structure and key governance decisions

TI supports governments and institutional investors in their call for shareholder approval of individual board and senior executive remuneration packages (including on types of long-term incentives, deferred stock options and pensions).

Liability of directors

The civil and criminal liability of directors should be reinforced. Greater personal liability encourages directors to actively promote good governance systems.