Procedure file

Basic information

INI - Own-initiative procedure	2010/2303(INI)	Procedure completed
Corporate governance in financial institutions Subject 2.50.03 Securities and financial markets, stock exchange, CIUTS, investments 2.50.04 Banks and credit 2.50.05 Insurance, pension funds 2.50.08 Financial services, financial reporting and auditing 2.50.10 Financial supervision 3.45.01 Company law 3.45.03 Financial management of undertakings, business loans, accounting		

Key players

European Parliament	Committee responsible	Rapporteur	Appointed
	ECON Economic and Monetary Affairs	ECR FOX Ashley	21/09/2010
	Committee for opinion	Rapporteur for opinion	Appointed
	DEVE Development	The committee decided not to give an opinion.	
	EMPL Employment and Social Affairs	The committee decided not to give an opinion.	
	IMCO Internal Market and Consumer Protection	PPE KARAS Othmar	13/10/2010
	JURI Legal Affairs (Associated committee)	ALDE THEIN Alexandra	23/06/2010
European Commission	Commission DG	Commissioner	
	Economic and Financial Affairs	REHN Olli	

Key events

26/05/2010	Non-legislative basic document published	COM(2010)0284	Summary
16/12/2010	Committee referral announced in Parliament		
16/12/2010	Referral to associated committees announced in Parliament		
16/03/2011	Vote in committee		Summary
24/03/2011	Committee report tabled for plenary	A7-0074/2011	

11/05/2011	Results of vote in Parliament		
11/05/2011	Decision by Parliament	T7-0223/2011	Summary
11/05/2011	End of procedure in Parliament		

Technical information

Procedure reference	2010/2303(INI)
Procedure type	INI - Own-initiative procedure
Procedure subtype	Initiative
Legal basis	Rules of Procedure EP 54
Other legal basis	Rules of Procedure EP 159
Stage reached in procedure	Procedure completed
Committee dossier	ECON/7/04549

Documentation gateway

Non-legislative basic document		COM(2010)0284	26/05/2010	EC	Summary
Committee draft report		PE454.525	13/12/2010	EP	
Amendments tabled in committee		PE456.724	18/01/2011	EP	
Committee opinion	IMCO	PE456.633	28/02/2011	EP	
Committee opinion	JURI	PE452.889	01/03/2011	EP	
Committee report tabled for plenary, single reading		A7-0074/2011	24/03/2011	EP	
Text adopted by Parliament, single reading		T7-0223/2011	11/05/2011	EP	Summary
Commission response to text adopted in plenary		SP(2011)6333	19/09/2011	EC	

Corporate governance in financial institutions

PURPOSE: to launch a debate and propose concrete solutions with the aim of improving corporate governance practices in financial establishments (Commission Green Paper.)

BACKGROUND: the scale of the financial crisis triggered by the bankruptcy of Lehman Brothers in autumn 2008 led governments around the world to question the effective strength of financial institutions and the suitability of their regulatory and supervisory systems for dealing with financial innovation in a globalised world.

Strengthening corporate governance is at the heart of the Commission's programme of financial market reform and crisis prevention. In its Communication of 4 March 2009, the European Commission announced that it would (i) examine corporate governance rules and practice within financial institutions, particularly banks, in the light of the financial crisis, and (ii) where appropriate, make recommendations, or even propose regulatory measures, in order to remedy any weaknesses in the corporate governance system in this key sector of the economy. The Commission considers that an effective corporate governance system, achieved through control mechanisms and checks, should lead to the main stakeholders in financial institutions assuming a higher degree of responsibility.

Conversely, the financial crisis and its serious economic and social consequences have led to a significant loss of confidence in financial institutions, particularly with regard to the following: the question of conflicts of interest; the problem of effective implementation by financial institutions of corporate governance principles, boards of directors, risk management, the role of shareholders, supervisory authorities and auditors.

The Commission considers that, while taking into account the need to preserve the competitiveness of the European financial industry, these deficiencies call for concrete solutions to improve corporate governance practices in financial institutions.

CONTENT: the Green Paper considers a variety of ways to respond to these deficiencies regarding corporate governance in financial institutions. It tries to strike the right balance between the need for improved corporate governance of financial institutions and the necessity of allowing these institutions to contribute to economic recovery by providing credit to businesses and households.

Each of the options explored could lead to the development of measures on corporate governance in financial institutions. The added value of such measures should nevertheless be assessed in the context of impact analyses carried out in accordance with the Commission's guidelines on the subject.

The different solutions presented in the Green Paper provide a platform for general improvement of corporate governance in financial institutions. Their concrete application should be proportionate and could vary according to the legal form size, nature and complexity, of the financial institution concerned and the various existing legal and economic models.

