POSITION PAPER

# ESBG Response to European Commission Consultation concerning the Green Paper on the EU corporate governance framework

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## Introductory Remarks

The European Savings Bank Group (ESBG) would like to convey our thanks to the European Commission for this opportunity to provide input and comments concerning the *EU corporate governance framework*. We understand that this consultation is an extension of the Green Paper of June 2010 on *corporate governance in financial institutions and remuneration policies* with the accompanying Commission staff working document *Corporate Governance in Financial Institutions: Lessons to be drawn from the current financial crisis, best practices*. We will therefore make several references to our answer to this former consultation.

We propose to set out our general comments concerning corporate governance and then respond to each of the specific consultative questions set out in the Green Paper.

## General Comments

### Existing Measures concerning Corporate Governance

As highlighted in our response to the Green Paper of June 2010 on *corporate governance in financial institutions and remuneration policies*, ESBG would ask the Commission to be mindful of interactions between the existing measures and on-going activities which relate to corporate governance in financial institutions at European level. Any future action from the Commission in this area must take into account the effectiveness of the existing regulatory framework as set out by the Basel[1] Committee on Banking Supervision and implemented in the Capital Requirements Directive (CRD) (Directive 2006/48/EC & Directive 2006/49/EC) as amended and by the Committee of European Banking Supervisors (CEBS) guidelines. In particular we recall attention to the agreed amendments to the CRD, as adopted by the Council and European Parliament (referred to as "CRD 3") or the revisions which are currently being drafted ("CRD 4"). In addition the Commission must consider the on-going discussion concerning the modernization of the Transparency Directive 2004/109/EC for listed companies.

Any potential future guidance concerning corporate governance must take account of what has already been dealt with at Community level.

### Legislative Approach

As corporate governance relates to a set of relationship between private parties ("*between a company's management, its board, its shareholders and stakeholders*), we would like to draw the Commission's attention on the fact that corporate governance rules are not necessarily to be imposed by legal provisions.

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[1] In particular Basel II

ESBG believes that in any proposed measure concerning corporate governance, the Commission must retain flexibility in its approach in order to reconcile the different corporate governance systems. It is in the interests of financial stability that diversity is maintained and ESBG would urge the Commission to allow different models of corporate governance to continue to evolve.

We are fully aware of the fact that the financial crisis brought out significant shortcomings of the financial environment and that the Commission and the supervisory institutions are making efforts to correct those shortcomings. But we have to stress that the corporate governance framework is essentially based on self – regulatory rules. These rules are mainly the result of the companies' commitment to promote responsible business behaviour. The principle "comply-or-explain" represents the key figure of the corporate governance framework and we would like to stick to it. There is a significant drawback with legal provisions: their rigidity. Based on these ideas, we would like to advise the Commission to reconsider the necessity of establishing corporate governance rules by mandatory legal obligations.

We are convinced that in times of stress the best solutions lie within flexibility rather than in rigidity. Amongst all the issues the Commission lists we have not found any which cannot be solved with increased practice and increased application of the "comply and explain principle". Furthermore some of the legal provisions that may be raised in the future may not be applicable in the same manner to financial institutions that have a different size or structure. This means that it would not be possible for any potential rules in relation to corporate governance to be applied to all financial institutions in the same way.

The application of guidelines and codes of conduct are, therefore, preferable to prescriptive rules as they would allow financial institutions with different systems the room to adapt their corporate governance system.

Indeed most of the issues raised in this consultation paper are already laid down in national corporate governance codes or are supposed not to be subject to corporate governance rules at all. That is why we consider that the first option for the European Commission when elaborating the corporate governance framework should be by ways of soft law (e.g. guidelines or recommendations) respecting the principles of subsidiarity and proportionality

**Proportionality**

ESBG notices that as opposed to the Green Paper *Corporate governance in financial institutions and remuneration policies* of June 2010, the present Green Paper of April 2011 does not explicity support the recognition in that corporate governance principles should take account of a financial institution's type and size[2].

