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RESPONSE OF THE FBF TO THE EUROPEAN COMMISSION GREEN PAPER ON CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS AND REMUNERATION POLICIES

The French Banking Federation (FBF) is the professional body representing the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 450 commercial and cooperative banks. FBF member banks have 40,000 permanent branches in France. They employ 400,000 people, and service 60 million customers.

The banking industry pays close attention to issues of corporate governance and involves itself in all the discussions conducted on this subject, both in France and internationally. The industry was in particular heavily involved in the development and implementation of the French corporate governance code of listed companies issued by the Association Française des Entreprises Privées (AFEP) and the Mouvement des Entreprises de France (MEDEF), which the banking industry has adopted (commonly called the AFEP-MEDEF code). The banking industry has also participated extensively in the consultations that led up to the introduction into French law of many provisions on corporate governance, whether of a legislative or regulatory nature, and in particular Regulation 97-02 of the French banking and financial regulatory committee on the internal control of credit institutions.

The FBF would thus like to thank the European Commission for providing it an opportunity to address the issues related to corporate governance in financial institutions and remuneration policies and to the legal framework that should prevail in this matter, in a context that it believes should be conceived of not so much as European but increasingly as international.

The FBF would like to make several general comments at the outset, before responding point by point to all the questions.

General remarks:

- The crisis has had a different impact on banks:

The FBF rejects the assertion underlying the Green Paper that the boards of directors were unable to have an impact during the crisis on corporate managements. Indeed, the magnitude of the financial crisis was not uniform and the injection of public funds into financial institutions varied in scale and nature in different countries. The FBF believes that the generalisation made in the Green Paper is detrimental to the financial system as a whole, and that the Commission should take note of these differences, so as not to impose the same rules everywhere.

- The powers of general management should be clearly distinguished from those of the board of directors:

The FBF believes that good governance of credit institutions depends primarily on good coordination between the board of directors and general management.

On the one hand, the board of directors is elected by the shareholders or in mutual companies by the members, and it is responsible for setting guidelines for the company's business and ensuring their implementation. The board is accountable to the shareholders or members for safeguarding the collective interest. Its work is guided by the corporate interest of the enterprise.

General management, on the other hand, implements the strategy of the financial institution.

- The measures need to be scaled to the size and structure of the companies

The FBF believes that, since a diversity of structures is a guarantee of financial stability and dynamism, it is essential to adapt the proposals that will be made to the size and structure of the financial institutions, as is stated in the introduction to the Green Paper.

The FBF considers, for example, that every institution should have the freedom to choose between setting up a special audit committee within its board of directors and adopting the solution of combining the missions of the risk committee and of the audit committee within a single committee.

It also believes that the rules of governance must take into account the specificities of mutual companies – there are three of them in France, with more than 60,000 administrators in their central, regional and local structures.

In general, the FBF believes that recommendations in this matter must be flexible enough to be adaptable to small structures as well as to major banking groups. Thus, while the FBF favourably views a limitation on the number of mandates, it considers that it would be dangerous to adopt an excessively rigid position on this matter and in particular that the number of mandates held within the same group should not be taken into account.

The FBF was also surprised that the Green Paper barely mentions limited companies with management and supervisory boards (*sociétés anonymes à directoire et conseil de surveillance*), as the issue of corporate governance affects them as much as companies with a board of directors (*sociétés à Conseil d'administration*).

General question 1: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the composition, role and functioning of the board of directors, and to indicate any other measures they believe would be necessary.

The FBF would like to point out that in commercial companies, as in mutual institutions, the members of the board of directors are always elected by a general meeting of the shareholders or members, as appropriate, so that in both types of companies the directors are called on to embody not only the interests of the shareholders but also the corporate interest of the enterprise.

1.1 Should the number of boards on which a director may sit be limited (for example, no more than three at once)?

The FBF is in favour of limiting the number of mandates, so that each director can devote

the time necessary for the proper administration of the companies for which he or she is responsible.

However, it considers that a limitation on the number of mandates should apply only to directorships in companies whose securities are admitted to trading on a regulated market and that it should in any event be excluded when the mandates are held within the same group, as defined in company law or banking law, for example the mutual companies in France.