The options outlined in the Green Paper are likely to accompany and supplement the legal provisions implemented or planned for the purpose of strengthening the financial system in particular in the context of the reform of European supervisory architecture the Capital Requirements Directive, the Solvency II Directive for insurance companies reform of the UCITS system and the regulation of Alternative Investment Fund Managers. The Commission gives some consideration to the following issues :

Board of Directors: it appears necessary for boards of directors to ensure the right balance between independence and skills is struck. Recruitment policies which identify precisely the skills needs of the board of directors and which aim to guarantee the objectivity and independence of members' judgment could help increase the board of directors' ability to monitor management effectively.

The Green Paper puts forward certain issues for consideration:

- strengthen measures intended to prevent conflicts of interest both within the board of directors but also within the financial institution in general, in particular by putting in place clear policies for managing conflicts of interest ;
- clearly define skills, role and responsibilities of the chairman plays in organising the work of the board;
- review the diversity of the composition of boards of directors;
- in view of the increasing complexity of the structure and activities of financial institutions, ways to improve the efficiency of the board of directors' work should be investigated;
- formalise the procedure for evaluating the board of directors' performance, in particular by defining the role of external evaluators and supplying supervisory authorities and/or shareholders with the results;
- strengthen the duties and responsibilities of the board of directors, particularly with regard to the board's role in risk supervision;
- clarify the respective roles and responsibilities of the various players in decision-making within the financial institution, particularly members of the board of directors and the senior management ;
- establish a requirement that the board of directors alert the supervisory authorities to any substantial/systemic risks that they are aware of could be considered.

Risk-related functions: one of the main observations in the wake of the recent financial crisis was the failure of risk management functions due, in particular, to the lack of authority of these functions and a poor system for risk-related communication and information. It therefore seems necessary to strengthen the independence and authority of the risk management function particularly by enhancing the status of the chief risk officer (CRO). It also seems desirable to improve the risk management function's communication system, in particular by introducing a procedure for referring any conflicts and problems encountered to the hierarchy for resolution.

Generally speaking, implementation of a policy to increase awareness of risk problems ('risk culture') for the benefit of all staff, including members of the board of directors, should be a requirement. In particular, it seems advisable to carry out an evaluation of the underlying risks before setting up any new financial products, market sectors or areas of activity.

External auditors: it seems necessary to examine ways of extending the reporting scheme by which external auditors alert the board of directors and supervisory authorities of any substantial risks they discover in the performance of their duties ('duty of alert').

Generally speaking, it seems desirable to strengthen cooperation between external auditors and the supervisory authorities in order to benefit from auditors' knowledge not only of individual financial institutions but also of the financial sector as a whole, while taking into account constraints relating to professional secrecy. Lastly, it is worth reviewing the role that external auditors should play more generally with regard to risk-related information in financial institutions.

Supervisory authorities: it seems necessary to redefine and strengthen the role of supervisory authorities in the internal governance of financial institutions whilst ensuring a clear delimitation of roles and responsibilities between the supervisors and the governing bodies of financial institutions.

In particular, it might be possible to envisage creating a duty for supervisory authorities to check the correct functioning and effectiveness of the board of directors, and regularly inspect the risk management function to ensure its effectiveness. It also seems necessary for the supervisory authorities to extend the eligibility criteria ('fit and proper test') for future directors to cover technical and professional skills, including those relating to risk, as well as candidates' individual qualities, in order to ensure better independence of judgment of future members of the board of directors.

Lastly, cooperation between supervisory authorities on corporate governance of cross-border financial institutions should be strengthened, particularly within colleges of supervisors but also in the context of future European supervisory authorities.

Shareholders: in order to motivate shareholders to engage in a dialogue with the financial institution and monitor senior management's decision-making, as well as to consider the long-term viability of the financial institution, the Commission intends to carry out a review centred around the following topics:

- strengthening shareholder cooperation through the creation of discussion platforms;
- disclosure by institutional investors of their voting practices at shareholders' meetings;
- institutional investors adherence to 'stewardship codes' of best practice;
- identification and disclosure of potential conflicts of interest by institutional investors;
- disclosure by institutional investors of the remuneration policy for intermediaries;

- providing shareholders with better information on risk.

Effective implementation of corporate governance principles: in addition to the role of supervisory authorities in implementing good corporate governance practices within financial institutions, it is worth considering senior management's legal accountability for the correct implementation of these principles. Effective and efficient sanctions may be needed in order to change the behaviour of the relevant actors.

Remuneration: the Commission has already adopted several recommendations on this subject. Legislative proposals for credit institutions and investment firms are also currently being discussed in the context of the modification of the CRD as well as for Alternative Investment Fund Managers.

As regards the remuneration of directors of listed companies, the Commission report on the implementation by Member States of measures to promote the application of existing recommendations shows that this application is neither uniform nor satisfactory.

