DRAFT OPINION

of the Committee on Legal Affairs

for the Committee on Economic and Monetary Affairs

on the Green Paper on ‘Corporate governance in financial institutions and remuneration policies’
(2010/2303(INI))

Rapporteur: Alexandra Thein

(*) Associated committee – Rule 50 of the Rules of Procedure
SHORT JUSTIFICATION

Background

The aim of the Green Paper under consideration here is to draw conclusions from the global financial crisis triggered by the bankruptcy of the Lehman Brothers bank in autumn 2008 following the inappropriate securitisation of US subprime mortgages. In the light of the development of new financial instruments in a globalised world, the Green Paper takes a critical look at the soundness of financial institutions and of the financial system as a whole, and at the regulation and supervision of the system, with a view to preventing any repeat of the crisis in the future. The Commission regards the strengthening of corporate governance as central to its financial market reform and crisis prevention programme. In that connection, the Commission notes in particular that in the financial services sector corporate governance must take account of the interests of other stakeholders (depositors, savers, life insurance policy holders, etc.) and of the stability of the financial system, owing to the systemic nature of many of the players involved.

The options outlined in the Green Paper are intended 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 the European supervisory architecture, the Capital Requirements Directive (CRD III), the Solvency II Directive for insurance companies, the reform of the UCITS system and the regulation of Alternative Investment Fund Managers (AIFM). The Green Paper focuses on a narrow definition of corporate governance which incorporates the role of external auditors. Important, further-reaching aspects of governance – such as the separation of roles within financial undertakings, the internal audit function and accounting independence – are not dealt with.

Rapporteur’s standpoint

Financial risk-taking is a quintessential aspect of the financial sector and fundamental to its success in business terms and to the functions it performs for the economy as a whole. It is in the public interest that these functions should not be restricted to a degree beyond that needed to prevent systemic crisis. To illustrate this point further, it must be possible for a financial institution to opt for orderly bankruptcy, provided that this does not pose a systemic risk and would not lead to a domino effect on the market as a result of interdependencies within the financial system.

Your rapporteur regards the development of a more comprehensive system and culture of sustainable risk management and risk monitoring in financial institutions as a key task.

This challenge, as important as it is complex, can be met by means of a package of measures which will have either a direct or indirect impact. Many of the measures concerned were already taken last year at European and Member State level, in particular in the area of management remuneration. In addition, academic studies suggest that measures to professionalise boards of directors and ensure that their members come from very diverse backgrounds would be both well advised and likely to bring about improvements. The accountability and liability of members of boards of directors must be clearly defined, but care must be taken when determining precisely what form that accountability and liability
should take, in order not to jeopardise financial institutions’ willingness to seize business opportunities, a desirable aspect of their work, or the quality of board members.

Your rapporteur regards the elimination, or at least the attenuation, of the impact which all issues relating to conflicts of interest have as contributory factors in financial crises as a further key task.

As regards the conflicts between the twin roles of financial institutions as providers of credit and investment banks, a mandatory legal requirement that individual financial institutions should be allowed to perform only one of these roles is worthy of consideration, but would in practice be unfeasible, given the potential losses of efficiency and the need for the European financial sector to remain globally competitive. What certainly are needed, however, are uncompromising measures to rule out conflicts of interest involving the individuals who play a decisive role in risk supervision, namely the members of boards of directors.

The UK’s Stewardship Code can be regarded as a suitable model for a uniform EU code for institutional investors.

**SUGGESTIONS**

The Committee on Legal Affairs calls on the Committee on Economic and Monetary Affairs, as the committee responsible, to incorporate the following suggestions in its motion for a resolution:

1. Takes the view that the number of boards on which directors of financial institutions may sit at the same time should be limited to three, in which connection membership of the boards of several companies within the same financial group should count as one directorship;

2. Emphasises that greater diversity among the members of boards of directors will reduce the vulnerability of the financial sector to crises, and 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;

3. Takes the view that the drafting of an annual report – involving as little bureaucracy as possible – on the adequacy and effectiveness of their internal control systems and the adoption of that report by their board of directors should be mandatory for financial institutions; takes the view, further, that it should likewise be mandatory for the annual report drawn up by a financial institution’s external auditors to contain a similar assessment;

4. Takes the view that the external auditors in financial institutions should be required to inform the board of directors and the competent supervisory bodies immediately if their audit brings to light facts which could jeopardise the future of the institution or seriously...
hamper its development or which point to a serious breach of the licensing requirements or the rules governing the performance of duties;

5. Does not regard it as appropriate to require investors to make public details of actual or alleged voting strategies in annual general meetings;

6. Takes the view that institutional investors should be required formally and publicly to explain any actions which breach the uniform EU code for institutional investors (‘comply or explain’);

7. Takes the view that all limited partnerships should be free to stipulate in their statutes whether their partners may remain anonymous or must be named and that, in the latter case, a law must be enacted to guarantee that their identities are in fact made public;

8. Regards a clearly defined European minimum standard for the accountability of the members of the boards of directors of financial institutions as desirable;

9. Draws attention, with reference to remuneration and remuneration policies in financial institutions, to the legislative action which has already been taken, in particular the EU Capital Requirement Directive (CRD III), which came into force on 1 January 2011, and recommends that the next step should be to assess its effectiveness;

10. Takes the view that external auditors and members of the board of directors should be strictly prohibited from engaging in any other form of business dealings, in particular consultancies, with the financial concern in question;

11. Takes the view that details of a conflict of interest policy covering the various areas of banking activity should form a mandatory part of the annual report of financial institutions and calls for consideration to be given to developing a corresponding EU code of conduct.