[2] While the green paper of April 2011 asks in its first question whether the size of companies should be taken into account, Green Paper of June 2010 in page 3 sets out clearly that *"the principles of sound corporate governance referred to in this Green Paper focus primarily on large financial institutions. These principles should be adapted so as to be applied effectively to smaller financial institutions."*

It is true that the April 2011 Green Paper does not focus on large financial institutions, but we would ask the Commission to continue to be mindful of the different conditions in smaller institutions. It is absolutely crucial for ESBG that the Commission continues to recognize the need for proportionality in the application of corporate governance principles. ESBG believes that in order for corporate governance measures to be effective it is essential that they are adapted to smaller financial institutions in a proportionate manner.

ESBG believes that the type of activities carried out by a financial institution and its systemic importance should also be important factors for the Commission to take into account in any future policy proposals. In this regard we would ask the Commission to consider the question of proportionality in its broadest sense and in addition to the type and size of a financial institution, examine its systemic relevance and complexity of business model.

**Diversity**

It is very important that diversity is maintained in the financial system, as recent research[3] highlights there is an advantage in having a mix of institutions with different portfolio structures and business models. Overall systemic risk, especially if arising from herd behaviour, can be reduced if institutions are not homogenous.

ESBG would like to urge the Commission to be mindful of the diversity of banking models in Europe and stresses that diversity of banking structures leads to greater financial stability and also stimulates competition and dynamism. Different banking models and structures coexist, which sometimes cannot be directly compared to each other - for example, distinguishing aspects of savings banks include the incorporation of stakeholder values in their business model, others aspects concern the cooperative structure of some banks. This diversity of banking structures in Europe is key for the funding of the real economy as in the majority of cases they have a local or regional focus and long established commitments to their community. It is important that the Commission takes into account that this diversity is borne out in the different characteristics of corporate governance systems that have evolved in Member States, a topic which we further explain below.

**Characteristics of Corporate Governance Systems**

As already explained in our answer to the June 2010 consultation, a distinction is often made between the Anglo-American Model (one-tier model) and the Continental European Model (two-tier model) of corporate governance.

One characteristic of the one-tier model is that there is only one governance body in the company. The company's highest decision-making body, the shareholders meeting, appoints the board of directors, which is responsible for the company's governance. There is no separate executive board.

[3] "Investigating Diversity in the Banking Sector in Europe, the Performance and Role of Savings Banks" Centre for European Policy Studies 2009

Thus in practice, the board of directors also has an executive function, the responsibility for which normally rests with the managing director, who is appointed by the board of directors.

The two-tier governance model, divides the governance function between two governing bodies – a supervisory board and a management board. The shareholders meeting is the company's highest decision making body. The meeting appoints the supervisory board which, in turn, appoints the management board. There is normally a strict division of functions between the supervisory board and the management board. The key governing body is usually the management board, which is responsible for looking after the administration of the company. The supervisory board supervises the work of the management board and may in general only intervene in the direct management of the company in a very limited way. In addition it is normally forbidden for the same person to sit on both boards.

Corporate governance systems differ greatly between Member States, but this does not mean that one system is preferable or better ensures adequate corporate governance; rather it may be seen as a product of the diversity and historical development of institutions.

**Listed and unlisted Financial Institutions**

It is apparent upon studying the Green Paper as well as the previous one of June 2010 that the main focus of the Commission's work is on listed financial institutions. ESBG notes this consultation relates to broader review on corporate governance within listed companies in general and, in particular, on the place and role of shareholders, the distribution of duties between shareholders and boards of directors with regard to supervising senior management teams, the composition of boards of directors, and corporate social responsibility. We suggest (and point to specific instances in our response) that it may be more appropriate to consider some of the issues discussed in the Green Paper in the overall context of all listed companies.

In addition ESBG would urge the Commission to be aware in their consideration of various policy options that it is not possible to draw parallels between corporate governance in listed and unlisted companies as they have fundamentally different structures.

