

European Commission
Directorate General Internal Market and Services

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CONSULTATION ON THE GREEN PAPER ON CORPORATE GOVERNANCE IN FINANCIAL INSTITUTIONS AND REMUNERATION POLICIES

The European Commission has launched a public consultation on the Green Paper on Corporate governance in financial institutions and remuneration policies. The Central Chamber of Commerce of Finland submits the following statement.

The Central Chamber of Commerce of Finland welcomes the Commission's action to consult the different actors in this very topical issue.

We regret to see the increasing risk of over-regulation of the financial market and listed companies. In Finland, the IPO market has been almost non-existing for many years. Also, we find the current regulations adequate for the functioning of the financial market. Instead of adding the amount of regulation we would like to emphasize the need to ascertain that the financial supervision functions properly in all Member States. We don't see the recent problems to have been caused by insufficient regulation but by lacking governance in the financial institutions in some countries combined with insufficient supervision. We don't support more binding legislation in this area. According to our experience, corporate governance codes are the primary tool to enhance governance in financial institutions and listed companies beyond the existing regulatory framework.

We would like to point out that in January 2006, the Central Chamber of Commerce of Finland issued a statement that significant organisations, including banks and insurance companies, should comply with the Corporate Governance Code for Listed Companies. Several companies, including major financial institutions, have followed this recommendation.

As a general remark on the Finnish board system, we would like to point out that the most common governance model is the one-tier model. Cooperative banks, however, have a board of supervisors in addition to a board of directors. In this statement we refer to boards of directors instead of boards of supervisors when we discuss boards. We find this clarification important because in the Finnish translation of the citizens' summary the term *hallintoneuvosto* is used as a translation for the English term board. We believe that this is a translation error. The translation means a board of supervisors while the main governance body in controlling risks etc in financial institutions is a board of directors, not a board of supervisors even in those institutions where they exist.

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.

1. Specific questions:

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

A board membership requires a considerable amount of time. If a director is engaged in a large number of board memberships, he or she may not be able to concentrate enough on each task. However, we do not find it appropriate to set a general limit for board memberships. Some board members have a demanding job in addition to board memberships while others don't have a day-to-day job but only board memberships. Directors' personal skills and experience differ. Also, some people wish to dedicate all their time to board work while others value private life more. These simple examples should elaborate why a common limit for board memberships will not function properly.

However, a prerogative for being a board candidate is that the person has a sufficient amount of time to devote to board work. We find it essential that a listed company discloses its directors' simultaneous board memberships so that shareholders can estimate if the person has sufficient time to be a board member. The issue of sufficient time and disclosure should be dealt with in corporate governance codes.

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

We find it recommendable that the functions of chairman of the board of directors and chief executive officer be separated. This recommendation is included in the Finnish Corporate Governance Code for Listed companies (recommendation 36). A binding rule might however not be appropriate considering all the different types of financial institutions.

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?

We find it important that directors have diverse expertise and that their individual skills complement other directors' skills. However, it is crucial that a board has a sufficient knowledge of the company's core business. Especially in financial institutions, it is necessary that some board members have a background in the financial sector.

We don't think it is possible to define exactly how much diversity and how much experience in the financial sector a board needs. Corporate governance codes should address the issue of expertise and diversity in a suitable manner. Binding legislation will inevitably prove inflexible and unpractical. It would also lead to the question who would be the right person to define exactly what the adequate skills are.

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?

Until recently, boards consisted almost solely of men and too often of men with similar backgrounds. In Finland this has changed considerably over the past five years without binding legislation. It has been acknowledged that the talent pool for boards is too limited if only men are considered suitable board members.

In 2004 the Finnish Government set a target of 40 per cent women board members in state-owned companies. This target was reached already in spring 2006.