It should also distinguish the situation of directors with no other activity from those who also exercise a professional activity or hold a corporate executive position.

In any event, if the idea of a limit should be adopted, the FBF believes that it is essential to maintain a certain flexibility and that the limitation should therefore be a maximum of five mandates. This is also the solution recommended in the above-mentioned AFEP-MEDEF code.

1.2 Should combining the functions of chairman of the board of directors and chief executive officer be prohibited in financial institutions?

The FBF believes that a prohibition on combining the functions of chairman of the board of directors and CEO would not be appropriate. It is up to the board of directors to choose whether to separate the functions of board chairman and CEO or to combine these functions, based on its own considerations and imperatives, without taking one model in the abstract as being more effective than the other. The board of directors must of course be able to justify the choice it has made in this regard to the shareholders.

1.3 Should recruitment policies specify the duties and profile of directors, including the chairman, ensure that directors have adequate skills, and ensure that the composition of the board of directors is suitably diverse? If so, how?

The FBF believes that the term "recruitment" is inappropriate for the appointment of directors and notes that in France the directors are always elected by a general meeting of the shareholders, usually based on proposals by the board of directors or supervisory board.

The FBF also wishes to clarify that the AFEP-MEDEF code has established a number of guiding principles for the composition of the board of directors and the profile of the directors sitting on it (competence, availability, independence, etc.).

Finally, it points out that in France the board of directors must review its composition every year in the course of a process of self-assessment set out in the French Commercial Code.

There is therefore no need for any additional provision on this point.

1.4 Do you agree that including more women and individuals with different backgrounds in the board of directors could improve the functioning and efficiency of boards of directors??

The FBF would like to point out that the AFEP-MEDEF code already contains provisions on strengthening the presence of women on boards of directors.

However, it does not seem that provisions governing the diversity of social and cultural backgrounds on boards could become law in France, given the current state of the country's Constitution.

The consideration of issues of diversity should, in the FBF's opinion, be the responsibility of

the appointments committee above all, since it is in charge of making proposals to the board of directors for election by the general meeting of new directors. This is obviously not to the exclusion of the possibility for companies that consider it desirable to establish their own guidelines on this matter.

Rather than setting rules on the composition and functioning of the board of directors, the FBF believes that attention needs to be paid above all to the effectiveness and methods of decision-making on these boards, as well as to the transparency of the choices made.

1.5 Should a compulsory evaluation of the functioning of the board of directors, carried out by an external evaluator, be put in place? Should the result of this evaluation be made available to supervisory authorities and shareholders?

The AFEP-MEDEF code provides that the board of directors conducts an annual evaluation of its own organisation and functioning. This assessment must be performed in a formalised way at least every three years. It can for instance possibly be performed under the leadership of an independent director, with the help of an outside consultant. Many listed companies regularly carry out this type of evaluation.

In France, the shareholders and investors are informed of the results of this annual assessment by the board by means of a report on corporate governance as well as on the internal control and risk management procedures set up by the company (Article L. 225-37 of the French Commercial Code).

In its 2010 report on corporate governance and executive compensation, the French financial market authority (AMF) has also highlighted an improvement in the practices of French companies with respect to corporate governance.

Requiring an external evaluation does not appear necessary, since the assessment described above is already being performed under conditions that ensure the quality of its findings.

Similarly, in view of current practice, the detailed communication of these assessments to supervisory authorities or shareholders does not seem appropriate, since the quality, fairness and accuracy of the assessment will necessarily be affected if their authors know that the study will be communicated in full to third parties (whether supervisory authorities or shareholders).

1.6 Should it be compulsory to set up a risk committee within the board of directors and establish rules regarding the composition and functioning of this committee?

The FBF supports the consideration of risk issues by a specialised committee. However, it does not consider it necessary to require that these issues be examined in a specific committee, entitled the "risk committee". For example, any issues related to risk can in fact be considered at the level of the audit committee. Some flexibility should be left to institutions to decide what kind of organisation they want to set up within the board of directors to discuss the issues related to risk.

1.7 Should it be compulsory for one or more members of the audit committee to be part of the risk committee and vice versa?