**ESBG replies to the Commission's specific questions**

**General questions**

**1. Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.**

ESBG does not consider that that governance measures should take into account the size of listed companies. The main issue concerns the different structure, business model and organisation of listed companies. Discriminating between listed companies in terms of size is artificial and could mislead investors. On the contrary ESBG believes that the fundamental difference lies between listed and unlisted companies. The Commission should consider possible corporate governance measures only after taking into account the fact that there are companies which are listed and others which are not listed.

Against this background ESBG stresses that given the different national structures and corporate governance models across Europe, the EU corporate governance framework has to remain principle-based. If the measures adopted are principle-based and remain subject to the "comply or explain" principle there is no need for a specific regime for listed SMEs. The primary distinction relevant for EU purpose seems to be between listed or non-listed companies, with much more flexibility granted for non-listed companies.

Regarding unlisted small and medium-sized companies, corporate governance principles should allow companies to have a flexible approach on their governance policies. Such an approach would allow SMEs to adapt their governance models to their needs and business interests. Some criteria such as number of employees or total turnover could be used to establish a special regime for small and medium-sized companies.

**2. Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?**

ESBG agrees with the European Commission on the fact that corporate governance is important for both listed and non-listed companies.

In terms of process, we encourage the European Commission to address corporate governance for listed companies. We do not consider necessary to take any corporate governance measures for non-listed companies at EU level for the moment. Such an option should be given to Member States as an application to the principles of proportionality and subsidiarity. Any move in that direction would

increase the regulatory burden for non-listed companies, which is not against the very policy of the European Commission[4].

Meanwhile non-listed companies should be free to decide whether they apply or not corporate governance rules, whether they originate from the EU or are specific to Member States.

**Boards of directors**

**3. Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?**

We refer to our remarks in the opening section and draw the Commission's attention to the different types of corporate governance systems and board organization and in particular the distinctions which need to be recognized between the one-tier and two-tier model of corporate governance. These different national systems mean that the combination of these two roles is not possible in member states which have a two-tier system.

We note that in some Member States there is a specific prohibition in all public companies for the chairman of the board of directors to hold the role of chief executive officer for example in Sweden[5].

Overall ESBG would consider a conditional restriction on the combination of these functions to be more appropriate than a complete prohibition. For example in Spain[6] when a company's chairman is also its chief executive an independent director is given special powers to request board meetings in order to give voice to concerns if necessary.

In addition, ESBG points out that some of the legislation currently in force in Member States already makes it impossible for the same person to be at the same CEO and chairman of the supervisory board while other member States allow this possibility.

Both solutions - a combination of the functions of chairman of the board of directors and chief executive officer or the prohibition of this combination - have their advantages and deficiencies. The combination of the two roles could create the risk of jeopardizing the critical monitoring function of the board but at the same time the French recent experience when a reunification of the two functions occurs in times of crisis (Axa, Saint-Gobain, Total and Vinci) showed an increased efficiency in decision-making.

Therefore ESBG does not support any prescriptive rule as financial institutions with different systems should have the room to adapt their corporate governance system.

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[4] http://ec.europa.eu/enterprise/policies/smart-regulation/administrative-burdens/

[5] Swedish Banking and Financing Business Act (Chapter 10 section 6) and the same rule is applicable to public listed companies according to Swedish Companies Act (Chapter 8 section 49)

[6] Unified Good Governance Code of Listed Companies approved by the Spanish Securities Market Commission (CNMV)

**4. Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?**

ESBG is generally supportive of the intention to enhance the qualifications and professionalism of supervisory board members.

On the first hand we have to emphasize that ultimately it is the duty of the shareholders to decide, as owners of a company, whether they are willing to reappoint a member of the supervisory board. Shareholders, in their meeting, are the responsible body for appointing the supervisory board members.

On the other hand we want to stress that it is also essential to consider the principle of proportionality with great scrutiny. Members of a supervisory board of a small regional bank do not need the same qualification as those of an international investment bank. As already underlined in our answer to question 1, everything depends on the type, amount and complexity of the business carried out.

ESBG notices that the shareholders' role in corporate governance was addressed in the Green Paper on corporate governance in financial institutions, published in June 2010. The June 2010 Green Paper found that a lack of appropriate shareholder interest in holding financial institutions' management accountable contributed to poor management accountability and may have facilitated excessive risk taking in financial institutions.

