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14. Januar 2011/VA

Consultation paper on the Guidebook on Internal Governance (CP 44)

Dear Madam or Sir,

The Association of Foreign Banks in Germany represents 220 foreign banks, investment firms and investment management companies active in the German market.

We appreciate the opportunity to comment on EBA's consultation paper CP 44 on the Guidebook on Internal Governance. Our comments and statements represent a consolidated view of our members who operate under relevant business models in the German market.

A lot of our members operate their German business activities by subsidiaries of their group. We would therefore particularly like to comment on Principle 2 – Checks and balances in a group structure. Apart from that, the envisaged Principle 12 on the management of conflicts of interest is of major concern to our members. As regards Principle 25 – Compliance function, we think that further discussion on the merits of the creation of a compliance function in credit institutions is needed; exemptions should be granted based on the principle of proportionality, at least to some institutions.

Our proposals are set out below as an attachment to this letter. In case of further queries, we will gladly answer any questions you may have.

Yours sincerely,

Dr. Oliver Wagner Wolfgang Vahldiek

Proposal 1:

Principle 2 – Checks and balances in a group structure

Para. 33 should be amended to read as follows:

"In a subsidiary **which is significant in relation to the group as regards the scale of its business activities and/or risks incurred**, an element of strong governance is to have independent members on the management body (e.g. non-executives who are independent of the subsidiary and of its group, and of the controlling shareholder)."

We welcome EBA's intention to strengthen the role of subsidiary management bodies in order to promote internal governance on the subsidiaries' level. However, the smaller a subsidiary is, the smaller is the potential positive impact that an independent management body member would have. In the case of a group with many small subsidiaries, the group governance could also be impaired by many independent members of management bodies on the subsidiaries' level.

So we would advocate, in the light of the principle of proportionality, to concentrate on significant subsidiaries in this respect.

Proposal 2:

Principle 12 – Conflicts of interest at institution level

Principle 12 should not be introduced as long as there are no legal provisions on level 1 or 2 allowing for the introduction of such requirements.

The envisaged content of Principle 2 is obviously inspired by MiFID rules on the avoidance and the management of conflicts of interest. We do not doubt that a conflict of interest management of this kind might prove to be useful for credit institutions as well, without prejudice to a proper cost-benefit assessment.

However, we are not aware of any provision in the Banking Directive or any other legal provision adopted with the consent of the Commission and the European Parliament that would allow for introducing the concept of conduct of business rules in the field of conflicts of interest management by EBA on level 3.

As a consequence we object to such level 3 rules, as long as EBA is not empowered on level 1 or 2 to introduce them.

Proposal 3:

Principle 25 – Compliance function

The costs and benefits of introducing a compliance function in credit institutions should be carefully reassessed. Any requirements in this area should be subject to the principle of proportionality, especially as regards small institutions and subsidiaries which are already subject to a group compliance function.

Principle 25 has obviously been inspired by MiFID rules. The introduction of a compliance function in credit institutions could theoretically be seen as a contribution to managing the legal risk an institution has to bear, within the framework set forth in Art. 22 of the Banking Directive.

However, there is one material difference between investment firms and credit institutions: Only the first are subject to comprehensive conduct of business rules on a European level, set forth by MiFID. These conduct of business rules are a complex legal area, which requires the presence of a compliance function in investment firms.

Credit institutions are not subject to such conduct of business rules. Their legal compliance is largely determined by quantitative capital requirements, risk management pursuant to Art. 22 of the Banking Directive and management of risks stemming from other European and national legal provisions. All these institutions have therefore already an organisational framework in place, consisting of risk management functions including internal control, internal audit and the legal department. Each of these functions is specialised on the particular area they are responsible for. So we think that the respective “compliance risks” are already adequately addressed in the legal framework as well as in practise.

Therefore, in the absence of any specific rules the compliance with which would require a new specialised compliance function to be introduced, we do not yet see the merit in introducing one on a mandatory basis.

This applies especially to small institutions and/or subsidiaries in groups of institutions. On the basis of the principle of proportionality, at least these institutions should be granted an exemption from new requirements which, in our view, would be overly bureaucratic and burdensome for them.