The proliferation of committees would raise practical problems in terms of their composition and the coordination of their missions, in a way that would undermine the principle of the collegial nature of decision-making by the board of directors. This is another argument for

not mandating the creation of a risk committee.

However, if the board of directors decided to create such a committee, it would then determine the way that it was organised and operated.

1.8 Should the chairman of the risk committee report to the general meeting?

In accordance with the operating methods of limited liability companies (*sociétés anonymes)* as set by French company law, the chairman of the risk committee, like the chairman of any committee established by the board, reports to the board of directors, which is responsible to the general meeting for all of its actions.

However, nothing forbids (and it is even quite often the case) the chairman of a committee from being invited by the board of directors to present to the annual general meeting an account of the work conducted by this committee during the current period or to answer questions from shareholders about matters relating more specifically to the committee. This kind of practice is likely to improve the quality of information given to the shareholders. In the FBF's opinion, this does not require any legislative changes.

1.9 What should be the role of the board of directors in a financial institution's risk profile and strategy??

The board of directors is responsible for setting the guidelines for the company's business and ensuring their implementation. It has the task of setting the strategy and monitoring the implementation of the strategy, with the general management being responsible for implementation. In this context, the board of directors determines, based on proposals by general management, the general guidelines for the risk policy. It is up to general management to define the risk profile.

Care should be taken not to create confusion between the missions for which the board of directors is responsible and those for which general management has executive responsibility.

1.10 Should a risk control declaration be put in place and published?

Such a declaration would add nothing to the existing rules.

Directive 2006/48 on the taking up and pursuit of the business of credit institutions already provides, in Annex XII, Part 2.1, for the publication of the objectives and policies of the credit institution with respect to risk management.

In France, these provisions are reinforced by the requirements laid down in Article 38 of Regulation 97-02 on the internal control of credit institutions, which provides for the periodic assessment and monitoring of the effectiveness of risk control policies, systems and procedures and for information to the supervisor about the thresholds and criteria for identifying significant incidents.

Precise information on risk is also contained in the annual reference documents published by financial institutions.

1.11 Should an approval procedure be established for the board of directors to approve new financial products?

Banking companies in France already have an obligation to establish procedures for approving new products or existing products that have undergone a significant change

(under the aforementioned Regulation 97 02). It does not seem either appropriate or realistic to directly involve the board of directors in this process, which already involves company specialists in law, compliance, marketing and contracts, and which may concern a large number of new products. It is necessary to avoid introducing any confusion between matters that are the responsibility of general management and matters concerning strategy and control over the implementation of strategy, which are, in turn, up to the board of directors.

1.12 Should an obligation be established for the board of directors to inform the supervisory authorities of any material risks they are aware of?

French credit institutions are already required to report to their supervisory authority any significant incidents of operational risk identified under the criteria and thresholds established in advance by the board of directors and forwarded to the supervisor. General management is responsible for the transmission of these incidents to the supervisor and for informing the board of directors. It seems neither consistent with the role of the board of directors nor appropriate to impose such an obligation directly on it.

1.13 Should a specific duty be established for the board of directors to take into account the interests of depositors and other stakeholders during the decision-making procedure ('duty of care')?

The FBF would first like to point out that the term "other stakeholders" needs to be defined precisely, since it could encompass very different realities in different countries. The essential role of the board of directors is, in the name of and on behalf of the shareholders to whom it is responsible, to ensure the growth of the business in accordance with the corporate interest. This by its very nature implies finding a fair balance between all the stakeholders. This concern should not, however, lead to the establishment of an excessive formalism that could put the board of directors in a situation where its collegial nature would come into question. There should therefore be absolutely no explicit duty imposed on the board of directors to take into account the interests of all stakeholders, or to consult all the stakeholders before any decision is taken, or to reflect in its composition the diversity of the stakeholders.

General question 2: Interested parties are invited to express whether they are in favour of the proposed solutions regarding the risk management function, and to indicate any other measures they believe would be necessary.

2.1. How can the status of the chief risk officer be enhanced? Should the status of the chief risk officer be at least equivalent to that of the chief financial officer?