ESBG understands that an evaluation of a board of directors could be a useful tool to ensure that the Board is functioning appropriately. However, in the opinion of ESBG, compulsory European specific rules on the profiles of the directors are not reasonable or practical to implement. Imposing capacity and honorability requirements to board members is more a Member State issue.

Directors are appointed according to a variety of different mechanisms in different member states and corporate governance systems. In some cases the appropriate qualifications and profile of directors may be specifically set out whilst in other cases there may not always be a formalized recruitment policy. For example, many directors are appointed upon a vote of the general meeting where it may not be possible to specify the profile of the candidate in advance. It is necessary to note that many small traditional savings banks have a limited pool from which they may appoint directors, are limited geographically to a single area, and may not have a specific recruitment policy.

Therefore it may be more appropriate to achieve the objective of ensuring directors are equipped with adequate skills through other non-binding means, for example through supporting and encouraging directors training. To give one example in France, the BPCE Group has an extensive training system for directors which is targeted at their role in the financial institution and based on the individual director's needs. The training is conducted both internally and in conjunction with external experts, for example the French Institute of Directors.

Regarding the rationale of the proposal, ESBG considers that companies are ultimately the responsibility of their owners. Therefore deciding for these owners the criteria by which one person is deemed professional enough to be a member of a board of directors undermines the very logic of private ownership. Such rules may be reasonable only when the society as a whole faces a systemic risk if the company faces unexpected issues. For other companies forcing them to select their directors upon a specific profile might have unintended consequences. The decision making of companies might turn in the hands of pure technical managers which, in turn, could weaken the attempt of the Commission to address the agency dilemma it is describing.

Regarding the supervisory board members representing shareholders, ESBG can consider certain general requirements; but stresses that such requirement should not be detailed and should be defined by the respective company rather than by legal provisions. What needs to be considered when defining the profile and the responsibilities in a recruitment policy is that the requirements should be in accordance with the characteristics of every individual company as an application of the principle of proportionality.

In addition, ESBG raises the attention of the European Commission on the fact that under some national jurisdictions a number of supervisory board members are representatives of employees. If any requirement is ultimately proposed by the European Commission, ESBG urges to spare this category of supervisory board members from these specific rules as it could lead to limitation of employees' representation in the supervisory board.

**5. Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?**

ESBG has no objection against disclosing whether companies have a diversity policy or not, as long as there is no obligation to have one.

**6. Should listed companies be required to ensure a better gender balance on boards? If so, how?**

ESBG favours equal access to responsibilities and, as a matter of principle, objects to any kind of gender discrimination.

If ESBG advocates for a higher number of female supervisory board members, ESBG also believes that prescriptive rules or the introduction of a quota regarding gender or cultural/social background may not prove to be the most appropriate method of improving the functioning of the board. When selecting the members of the board, the primary focus must be on their experience and qualifications. From a practical point of view it may be very difficult for small financial institutions and SMEs to ensure compliance with such rules given the limited pool from which potential directors may be drawn. In such a situation a quota regarding gender or cultural/social background could have the potential effect of surpassing the primary need of adequate skills. Therefore selection

criteria in appointments should remain flexible and proportionate with the ultimate aim of the good functioning of the board whilst ensuring the principle of diversity is respected.

This is why we oppose any fixed ratios and specifications regarding gender balance laid down by legal provisions. These kinds of issues should be decided by every individual company based on its profile and strategy. Shareholders have a specific interest in the selection of their representatives on the supervisory board and this has to be taken into account.

**7. Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?**

ESBG considers that in principle such a decision is to be taken by shareholders. However ESBG also understands the soundness of the arguments which advocate for a limitation on the number of mandates a non-executive director may hold.