The Finnish Corporate Governance Recommendation of 2003 was the first national code in the world to mention the sex of board members:

"It is imperative for the board's work and its effective functioning that the board is composed of directors with versatile and mutually complementary capabilities and skills. The age mix and the proportions of both sexes can also be taken into account in the composition of the board."

In 2008, an updated Finnish Corporate Governance Code was issued. Recommendation 9 stated as follows:

“Both genders shall be represented on the board.”

The Code was updated in June 2010 and the recommendation remained. If a company does not comply with the recommendation, it must account for and explain the departure from the Code.

The general experience in the Finnish market is that most companies are reluctant to depart from the Code due to the publicity of the departure. So there was confidence that a recommendation requiring an explanation if not complied with will have an effect. This confidence was not unfounded.

In 2008, when the Code was issued, only 51 per cent of Finnish listed companies had a female board member while 49 per cent of the companies had all-male boards. After the recommendation was given, the ratio soon started to change. In 2009, already 59 per cent of the companies had at least one female board member even though the recommendation had not entered into force. After the annual general meetings of spring 2010, already 74 per cent of Finnish listed companies have at least one woman board member. All large cap companies fulfill the recommendation. The companies with all-male boards are mostly small cap companies. When the recommendation was given in 2008, it was stated that this was a long-term goal for small listed companies. In the Code of 2010 this statement concerning the small companies was deleted.

We believe that the Finnish experience proves that change is possible without binding legislation. However, in order to achieve this, the government must have a will to change things in the state-owned companies and the private sector or other corporate governance code authors have to see the importance of the issue. The situation seems to vary considerably in the different Member States. Some countries are making remarkable progress while others fail completely even to notice the existence of this issue. We find it important that inflexible binding legislation is not imposed on countries where progress has been 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?

We find it important that board performance is evaluated annually. This requirement is included in the Finnish Corporate Governance Code. However, requiring an exter-

nal evaluator will cause administrative burden and costs especially for small companies.

We cannot support the disclosure of the board evaluation results to shareholders. This would inevitably lead to superficial evaluations when companies would have to avoid internal affairs and trade secrets such as strategic goals from being published. Board evaluation should take the company strategy into account and the public disclosure of these issues would be harmful for the company.

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?

Some financial institutions are relatively small and have small boards. In those cases it is not practical to set up separate committees. The size of the financial institution may be quite decisive in this issue. Also, the financial sector is divided into different types of institutions with different risk profiles. For example, institutions in the banking sector and insurance sector may have different needs for risk committees. It seems to be quite common that large banks have separate risk committees.

In small banks a functioning arrangement can be that the audit committee handles also risk control issues. For this purpose, the committee can be divided into smaller sub-committees for practical preparatory work.

Different solutions may function for different types and sizes of financial institutions and it is important not to force financial institutions to set up unnecessary separate bodies. Efficient governance is the main thing, not having various separate organs. Also, in a group structure it may be sufficient that the mother company has a risk committee and subsidiaries or member units don't have separate risk committees.

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?

It seems to be natural that both committees have at least one mutual member.

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

We do not support additional rules on reporting to the general meeting. Currently, several reports will be issued before a general meeting and shareholders have access to information. In fact, too much information is often less information because shareholders cannot distinguish key information from a huge amount of different re-

ports. Besides, shareholders have a right to ask questions in a general meeting. For that purpose, the chairman of the risk committee should be present at the annual general meeting. We would like to point out that the Finnish Corporate Governance code recommends that a sufficient number of committee members attend the annual general meeting (recommendation 3).

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

The board decides on risk policy. This includes instructions which issues are to be brought to the board to decide and which issues are operational matters to be decided by the management.

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

We oppose the requirement of issuing more reports, statements and declarations. Already, companies are required to give inter alia annual reports and corporate government statements. The corporate governance statement must have a description of the main features of the internal control and risk management systems in relation to the financial reporting process. Also, corporate governance codes for listed companies as well as other regulation require the disclosure of major risks and the principles of risk management in the organization. An additional risk control declaration would add the administrative burden of financial institutions without producing new information or giving added value to the company or its shareholders.

