

# The Balance of Power in the Public Corporation in EU Legislation

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# EU corporate law

## Balance of power

- **Company law:**

Traditional approach with the protection of shareholders and creditors

(1st, 2<sup>nd</sup>, 3rd, 6th, 10th, 11th CLD, but also 4th, 7th CLD)

- **External corporate governance control**

MAD, TD, comply or explain, 8th CLD

- Market sanctions, securities regulators, external audit

- **Internal corporate governance control**

- Boards: independence, remuneration, 8th CLD

- Shareholders: Directive 2007/36/EC

# Looking into the future

## Rebalancing act?

- Green Paper on Corporate Governance in Financial Institutions
- Green Paper on Corporate Governance Framework

# 1. CG in Financial Institutions

## Commission response to the financial crisis

Commission committed in spring 2009:

- To report on corporate governance in financial institutions and to propose solutions to deal with failures revealed by the financial crisis
- To adopt measures on remuneration policies in order to avoid excessive risk-taking by financial institutions

# 1. CG in financial institutions

- **Green Paper** launched public consultation from June to September on ways forward to improve corporate governance in FI
- **Commission Staff Working Document** with key findings and detailed analysis of the corporate governance failures in FI

# 1. CG in financial institutions

## Green Paper- Methodology

- **Existing analyses and studies :**
  - ✓ OECD, Basel Committee, IIF
  - ✓ CEBS, CCSR, CEIOPS work
  - ✓ The Turner Review and the Walker Report in UK
  - ✓ Other publications and academic studies
- **Discussions with stakeholders (investors, shareholders, supervisors...)**
- **Case study of 10 major financial institutions and their corporate governance practices**

# 1. CG in financial institutions

- Topics of Green Paper:
  - Specific nature of financial institutions
  - Role of boards
  - Organisation of risk management
  - Role of shareholders
  - Role of external auditors
  - Role of financial supervisors

# 1. CG in financial institutions

## **FIs are different from ordinary listed companies:**

- Special role in the economy (maturity transformation, liquidity)
  - Systemic risk (interdependence of the financial services sector)
  - High leverage, easy risk shifting
  - Specific stakeholders (depositors, other debt holders, taxpayers)
- Need for special rules on CG for FIs



# 1. CG in financial institutions Boards

**Weakness** revealed by financial crisis:

*“In many cases, boards did not challenge efficiently the senior management decisions and were unable to exercise objective and independent judgement.”*

**Need to :**

- Improve the performance and the functioning of boards  
(enhanced challenge of senior management decisions, better time commitment, more expertise, improved knowledge of the structure of the FI, more diversity in board composition)
- Improve the risk oversight by boards  
(ex : create a separate Risk Committee)
- Improve cooperation of boards with supervisors

# 1. CG in financial institutions

## Risk management

**Weakness** revealed by financial crisis:

*“Risk considerations were not sufficiently taken onto account in the decision-making process in the FI.”*

**Need to :**

- Improve the standing and the authority of risk management function
- Improve the flow of information on risk  
(ex: direct reporting to the Risk Committee, Risk Statement, improved IT tools)
- Establish a risk culture on all levels of the FI  
(board sets the tone at the top)

# 1. CG in financial institutions

## Shareholders

**Weakness** revealed by financial crisis:

*“Shareholders were passive and did not play their role as owners of FI.”*

**Need to** enhance the involvement of shareholders in FIs. But how?

- Adherence to “stewardship codes”?
- Disclosure on voting policies and practices?
- Shareholder co-operation?
- Disclosure of conflicts of interests?

Further analysis of existing shareholding models in EU is needed to propose concrete solutions

# 1. CG in financial institutions

## External auditors

*For the time being, external auditors only have a limited role as regards corporate governance in companies*

### **Need to :**

- Increase cooperation of auditors with supervisory bodies on corporate governance matters
- Reflect on compulsory reporting of serious facts by external auditors to both supervisors and boards
- Reflect on the role of auditors in the assurance providing connected to risk related financial information

The Commission will come up with other initiatives on external auditors

# 1. CG in financial institutions Supervisors

*Play an important role in monitoring the effective implementation of the principles on corporate governance.  
However, did not efficiently monitor corporate governance in FI*

## **Need to :**

- Increase involvement of supervisors with regard to oversight of corporate governance systems
- Enhance the role of the supervisor in the review of the functioning of the board
- Enhance supervisory review of the governance arrangements of risk management
- Improve the “fit and proper” test to take account of expertise and behaviour of board members

# 1. CG in financial institutions Follow-up to Green Paper

- More than 200 replies to consultation
- Analysis ongoing
- Commissioner Barnier will announce his vision for future action shortly

## 2. CG Framework

Some of the key issues identified for FIs could also apply to listed companies in general:

- How to ensure long term wealth creation and combat system-wide short-termism?
- How to incentivise shareholders?

## 2. CG Framework

- Boards (selection of directors, diversity, committee structure, board review,...)
- Shareholders (transparency, engagement, proxy voting, minority protection,...)
- Risk management, internal & external auditors
- Shortcomings in CG monitoring (quality of CG statements, European angle?...)



## 2. CG Framework

- Commission has started work on this project
- Further analysis needed
- Green Paper to be published Q2 2011
  
- Your comments and ideas are welcome!