ESBG would ask the Commission to be mindful that in imposing an absolute limit they must take into consideration the different types of structures of financial institutions that exist in Europe. It is absolutely necessary that in any proposed measures, the principle of proportionality is taken into account. It is particularly important for ESBG that a distinction is made between the time commitments necessary of a director of an SME or of a small traditional savings bank and a director of a large listed institution. Furthermore a difference has to be made with regard to the function of the respective director on the board, i.e. management or supervisory function. In the case of group structures, it can be useful and efficient to have some directors who sit on a number of boards in order to ensure consistency within the group and uniformity in control and inspection. This is particularly the case for cooperative groups. In such groups multiple mandates ensure more coherence as opposed to more "centralised" companies. In this scenario an absolute limit on the number of boards upon which a director may sit could prove counter-productive in the operation of the internal control mechanisms.

Overall ESBG considers proportionate guidelines or recommendations according to a 'comply or explain' principle more appropriate than prescriptive rules in this area and consider a strict limitation of three directorships to be inappropriate.

We have to point out that a number of Member States' Corporate Governance Codes (for instance in Austria, France, Spain) already contain sufficient rules.

ESBG understands the European Commission concern and believes that abuses should be corrected. This being said, ESBG also highlights that the situation is not the same throughout Europe. As different situations should never be treated similarly, ESBG stresses the need to continuously uphold the principles of subsidiarity and proportionality.

**8. Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?**

ESBG considers that voluntary self-assessment, i.e. self-evaluation, at appropriate intervals are sufficient.

Ultimately, it is the responsibility of shareholders to choose supervisory board members – and it is also their responsibility to evaluate their activities. Ultimately shareholders are the ones who approve or disapprove the actions the board of directors in shareholders meeting.

As already answered in question 4, ESBG understands that an evaluation of a board of directors could be a useful tool to ensure that the Board is functioning appropriately. However, in the opinion of ESBG, a compulsory evaluation of the functioning of a board of directors by an external evaluator is not reasonable or practical to implement. ESBG would require further details of what such an evaluation would entail for example on the quality of decision making to be assessed and if so how would such an evaluation attempt to assess the practical knowledge of directors would be performed. In addition, where a financial institution's structure incorporates a general meeting of the shareholders the performance of the board will be evaluated at this meeting.

When the proportionality principle is considered it is clear that a compulsory evaluation by an external evaluator would be too onerous for many traditional savings banks. As ESBG understands the importance of the correct functioning of the board we would suggest proportionate self-evaluation would be more appropriate.

**9. Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?**

ESBG believes that remuneration policies in a financial institution should support long-term and sustainable, firm-wide profitability. In light of the financial crisis, it appears that both the level and the structure of remuneration may be factors that could encourage short-termism and induce high risk-taking to the disadvantage of a bank's long-term interests and of other stakeholders. ESBG agrees that close attention must be paid to the alignment of compensation incentives with the long-term interests of the entire institution. ESBG also believes that policy and regulatory reactions targeting remuneration issues should specifically focus on the inappropriate compensation incentives that induced excessive risk-taking.

The issue of remuneration in financial institutions has already been subject to discussion in numerous fora. The European Commission, the Financial Stability Board and the Committee of European Banking Supervisors, have all issued recommendations or guidelines concerning remuneration in listed companies and or in the financial sector.

In particular at European level, the Council and European Parliament have recently agreed upon amendments to the Capital Requirements Directive (referred to as "CRD 3") part of which deals with remuneration policies.

The CRD 3 package, which came into force on 1 January 2011, specifically provides principles on sound remuneration in order to ensure that remuneration does not encourage excessive risk-taking.

It aims to ensure that staff incentives are aligned with the long-term interests of the financial institution. ESBG considers the provisions of the CRD 3 package to be very far-reaching and to have a significant impact on remuneration policies that shall be disclosed to the public regularly. As the disclosing requirements under CRD 3 are very comprehensive, we do not consider that additional requirements are necessary at the moment. ESBG urges the Commission to give financial institutions an opportunity to have sufficient time to examine and properly implement CRD 3 concerning remuneration policies; as at present further steps and initiatives in this area would be premature. Banks and regulators alike should have the time they need to consider the full effects of the CRD 3 package.