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

Such a detailed rule may lead to unnecessary bureaucracy. When companies would try to interpret the rule, they might be careful in the interpretation and minor issues might be taken to the board. This would inevitably weaken the board's possibility to work on important issues and to dedicate sufficient time to strategic issues and risk control.

A financial institution should however define the procedure for the approval of new products. The approval of new products is an operational matter to be decided by the management.

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?

The Finnish Financial Supervision Authority already supervises the risks of financial institutions. The management of a financial institution informs the authority regularly of its operations. Also the audit committees are informed of material risks.

One of the Finnish Financial Supervision Authority's key supervisory tasks is to ensure that supervised entities do not take on such a level of risk as may jeopardise their capital adequacy. The task is dual: on one hand they assess supervised entities' risk-taking, while on the other hand the capital adequacy is measured.

Risk-taking is supervised in three different ways by the Finnish Financial Supervision Authority. Quantitative or measurable risks are monitored through regularly submitted reports and supervised entities' own risk reports. Qualitative risks are monitored through inspections. Individual institutions also encounter risks arising from changes in the operating environment and this is also dealt with in the supervisory work.

We don't see any need to an additional flow of information.

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')?

We oppose such a duty to be established in the European legislation. This is due to the fact that Member States have their own legislation and rules on duty of care. We oppose the requirement of issuing more reports, statements and declarations. Already, companies are required to give inter alia annual reports and corporate government statements. The corporate governance statement must have a description of the main features of the internal control and risk management systems in relation to the financial reporting process. Also, corporate governance codes for listed companies as well as other regulation require the disclosure of major risks and the principles of risk management in the organization. An additional risk control declaration would add the administrative burden of financial institutions without producing new information or giving added value to the company or its shareholders.

The Finnish financial sector experienced a crisis in the 1990's. During that time we had several court cases, initiated as criminal proceedings by the public prosecutor, where such rules were interpreted. Some of these cases lead to bank directors being sentenced to criminal sanctions and damages. Naturally, in some cases the defendant was acquitted. It can be concluded through this experience, that we have a functioning system in our corporate, financial and criminal legislation to bring to lia-

bility such persons who have broken their duty. Furthermore, the principle of equitable treatment of shareholders is already included in legislation. Also the interests of creditors are addressed in legislation.

Of course, if there is some Member State where this sort of legislation does not exist, the Commission could address the issue while making sure that the measure would not be harmful for the existing legislation in the Member States.

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.

Specific questions:

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?

Financial institutions are a heterogenic group. Enhancing the status of the chief risk officer will not be decisive as the CEO will anyway have the decision-making power. The presence of the chief risk officer in risk committee meetings is recommended. This would enhance the role of chief risk officers. Other suitable measures may be difficult to find, taking the chief financial officer's role also into account. We would also like to point out that often the chief financial officer is responsible for risk control functions.

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?

Chief risk officer should have a right to report directly to the risk or audit committee, also bypassing his or her superior.

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

Yes, we think that the chief risk officer should have a right to report directly to the risk or audit committee, also bypassing his or her superior.

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?

According to our point of view, IT-tools are adequate already and are under constant development. We don't see any need to address this issue on EU level. We find this to be an operational matter with little relevance to board work.

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

We oppose the requirement of an approval by executives of a report on the adequacy of internal control systems. Already, companies are required to give inter alia annual reports and corporate government statements. The corporate governance statement must have a description of the main features of the internal control and risk management systems in relation to the financial reporting process. Also, corporate governance codes for listed companies as well as other regulation require the disclosure of major risks and the principles of risk management in the organization. An additional risk control declaration would add the administrative burden of financial institutions without producing new information or giving added value to the company or its shareholders.