The Commission gives consideration in this Green Paper to the need for and content of relevant legislative measures. 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.

Conflicts of interest: conflicts of interest should be at least partly regulated by very clear rules rooted in law and by attributing a clearly defined role to the supervisory authorities in monitoring their correct application. The Green Paper asks 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.

Member States, the European Parliament, the European Economic and Social Committee and other interested parties are invited to submit their views on the suggestions set out in the Green Paper with a view to establishing a broad consensus on any measures that could be envisaged. Contributions should be sent to reach the Commission by 1st September 2010 at the latest.

Corporate governance in financial institutions

The Committee on Economic and Monetary Affairs adopted the own-initiative report by Ashley FOX (ECR, UK) in response to the Commission Green Paper on corporate governance in financial institutions and remuneration policies.

Whilst welcoming the Commission?s Green Paper and the opportunity to improve corporate governance structures throughout the EU, Members are aware that in the wake of the financial crisis it has become clear that the quality of consumer protection and safeguards in the financial services sector requires tangible and strong improvement, particularly as regards the monitoring and supervisory aspects.

General approach: the report notes the diversity of corporate governance structures throughout the European Union and the diversity of approaches that Member States take in regulating these structures. It recognises that a ?one size fits all? approach would be inappropriate and damaging to the competitiveness of financial institutions but stresses nonetheless that strong minimum standards are required to ensure good governance across the financial sector in the EU.

Members recognise that the area of corporate governance is constantly evolving and that a proportionate approach combining both targeted principle-based regulations and flexible 'comply or explain' codes of best practice on an equal footing is appropriate. They believe that in other areas a procedure of enhanced ?comply or explain? with scrutiny may nevertheless be more appropriate with specific legislative requirements and more intrusive checks into compliance or variation.

The Commission is asked to subject every proposal it considers to improve corporate governance to a cost-benefit impact assessment which focuses on the need to keep financial institutions strong, stable and competitive.

Risk: Members believe that effective risk governance is a major essential element in preventing future crises. They call for:

- the establishment in all financial institutions of an effective governance system, with adequate risk management, compliance, internal audit functions (and, in the case of insurers, actuarial functions), strategies, policies, processes and procedures;
- the establishment of mandatory risk committees or equivalent arrangements at board level for all economically significant financial institutions and at parent company board level for all economically significant financial groups.

Members believe that the risk committee or other equivalent body should have responsibility for oversight and for advising the board on the current risk exposures of the financial institution concerned and should advise on future risk strategy, including strategy for capital and liquidity management, taking into account financial stability assessments developed by supervisors and national banks.

Firms should establish an internal procedure, reviewed by the supervisor, to address conflicts which may arise between their risk management and operational units. In addition, there should be an obligation for the board of directors to inform the supervisory authorities of any material risks they are aware of.

Boards of directors: the report calls on EU supervisors in consultation with the relevant national authorities to develop competence criteria for a ?fit and proper person? test, by which to assess the suitability of individuals for controlled functions, taking into account the nature, complexity and size of the financial institution.

The Commission is called upon to develop legislation requiring large financial institutions to submit their boards to regular external evaluation aimed at ensuring not only high standards of contributions by individual directors, but also that the board as a whole and its committees are in a position to deliver on the institution's strategic objectives and management of the risk.

Members believe the role of the CEO and Chairman should be separated. They believe that all members of unitary or supervisory boards should possess recent and relevant professional qualifications, knowledge and experience, including financial, for jointly piloting the financial undertaking.

The report emphasises that greater diversity among the members of boards of directors will reduce the financial sector?s vulnerability to crises and contribute to economic stability. It calls on the Commission to submit a plan to bring about phased increases in gender diversity with the aim of achieving at least 40% representation for each gender on the boards of directors of financial institutions, to ensure that this target is met within a foreseeable period and to consider measures to strengthen diversity in terms of professional, social and cultural background.

Remuneration: stressing the importance of a strict remuneration policy, Members believe that remuneration policies must be based on the

long-term performance of the individual and their firm to ensure remuneration policies do not contribute to excessive risk-taking, and that remuneration policies or payments should never undermine the stability of a firm. All share options must be properly disclosed and have vesting periods of at least three years. Members consider that greater use should be made of contingent capital instruments rather than shares, as they have less conflict of interest in inducing short-termism.

The report insists that full transparency is necessary for shareholders to be able to conduct proper oversight of remuneration policies, and calls in particular for the publication of the number of staff in each institution receiving total remuneration greater than EUR 500 000, in bands of at least EUR 500 000.

Supervisors, auditors and institutions: Members believe that an enhanced three-way dialogue between supervisors, auditors (both internal and external) and institutions would improve the likelihood of substantial or systemic risk being detected at an early stage. It encourages supervisors, the European Systemic Risk Board, auditors and institutions to engage in open discussions and to increase the frequency of meetings in order to facilitate prudential supervision.