In order to avoid potential legislative confusions, we are of the opinion that any legislative proposals or amendments regarding the remuneration requirements for the banking and financial sector should be treated solely under the special framework for the banking and financial environment (for example, the *Green Paper on Corporate Governance in financial institutions and remuneration policies* of June 2010).

**10. Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?**

We do not consider necessary to establish mandatory legal obligations with this respect. This opinion is also reflected by the provisions of the OECD Principles of Corporate Governance which recommend giving the shareholders the possibility to make their views known on the remuneration policy for board members and key executives (II. C. 3), but not to vote on this.

In other words ESBG believes that decisions regarding remuneration policies should be adopted by in-house specialists and approved by the relevant governing bodies. In the case of listed companies it may be appropriate for the board's decision concerning remuneration to be presented annually at the general meeting of shareholders.

**11. Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?**

The responsibility for determining a company's risk profile/appetite and strategy lies with the board of directors. Whether a single or two-tier model of corporate governance is employed, the board is the key governing body and both controls and advises on the direction of the financial institution.

In two-tier system this task should belong to the management board and not to the supervisory board. The management board should inform regularly the supervisory board on risk management issues and the supervisory board should be entitled to ask for reports with this regard, but the approval of the risk appetite should stay within the management board hands. The role of the supervisory board is to monitor the company's risk assessment.

On this other hand, in the event that specific cases are taken into account, it would probably be most appropriate for that chairman of the risk committee to report to the board and not the general meeting for purposes of efficiency, as the ultimate responsibility to arrange risk management should reside with the board.

In case of financial institutions, supervisory authorities also play a substantial role in assessing the risk profile of the supervised institutions. ESBG does not consider that the publication of a risk control declaration would constitute an improvement in risk governance. Financial institutions publish information concerning risk control that is of relevance to the confidence of the markets through Basel 2 Pillar 2 (Supervisory Review, where it is clearly stated and emphasized the responsibility of the Board in the definition of the risk appetite of an entity by approving the Risk Policy) and Pillar 3 (Market Discipline)[7] reporting obligations. Pillar 3 imposes disclosure requirements on information related to risk management in particular:

(1) the strategies and processes to manage those risks;

(2) the structure and organization of the relevant risk management function or other appropriate arrangements;

(3) the scope and nature of risk reporting and measurement systems;

(4) the policies for hedging and mitigating risk and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants.

In addition in many instances national regulation provides for further information to be published in the financial institution's annual report.

**12. Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?**

The answer to this question is similar to the answer to question (11) above: in a two-tier systems we believe that this is a matter for the management board, the supervisory board should have just a monitoring function.

**Shareholders**

**13. Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.**

[7] As implemented by CRD Article 145, Annex XII part 2

In our opinion, the issue of short-termism of capital markets is not supposed to be subject to any legal rules. This matter is rather to be decided by every individual investor based on his investment strategy and his business interests. Every investor should be free to decide whether he follows a short- or long-term strategy and should not be restricted with this regard by way of legal rules.

ESBG also points out that the introduction of fair value in the International Financial Reporting Standard (IFRS) which was made compulsory in the EU for listed companies as of 2005 contributes to inappropriate short-termism among investors. Indeed, with fair value companies are more likely to be seen more as a pool of assets that can be actively traded rather than as sum a long term projects which requires stable shareholders. In this regard ESBG recalls its strong position in favour of more amortised cost in IFRS as opposed to more fair value. Similarly, ESBG considers that the increasing tendency to publish quarterly results reinforces, de facto, short-termism among investors.

**14. Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?**

The answer to this question is similar to the answer to question (16) below. Asset management is an investment service under MiFID. Provision of this investment service is subject to the conflict of interest rules stipulated by MiFID. These rules are sufficient and no additional rules are needed.

ESBG recalls the last question of the Green Paper of June 2010 which openly asked if 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.

More generally speaking, it is necessary to note that the existing Community rules concerning conflicts of interest in financial institutions are directed at different targets;

- The CRD 3 deals with conflicts within a credit institution in terms of risk management.
- The UCITS Directive and Solvency 2 address conflicts of interest in the context of internal control and management.
- The MiFID directive deals with conflicts of interest in terms of the provision of investment services.

