Committee of European Banking Supervisors

25 November 2009

Summary of the survey on the implementation of CEBS principles for internal governance

1. The CEBS subgroup "Internal Governance Task Force" performed in October 2009 a survey on internal governance issues of EU private sector banks. A questionnaire on the implementation of the CEBS Guidelines on Internal Governance[1] ("the Guidelines") was circulated to all CEBS Members and Observers. The objective of the survey was to identify whether there are major issues and topics arising from the financial crisis that need further detailed investigations, in order to update the Guidelines. The questionnaire covered the implementation of the Guidelines by supervisors, weaknesses identified and good practices observed within institutions, and some questions aiming to enhance the quality and consistency of the Guidelines. 27 supervisory authorities provided their answers to the questionnaire.

2. The questionnaire divided the internal governance framework into four themes (i.e. "Corporate Structure and Organization", "The Management Body", "Internal Control Functions" and "Public Disclosure and Transparency"), following the structure of the Guidelines.

3. The changes within the regulatory framework, i.e. the proposed changes of the Capital Requirements Directive ("CRD") and the already finalized and proposed CEBS guidelines (e.g. the High Level Principles on Remuneration and on Risk Management) will be taken into account when CEBS evaluates whether additional guidelines are needed and, if so, how they will be developed.

[1] The CEBS Guidelines on Internal Governance are included in the "CEBS Guidelines on the Application of the Supervisory Review Process under Pillar 2" (GL 03, as originally published in January 2006).

Main findings of the survey:

4. Overall the regulatory framework on internal governance can be considered to be broadly complete. Most Member States have adopted the Guidelines into their regulatory framework and apply them to institutions both on solo and group basis. All Member States allow for the principle of proportionality, either as an open norm that takes into account the size and complexity of the institutions or by setting specific thresholds or limits.

5. The Guidelines themselves were not thought to be deficient or inadequately adopted. Where weaknesses were identified they were often a result of institutions' weak or non-substantial implementation of internal governance practices, many of which have since been remedied following supervisory investigation or own initiatives.

6. The Guidelines could in some areas (e.g. remuneration, quality of the supervisory function, internal control functions especially with regard to risk management) be spelled out in more detail. This extra detail and maybe the inclusion of examples in an annex to the guidelines could also improve the Guidelines' clarity for both supervisors and institutions.

7. The supervisory procedures can be considered as sufficient, even if they differ between Member States. Some improvements have already been made (i.e. set up of supervisory colleges). It could be further investigated if a higher degree of harmonization within the supervisory procedures and methodologies would further enhance the consistent implementation of the Guidelines by supervisors,.

8. Sound internal governance practices helped some institutions to manage the financial crisis significantly better than others. These practices included a holistic risk management approach, sound reporting lines to management and supervisory function, including reports of the audit function and the setting of an appropriate strategy and risk appetite.

9. The main weakness identified with regard to the corporate structure and organization was that institutions' structures are too complex. The weakness might be multiple reporting lines (e.g. in a matrix organization), unclear assignment of responsibilities or too many layers in the group structure. The "Know-your-structure" principle was not always complied with very well because of ineffective reporting lines.

10. Respondents identified the complexity and riskiness of the products and services offered by institutions and the different nature of local markets in which cross-border groups operate as reasons for the complexity of the organization. In addition, adequate integration policies for new acquisitions were not always in place.

11. Apart from complexity, respondents mentioned organisational imbalances. Many respondents, especially supervisors who have mainly a host supervisor perspective, considered too much centralisation and dominant business line management to be the reason for some of the problems they found. The lack of management of conflicts of interest between parent and subsidiary was frequently observed.

12. Regarding the management body theme, respondents identified inadequate oversight by the management body in its supervisory function of the senior management as the most important and the most frequently observed weakness. Many other problems were related to this, e.g. concerns about the quality of the management body, both executive and non-executive members, as well as concerns about the independence of the latter. As a result board challenge to management's business proposals and practices could be weak.

13. Boards might not have understood the complexity of their business and the risks involved and consequently failed to identify and constrain excessive risk-taking. Boards might have been passive or unwilling to challenge or followed a 'herd mentality' and simply signed off proposals. Contributory factors might have been time constraints, particularly for non-executive directors to fulfil their duties, and a failure to check the institution's control environment, aggravated in some cases by poor reporting to board and management.

14. On internal controls, the main concerns raised were whether the risk management framework was sufficiently integrated within a firm or group, whether the framework covered all the risks the business faced and whether it had the appropriate standing, in terms of resources, status or expertise (e.g. the standing and independence of the chief risk officer). Risk management processes were felt to be generally operating, but their effectiveness was lacking in some cases.

15. The right relationship between the operational units, with prime responsibility for the risks taken by the institution, and the internal control systems could be delicate. Risk control functions needed to be close to the day-to-day business but also to exert independent leverage on, and stand separate from, them.

16. Weaknesses with regard to transparency and disclosure have been perceived as less important by the respondents. However, two transparency weaknesses stand out. Respondents indicated often that information should not only depict the internal governance framework, but also assess whether and how this framework works effectively. More detailed information on the governance structures within the group and information about intra-group relations were generally lacking.