



FEDERATION  
BANCAIRE  
FRANCAISE

*Banking supervision  
And Accounting issues Unit*

*The Director*

Paris, January 14<sup>th</sup> 2011

**French Banking Federation's Response to Consultative Paper on the Guidebook on Internal Governance - CP 44**

Dear Sir,

The French Banking Federation (FBF) is the professional body representing over 430 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations

The FBF welcomes the consultation process that the CEBS/EBA is using to help enhancing sound principles of internal governance and developing prudent management. The FBF is pleased to comment on the Committee/Authority's consultation paper on guidelines which could be adopted to improve the existing practices.

Our main concern lies in the definition of "management body" used in the paper. In several instances, the principles blur the distinction between the management body in its supervisory function and the management body in its executive function. The FBF believes there is a need to clarify the roles and missions assigned to each body within the internal governance process.

You will find in the annex some examples where the use of the term management body may be misleading.

The French Banking Federation wants to see the instigation of healthy competitive conditions and believes the only way to do is to establish appropriate regulations. The FBF remains at your disposal for any further discussion on these matters.

Yours sincerely,

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## FBF Draft detailed comments on the CEBS Consultation Paper on the Guidebook on Internal Governance

### 1) Confusion on the term “management body”

In the CEBS' consultation paper, the term “management body” refers to both the board in its supervisory function and the executive management of an entity. As a consequence, some of the issues raised in the document referring to the management body are not clear enough and there is a doubt on the legal body concerned, in particular where a two-tier governance model is in place, as it is for instance the case in France. Indeed, within such type of structure, the board of directors has a supervisory but not an executive function while a management board carries out the executive function. Thus, on many issues raised in the consultation paper, our position would be totally different if the term “management body” is meant to refer to the executive management or to the board in its supervisory function.

The absence of distinction between the responsibilities of the board in its supervisory function and the executive management leads to a real confusion and tends to implicate the supervisory function in the management of the institution on a wider range of subjects.

This trend is neither efficient nor realistic, as the principle of checks and balances is not respected and the internal control framework is not appropriate. The executive management is fully responsible of the company's actions; the supervisory board does not interfere with the responsibilities of the executive management, however it assesses its efficiency and eventually passes a vote of non confidence and dismisses it.

Please find below examples of the misleading use of the term “management body” in the CEBS's document:

- Principle 3, point 37: *“The management body of an institution's parent company should ensure the different group entities (including the institution itself) receive enough information for all of them to get a clear perception of the general aims and risks of the group.”*  
This is not the role of the board in its supervisory function to deal with a day-to-day check on information received by each entity.
- Principle 4: *“The management body should only accept these activities when it has satisfied itself the risks will be appropriately managed.”*  
Once again, this is not the role of the board in its supervisory function, as it has neither the time nor the means to approve particular business situations. This is the role of the executive management.
- Principle 7: *“The management body should have policies for selecting, monitoring and planning the succession of its members.”*  
If this principle refers to the executive management, the FBF agrees that it is absolutely necessary to put in place policies to ensure a planned succession of the management team. However, concerning the board in its supervisory function, such assertion should be limited to the executive directors.
- Principle 17, point 97: *“Business units, under the oversight of the management body, should be primarily responsible for managing risks on a day-to-day basis, taking into account the institution's risk tolerance/appetite and in line with its policies, procedures and controls.”*

This sentence should not be interpreted as giving to the management body in its supervisory function the responsibility of the oversight of risk management on a day-to-day basis, as it would be totally unrealistic.

- Principle 21, point 122: *“Control functions should regularly submit to the management body formal reports on major identified deficiencies.”*  
If the management body is understood in its supervisory functions, such transmission of information should not have the consequence to by-pass the executive directors.

## 2) Missions assigned to the management body in its supervisory function

In many cases, the CEBS Consultation Paper clearly assigns missions to the management body in its supervisory function, or to the Risks Committees, while it seems to us that it is not their role.