The FBF believes that the chief risk officer must be independent and have sufficient experience – of business lines in particular – to influence the decision-making process with a view to protecting the long-term interests of the company. This is already the case in France where regulations state that the risk management function must be led by a member of the executive body or, if this is not the case, that it should report directly to said body. This regulation has been supplemented by professional standards whereby "the chief risk officer is independent and must have sufficient experience to influence the decision-making process. He reports to the executive body or may be part of it and can be heard by the ruling body if said body deems it necessary". There is no reason to add to this.

2.2. How can the communication system between the risk management function and the board of directors be improved? Should a procedure for referring conflicts/problems to the hierarchy for resolution be set up?

The FBF believes it is the risk management function's role to establish a clear view of all risks incurred by the group, to present this to the General Management, which is ultimately responsible for risk management. The information provided to the board of directors must be legible, concise and easy to take in, so that the board has a clear view of risks. The FBF considers that the French system described above is sufficient in this respect and does not require any change.

2.3. Should the chief risk officer be able to report directly to the board of directors, including the risk committee?

The FBF believes there is no justification for giving information to the board of directors and potentially the risk committee without first informing the General Management in its role overseeing the chief risk officer, given that it is ultimately responsible for risk management from a regulatory perspective.

However, it is worth reiterating that a committee still has the option (if this is provided for in the internal rules of the Council or committee) of asking to hear any competent person on issues concerned by its work.

In France, the aforementioned regulation 97-02 (art. 11-8) already states that when the executive or ruling body deems it necessary, the chief risk officer shall also report directly to the ruling body and, where appropriate, the audit committee.

2.4. Should IT tools be upgraded in order to improve the quality and speed at which information concerning significant risks is transmitted to the board of directors?

This question applies to every institution but the FBF believes that IT tools have more of a role to play in detecting and analysing risk than in transmitting information, which should remain the responsibility of the chief risk officer.

2.5. Should executives be required to approve a report on the adequacy of internal control systems?

The FBF believes it is up to the General Management to report on internal control procedures over the previous year and cover the measurement, monitoring and supervision of risks to which the institution is exposed. It considers that, as in France, this should take the form of a report presented to the board of directors (and the risk committee if there is one) and addressed to the supervisor.

General question 3: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of external auditors, and to indicate any other measures they believe would be necessary.

3.1. Should cooperation between external auditors and supervisory authorities be deepened? If so, how?

The FBF believes that, as is the case in France, it is the responsibility of financial institutions' external auditors to promptly inform the supervisor of any fact or decision that may 1) constitute a breach of applicable laws and regulations and possibly have significant effects on its financial position, solvency, results or assets, 2) harm its ability to continue as a going concern, 3°) require the auditors to state reservations or refuse to sign off the accounts. The supervisor should be able to ask the external auditors for any information on the business and financial position of entities it inspects as well as diligence carried out in the course of their work.

However, cooperation between external auditors and regulators must remain a matter of professional secrecy and not infringe on the independent exercise of their respective duties (on the one hand, ensuring the integrity of financial disclosures and on the other, protecting customers/counterparties).

3.2. Should their duty of information towards the board of directors and/or supervisory authorities on possible serious matters discovered in the performance of their duties be increased?

The FBF refers back to what it has written above on the external auditors' duty of alert and feels there is no reason to expand on this.

3.3. Should external auditors' control be extended to risk-related financial information?

The FBF considers that the role of external auditors should must remain limited to financial and accounting matters, which include internal control and risk management procedures involved in the production and processing of accounting and financial information.

General question 4: Interested parties are invited to express whether they are in favour of the proposed solutions concerning the role of supervisory authorities, and to indicate any other measures they believe would be necessary.

4.1 Should the role of supervisory authorities in the internal governance of financial institutions be redefined and strengthened?

The FBF believes that supervisors must be able to ascertain they have the information they need to check that financial institutions' governance complies with corporate law and the regulations drawn up by the supervisors. However, any interference by the supervisor in the management or organisation of the company – except in cases where regulations have been breached – seems unwise unless there are drastic changes in the corporate structure as it

exists today, as the board of directors has only to report to the shareholders meeting, at which it is appointed.