ESBG is aware that in some cases the provisions of MiFID in relation to conflicts of interest are already applied by large banking groups to their banking, insurance and investment activities. However we would urge caution as each Community provision has a different purpose concerning conflicts of interest and it may not be appropriate or practical to harmonize the content

**15. Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?**

We consider that it is not effective to impose monitoring of asset managers by institutional investors through regulation. Institutional investors, as any other investors, are focused on profit which is the basic source of any economic development. Therefore the EU legal framework should focus on promote achieving profit from a permanent and long-term perspective. Decisions of the institutional investors how to monitor the activities of asset managers should be left to the investors themselves. Public authorities (including the EU) should intervene in the life of companies and investors' strategies only if it is justified from a public interests point of view. Any monitoring of the asset managers by institutional the investors is predominantly an issue for the investors.

Instead, efforts must be focused on soft law and a fully effective a comply-or-explain regime with the aim to improve the information that institutional investors give to their members about the general criteria they use to take their decisions and the exercise of their voting rights.

**16. Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?**

The answer to this question is similar to the answer to question (14). Asset management is an investment service under MiFID. Provision of this investment service is subject to the conflict of interest rules stipulated by MiFID. These rules are sufficient and no additional rules are needed.

**17. What would be the best way for the EU to facilitate shareholder cooperation?**

We do not believe that facilitation of shareholders cooperation is necessarily to be regulated on EU level. Basically shareholders are able to effectively cooperate if they are interested in such cooperation in order to achieve their business interests.

In our opinion, as longs as companies:

- ensure equal treatment and protection of shareholder rights,
- take measures to encourage shareholders to participate actively in the work and decisions of the shareholder meeting,
- provide comprehensive and timely information to the shareholders on all issues of importance for the realization of their rights and status,

the necessary premises for shareholder cooperation are already in place.

Against this background we notice that there are by broad and divergent interpretations of the notion of "acting in concert". ESBG encourages the European Commission to work further in order to address this issue.

**18. Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?**

ESBG notices that these kinds of services do not exist in all Member States. Thus, our suggestion is to leave this matter to be regulated at the Member States' level as an application of the principle of subsidiary. Should the Commission persist in introducing EU-wide rules regarding proxy advisors, ESBG would support a clear and transparent framework in this respect.

**19. Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?**

The answer to this question is similar to the answer to question (18) above.

**20. Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).**

We do not see the need for a technical and/or legal European mechanism for shareholder's identification by the shares issuers. Dialogue on corporate governance issues take place very well as within shareholders meetings. Actually, we believe that with regards to the content of the issue, this topic is not subject of the corporate governance framework. More specifically, while some countries such as France and Spain have tools to identify shareholders, such tools are not available in all Member States most importantly in those who are used to registered shares.

**21. Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?**

ESBG considers that the rights of minority shareholders are sufficiently covered by current legislation (including corporate governance framework). This ensures the equal treatment of shareholders regardless of the number of shares they hold, their country of origin and their other characteristics.

We do believe that the current legal framework of the Member States ensures basically the balance of rights between minority shareholders and major shareholders and avoids both abuse of minority

rights and abuse of majority rights within companies. For example, many Member States apply the OECD Principles of Corporate Governance (chapter III) which indicated that all shareholders are to be treated equally under the same conditions and also that all shares are to be construed in accordance with the principle "one share – one vote" (art. 2).

**22. Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?**

Related-party transactions are already regulated; both at European and national level. ESBG notices that there are different interpretations between Member States and that related party transactions became in the course of time more and more difficult to manage, due to the numerous and partially confusing cross references and interpretations. More clarity of the rules concerning the related party transactions would be welcome as well as simplification of their legal provisions.

**23. Are there measures to be taken, and is so, which ones, to promote at EU level employee share ownership?**

In our opinion, in order to enhance the employee's involvement in the affairs of the company and also in order to encourage employee share ownership, the focus should lie on incentives which are based on the shares retention period.