Shareholders and the AGM: Members consider that significant transactions above a defined and proportionate size should require specific shareholder approval or be subject to an obligation to inform shareholders before the transaction can take effect. They call for mandatory annual elections of each member of the board, for mandatory annual requests for approval of the board's policy or for discharge of the board at the AGM, with a view to making the board more accountable and encouraging a culture of greater responsibility.

Corporate governance in financial institutions

The European Parliament adopted a resolution in response to the Commission Green Paper on corporate governance in financial institutions and remuneration policies.

Whilst welcoming the Commission?s Green Paper and the opportunity to improve corporate governance structures throughout the EU, Members are aware that in the wake of the financial crisis it has become clear that the quality of consumer protection and safeguards in the financial services sector requires tangible and strong improvement, particularly as regards the monitoring and supervisory aspects.

General approach: the resolution notes the diversity of corporate governance structures throughout the European Union and the diversity of approaches that Member States take in regulating these structures. It recognises that a ?one size fits all? approach would be inappropriate and damaging to the competitiveness of financial institutions but stresses nonetheless that strong minimum standards are required to ensure good governance across the financial sector in the EU.

Members recognise that the area of corporate governance is constantly evolving and that a proportionate approach combining both targeted principle-based regulations and flexible 'comply or explain' codes of best practice on an equal footing is appropriate. They believe that in other areas a procedure of enhanced ?comply or explain? with scrutiny may nevertheless be more appropriate with specific legislative requirements and more intrusive checks into compliance or variation.

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- the establishment in all financial institutions of an effective governance system, with adequate risk management, compliance, internal audit functions (and, in the case of insurers, actuarial functions), strategies, policies, processes and procedures;
- the establishment of mandatory risk committees or equivalent arrangements at board level for all economically significant financial institutions and at parent company board level for all economically significant financial groups.

Parliament believes that the risk committee or other equivalent body should have responsibility for oversight and for advising the board on the current risk exposures of the financial institution concerned and should advise on future risk strategy, including strategy for capital and liquidity management, taking into account financial stability assessments developed by supervisors and national banks.

The resolution stresses that ultimate responsibility for risk governance lies with the board, which must also take responsibility for demonstrating compliance and the formulation of recovery plans.

Firms should establish an internal procedure, reviewed by the supervisor, to address conflicts which may arise between their risk management and operational units. In addition, there should be an obligation for the board of directors to inform the supervisory authorities of any material risks they are aware of.

Members take the view that it should be mandatory for financial institutions to draft an annual report on the adequacy and effectiveness of their internal control systems and for their board of directors to adopt that report. Parliament also agrees that it is necessary to strengthen measures at EU level to prevent conflicts of interest in order to safeguard the objectivity and independence of judgement of board members across the banking, securities and insurance sectors.

Boards of directors: the resolution calls on EU supervisors in consultation with the relevant national authorities to develop competence criteria for a ?fit and proper person? test, by which to assess the suitability of individuals for controlled functions, taking into account the nature, complexity and size of the financial institution.

The Commission is called upon to develop legislation requiring large financial institutions to submit their boards to regular external evaluation aimed at ensuring not only high standards of contributions by individual directors, but also that the board as a whole and its committees are in a position to deliver on the institution's strategic objectives and management of the risk.

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met within a foreseeable period and to consider measures to strengthen diversity in terms of professional, social and cultural background.

Remuneration: stressing the importance of a strict remuneration policy, Members believe that remuneration policies must be based on the long-term performance of the individual and their firm to ensure remuneration policies do not contribute to excessive risk-taking, and that remuneration policies or payments should never undermine the stability of a firm. All share options must be properly disclosed and have vesting periods of at least three years. Members consider that greater use should be made of contingent capital instruments rather than shares, as they have less conflict of interest in inducing short-termism.

The resolution insists that full transparency is necessary for shareholders to be able to conduct proper oversight of remuneration policies, and calls in particular for the publication of the number of staff in each institution receiving total remuneration greater than EUR 1 million, in bands of at least EUR 1 million.

The resolution notes that the application of existing recommendations for the remuneration of directors of listed companies is neither uniform nor satisfactory. Parliament calls therefore on the Commission to come forward with legislation at EU level on remuneration for directors of listed companies in order to ensure that the structure of remuneration in listed companies does not encourage excessive risk-taking, as well as to ensure a level playing field in the EU.

Supervisors, auditors and institutions: Members believe that an enhanced three-way dialogue between supervisors, auditors (both internal and external) and institutions would improve the likelihood of substantial or systemic risk being detected at an early stage. It encourages supervisors, the European Systemic Risk Board, auditors and institutions to engage in open discussions and to increase the frequency of meetings in order to facilitate prudential supervision.

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