4.2. Should supervisory authorities be given the power and duty to check the correct functioning of the board of directors and the risk management function? How can this be put into practice?

See answer to question 4. 1

4.3. Should the eligibility criteria ('fit and proper test') be extended to cover the technical and professional skills, as well as the individual qualities, of future directors? How can this be achieved in practice?

Supervisory authorities' involvement in determining the eligibility criteria for directors is not desirable. A financial institution's board of directors must combine not only risk management skills but also a range of skills covering strategy, management and distribution amongst others. Directors' profiles must therefore be determined by the board of directors, taking into account the characteristics of the institution and the balance of its composition when it looks to appoint a new director.

General question 5: Interested parties are invited to express their view on whether they consider that shareholder control of financial institutions is still realistic. If so, how in their opinion would it be possible to improve shareholder engagement in practice?

As long as the equality of shareholders principle is respected and shareholders can exercise their voting rights at general meetings, there is no reason to consider financial institutions any differently from other listed companies.

In listed companies (including financial institutions), we have noted an increase in shareholder attendance at general meetings in recent years, reflecting shareholders' engagement and their interest in the running of companies in which they hold shares. This increase in attendance has come as a result of major efforts to improve communications and transparency for shareholders as both factors seem essential in ensuring presence at meetings.

5.1. Should disclosure of institutional investors' voting practices and policies be compulsory? How often?

The FBF believes that the term "institutional investor" should be clarified, especially as it does not in theory cover UCITS management companies.

Investors' (who may be private or para-public) exercise of their voting right is a separate issue from that of corporate governance, which in our view deserves its own in-depth study before any particular obligatory measure can be proposed.

According to article 314-100 of the French Financial Market Authority (AMF)'s General Regulation, publication of voting policy is only required of management companies, as they act on behalf of UCITS unitholders.

5.2. Should institutional investors be obliged to adhere to a code of best practice (national or international) such as, for example, the code of the International Corporate Governance Network (ICGN)? This code requires signatories to develop and publish their investment and voting policies, to take measures to avoid conflicts of interest and to use their voting rights in a responsible way.

Adhering to a code that establishes a general framework may be a solution but as the law of the issuer's country would prevail at general meetings, the code would only apply domestically.

5.3. Should the identification of shareholders be facilitated in order to encourage dialogue between companies and their shareholders and reduce the risk of abuse connected to 'empty voting' ?

The question takes aim at the situation of countries where legislation does not allow for the complete identification of shareholders able to vote on the date of the general meeting. This is not the case in France where the law already allows shareholders to be identified (declaration when thresholds are reached, identifiable bearer securities).

However, FBF believes it may be useful to tighten transparency rules in the case of the lending and borrowing of securities when general meetings are taking place.

5.4. Which other measures could encourage shareholders to engage in financial institutions' corporate governance?

The FBF has observed that many institutional shareholders limit themselves to acting on consultants' voting recommendations instead of applying their own policy. Consultants' activity absolutely has to be regulated to ensure (i) the transparency of their opinions vis-à-vis issuers, (ii) the quality of information provided to investors, (iii) the handling of any conflicts of interest and (iv) possible sanctions in the event of a breach.

General question 6: Interested parties are invited to express their opinion on which methods would be effective in strengthening implementation of corporate governance principles?

6.1. Is it necessary to increase the accountability of members of the board of directors?

The FBF does not think it necessary to increase the accountability of the board of directors. It would reiterate that the powers vested in the board by French law are extensive with article L. 225-35 of the French Commercial Code stating that: *"the board of directors determines the company's business strategy and oversees its implementation. Within the powers expressly granted to shareholders meetings and in accordance with the corporate purpose, it considers any issue affecting the proper functioning of the company and, following deliberation, rules on affairs that concern it."*

6.2 Should the civil and criminal liability of directors be reinforced, bearing in mind that the rules governing criminal proceedings are not harmonised at European level?

The FBF would first like to stress that as liability law – especially with regard to directors' criminal and civil liability – differ greatly from one country to the next, it is very hard to establish general principles on the issue at a European level.