One of the most efficient instruments for this purpose is tax incentives with the aim to enhance employee share ownership by way of a tax shelter when purchasing the shares (for example, tax-free amount for a certain retention period), but also by stimulating fiscally long-term shares retention. Should the Commission reach the conclusion that EU-wide tax incentives for employee share ownership are appropriate, further discussion on the length of the tax-free/tax-privileged period would be welcome.

While the issue from the employee's point of view is critical, the employer's interest is equally important. Focus should also lie on stimulating companies to encourage employee share ownership. Thus, it is advisable for the Commission to also consider some financial facilities/improvements in favour of the companies granting shares to their employees.

**Monitoring and implementation of Corporate Governance Codes**

**24. Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?**

This principle is already in place in numerous Member States in which the obligation for companies to provide explanations in cases of non-compliance (including the reasons therefore) is already a legal requirement.

ESBG understands the European Commission's position that the required explanations for refusing to apply the corporate governance rules are not sufficiently informative and comprehensive. However the European Commission, in its Green Paper, acknowledges that a slow but gradual improvement can already be observed. It notices that better explanations are being provided thanks to the educational activities of public or private bodies (financial market authorities, stock exchanges, chambers of commerce, etc). As a consequence, ESBG does not consider that further requirements are necessary with regard to this issue, as the comply-or-explain approach represents the appropriate framework for the functioning of Corporate Governance Codes.

**25. Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?**

We do not agree with having EU rules empowering monitoring bodies to check the corporate governance statements.

We consider that regulatory authorities, under a "comply or explain" feature, should limit their role to checking the existence of the statement, only reacting to blatant misrepresentation of facts. In addition, we consider these authorities should not judge the explanations of the Board, leaving this as a matter for the company's shareholders or the supervisory board. The supervisory board could decide to involve an external auditor, if it considers necessary. Shareholders have also the right to ask questions and also additional explanations on this issue within the shareholders meeting.

We reiterate that granting such a competence to monitoring bodies would exceed the self-regulatory characteristic of corporate governance rules. Consequently we strongly disagree with the idea of applying sanctions in cases of non-compliance.

The system should build further on the private law Codes of Conduct. Putting this issue in the hands of a regulatory authority would simply turn the "comply or explain" principle into just another regulatory matter.

The fact is that some securities regulators in some jurisdictions (in France and Spain for instance) publish one or two report(s) every year on the implementation of the "comply or explain" principle.

For instance, in Spain, listed companies and Savings Banks have to make their Annual Corporate Governance Reports public as a "significant event" and as so, they are reported to the National Securities Market Commission being under its supervision. The Spanish market authority collects such information and publishes, on an annual basis, two extensive reports regarding the corporate governance of listed companies. The public is then provided with comprehensive information about the Spanish corporate governance framework.

This example illustrates that there is also some logic in publishing such reports since securities regulator are legally responsible for market transparency. However it has to be stresses that they should not have an exclusive role in this matter: a professional body (like the organisation responsible for the corporate governance code or an emanation of it) may also publish similar reports; which should not go beyond a formal check of adequate disclosure.

ESBG considers that as a matter of consistency, more thought should be given as regards the substantive check of implementation of the corporate governance provisions in respect of the principles of subsidiarity and proportionality. Particular concern on lack of bite of the "comply or explain" principle is a reality but this issue is a shareholder issue and not a regulatory issue. Such a control should not be delegated to any authorities if the Commission does not want to see a soft law principle degenerate into additional hard law. On the contrary, the assessment of the implementation of corporate governance codes should be a competitive one in which securities regulators can have their fair share along with other market stakeholders. The sanctions should always be: "*name and shame*"; and nothing else.

## About ESBG (European Savings Banks Group)

**ESBG – The European Voice of Savings and Retail Banking**

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of over € 6.000 billion, non-bank deposits of € 3.100 billion and non-bank loans of € 3.300 billion (all figures on 1 January 2009). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

ESBG - Association internationale sans but lucratif/Internationale vereniging zonder instoogmerk/ International not-for-profit association

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