- Principle 10, point 72: *“The management body in its supervisory function should consider, taking into account the size and complexity of an institution, setting up specialized committees consisting of members of the management body.”*  
The management body, in its supervisory capacity, should consider setting up specialized committees (audit, account, risk, internal control, compliance, strategic, compensation or other committees or combination of them) when the size and the complexity of the company justify it in order to fulfill its duties in the most efficient manner.
- Principle 10, point 78: *“To enhance the effectiveness of the risk committee, it should regularly communicate with the institution’s Risk Control function and Chief Risk Officer.”*  
The committees are merely emanations of the management body in its supervisory function which holds ultimately the decision-making power. Thus, it should be clear that the Risk Control function (as well as the CRO) shall not have a direct access to the board committees (or to the board) without the approval /knowledge of the chief executive officer. The CRO reports to the CEO and cannot be independent from him. The chain of command must be clear and should not be challenged by any direct reporting to the board. When examining the risk exposures of the bank, the board can call the CRO to report to the board in presence or not of the CEO but on the basis of information also made available to him/her.
- Principle 19, point 109  
We agree with this principle. However exemptions should be allowed for basic/simple transactions.
- Principle 19, point 112: *“If a risk committee has been set up it should receive regularly formal reports and informal communication as appropriate from the Risk Control function and the Chief Risk Officer.”*  
See our comment under point 78.
- Principle 21, point 119 and 120: *“The control functions should be established at an adequate hierarchical level and report directly to the management body. They should be independent of the business and support units they monitor and control as well as organizationally independent from each other.”*  
As it is stated that the control functions should be independent from the business, we understand it is here referred to the management body in its supervisory function.

However, we strongly support the fact that the control functions should ultimately report to the executive management and not to the board of Directors. This position does not prevent the head of the control function from regularly providing the board of directors with identical or condensed information prepared for the use of the executive management.

- Principle 26, point 157: *"The IAF should report directly to the management body and/or its audit committee its findings and suggestions for material improvements to internal controls."*

Given the context of this sentence (and in particular the reference to the audit committee), we understand that the "management body" referred to here is the board of directors. However, there is no mention of the implication of the executive management which is misleading, the latter must be the first informed of any deficiencies of the internal control framework.

### **3) Confusion on the allocation of missions between the different actors in the risk area**

The CEBS Consultation Paper creates confusion concerning the allocation of missions between the different actors involved in risk management.

- Principle 23, point 137: *"The Group RCF should review the consistency of the activities of subsidiaries with approved group strategy and report its findings to the management body."*

The RCF is responsible for ensuring a consistency between the activities of subsidiaries and the approved group strategy. However, the review and the report of the findings to the management body rather falls under internal audit assignment.

### **4) Particular points on which the FBF would like to draw the CEBS's attention :**

- Principle 2, point 33: *"In a subsidiary, 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)."*

This principle seems difficult to apply for most wholly-owned subsidiaries when directors are directly representing the sole shareholder.

- Principle 4, point 40: The reference to "external audit reviews" must be detailed.

- Principle 4, point 42: *"The same measures should be taken when an institution performs certain activities for clients."*

The attention should be paid to the fact that, when serving clients, the role of the bank is to advise and not to take decisions for its clients. Certain measures may be taken when acting for clients (advised information to the client on such matters for instance), but we do not think that, in nature, such measures can be exactly the same as the ones taken internally for the bank's own account.

- Principle 13, point 84: *"The management body should put in place appropriate internal alert procedures for communicating internal governance concerns from the staff."*

The document also mentions that in some Member States, there is the possibility for the staff to alert directly the supervisors on such concerns. We understand that this "external" alert is not presented as being compulsory; however, we would like to draw the attention on the fact that such type of external alert is not appropriate and may lead to uncontrolled exposures. We fully support the need for an internal alert system that is reviewed by both the internal audit and ultimately by the supervisory body.

- Principle 14: *"The management body should approve and regularly review the outsourcing policy of an institution"*.  
It should be specified that this should only concern the bank's core business activities, and not all type of outsourcing.
- Principle 24, point 147: *"If the CRO is replaced it should be done with the prior approval of the management body in its supervisory function."*  
The CRO being appointed by the Executive Management, we believe that prior approval of the Board of Directors should not be compulsory but remain an option within the internal governance policies while prior information should clearly be mandatory.