In France, directors' civil and criminal liability is a common law matter (notwithstanding a few specific aspects of proceedings). There are no rules specifically limiting the directors' criminal or civil liability. However, under common law a person may only be held liable if he or she is at fault and if this fault has caused damage. Proof of this causal relationship is essential.

In light of this, reinforcing the civil and criminal liability of directors seems unnecessary, especially as it would probably make it harder to recruit non-executive directors.

General question 7: 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.

Directors' remuneration is subject to numerous regulations – mostly domestic – that apply either to all companies or just financial institutions, depending on the case. However, the banking regulations of some countries may sometimes require these standards to be applied to all group entities, even though located abroad.

In France, each company must adhere to a code of corporate governance that includes numerous provisions on remuneration for directors.

The main improvements to be made involve:

- simplifying remuneration issues and international harmonisation;
- stabilising rules.

7.1. What could be the content and form, binding or non-binding, of possible additional measures at EU level on remuneration for directors of listed companies?

A non-binding recommendation aimed at simplifying, harmonising and stabilising applicable rules would be desirable in this area.

7.2. Do you consider that problems related to directors' stock options should be addressed? If so, how? Is it necessary to regulate at Community level, or even prohibit the granting of stock options?

7.3. Whilst respecting Member States' competence where relevant, do you think that the favourable tax treatment of stock options and other similar remuneration existing in certain Member States helps encourage excessive risk-taking? If so, should this issue be discussed at EU level?

To answer questions 7.2 and 7.3, we would stress that awards of stock options or warrants are intended to increase the convergence of shareholders' and directors' interests over time. In France, the AFEP-MEDEF code has set out the conditions under which these options may be awarded and exercised. The French act of 30 December 2006 also requires corporate officers to hold the shares acquired by exercising these options for a certain period.

It is the board of directors' responsibility to adapt the stock option policy to the risks facing the company. As such, the FBF believes the issue does not require any legislative measures at an EU level.

7.4. Do you think that the role of shareholders, and also that of employees and their representatives, should be strengthened in establishing remuneration policy?

At general meetings, shareholders (including employee shareholders) already have a say in the award of free shares or options, and vote on regulated agreements concerning post-employment benefits (pensions, non-compete clauses, etc.).

In terms of the remuneration itself, it is for the board of directors to establish rules and report to the general meeting.

7.5. What is your opinion of severance packages (so-called 'golden parachutes')? Is it necessary to regulate at Community level, or even prohibit the granting of such

packages? If so, how? Should they be awarded only to remunerate effective performance of directors?

In France, severance packages are subject to the regulated agreement system (authorisation by the board and approval of shareholders, based on a specific resolution when each mandate is renewed) as well as performance conditions.

For all other aspects, severance packages must remain a matter of corporate governance codes.

If there was to be EU legislation on the matter, it should focus exclusively on establishing transparency rules on all aspects of directors' pay, including benefits and deferred compensation.

7.6. Do you think that the variable component of remuneration in financial institutions which have received public funding should be reduced or suspended?

For reasons of competition, it is important to have an international standard to avoid prompting artificial relocations of business and to prevent the transfer of individuals and skills not just between European countries but to the rest of the world.

Credit institutions that receive public funds are already subject to specific constraints including at a domestic level.

General question 8: Interested parties are invited to express whether they agree with the Commission's observation that, in spite of current requirements for transparency with regard to conflicts of interest, surveillance of conflicts of interest by the markets alone is not always possible or effective.

The FBF would reiterate that conflict of interest situations are normal in business and that the measures being considered by the MIFID to handle these conflicts are satisfactory from its own point of view.

8.1. 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?

Despite existing rules to manage these conflict situations, a number of difficulties remain in terms of identifying potential conflict of interest situations. Furthermore, the constant change in products and structures makes it impossible to develop an effective long-term solution.

That said, drawing up a set of guidelines to help businesses deal with the various situations that may arise would assist with the identification of these situations and the adoption of necessary measures.

8.2. Do you agree with the view that, while taking into account the different existing legal and economic models, 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?

As financial institutions are increasingly likely to provide banking and investment services along with insurance policies, the FBF believes that harmonising different regulations would certainly be a positive simplification.