We would also like to point out that the Finnish Financial Supervision Authority regularly reviews the level and adequacy of internal control exercised by the largest credit institutions and other key supervised entities. Related inspections have a particular focus on the function and role of the board of directors in internal control. The aspect of internal control is included in all inspections.

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.

Specific questions:

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

We find the current level of cooperation sufficient.

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?

This duty already exists. We oppose new rules that would make unnecessary changes in the current practices.

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

We find it sufficient that the external auditors review the overall risk, liquidity and capital handling as required by Finnish law.

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.

Specific questions:

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

The Finnish financial sector experienced a crisis in the 1990's which led to serious efforts to enhance the functioning of the supervisory authority. We find the current situation satisfactory and sufficient.

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?

They already have these powers. We don't see any need for changes.

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?

We oppose this proposal. It would lead to unnecessary administrative burden and to too detailed rules.

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?

Specific questions:

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

We oppose this proposal. The role of institutional investors is developing in a very satisfactory manner through self-regulation. We find it unnecessary to address the issue on EU level.

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.

We oppose this proposal. The role of institutional investors is developing in a very satisfactory manner. We find it unnecessary to address the issue on EU level.

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'?

Some listed companies have informed us that they have not experienced any empty voting and therefore we see no reason for facilitating the identification of shareholders.

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

We already see very much positive development and don't see a need for EU level action. The attendance of foreign investors in general meetings has increased during the past years. It will continue to increase further due to the development of electronic voting mechanisms.

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

Specific questions:

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

We oppose strongly the increasing of the accountability of board members. This is due to the fact that the Member States have their own legislation and rules on board members' accountability. The Finnish financial sector experienced a crisis in the 1990's. During that time we had several court cases, initiated as criminal proceedings by the public prosecutor, where such rules were interpreted. Some of these cases lead to bank directors being sentenced to criminal sanctions and damages. Naturally, in some cases the defendant was acquitted. It can be concluded through this experience, that we have a functioning system in our corporate, financial and criminal legislation to make board members accountable for their actions.

Of course, if there is some Member State where this sort of legislation does not exist, the Commission could address the issue while making sure that the measure would not be harmful for the existing legislation in the Member States.

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?

We oppose strongly the reinforcing of the civil and criminal liability of directors. The Member States have their own legislation and rules on board members' civil and criminal liability. The Finnish financial sector experienced a crisis in the 1990's. During that time we had several court cases, initiated as criminal proceedings by the public prosecutor, where such rules were interpreted. Some of these cases lead to bank directors being sentenced to criminal sanctions and damages. Naturally, in some cases the defendant was acquitted. It can be concluded through this experience, that we have a functioning system in our corporate, financial and criminal legislation to make board members accountable for their actions.

If there is some Member State where such legislation does not exist, the Commission could address the issue while making sure that the measure would not be harmful for the existing legislation in the Member States.

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.

Specific questions:

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?

We cannot support binding measures on remuneration. The latest Commission's recommendation on remuneration in listed companies is very detailed and relatively recent. We find additional measures unnecessary and harmful. Finland as well as many other Member States have recently updated their corporate governance codes. Now we should have time to monitor the functioning of the new codes.

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?

Stock options can be a successful tool for remunerating the management of companies. We are quite surprised to hear that the idea of prohibiting stock options has even been expressed.

The problems related to stock options have not been caused by the instrument itself but by the terms of the stock option schemes. If stock options were to be prohibited, many companies would opt to grant synthetic stock options. This development is not unknown. Synthetic stock option schemes can be as good or bad as stock option schemes. It should be noted, however, that the granting of stock options requires a resolution of the general meeting whereas synthetic stock options as well as other monetary remuneration can be granted by the board. So the prohibition of stock option would in fact reduce the powers of shareholders. Furthermore, stock options are not costly for companies whereas synthetic stock options and other bonus systems may be burdensome.

Also, it should be realized that stock option schemes are a very practical method of remunerating company management. Also, in some Member States, stock options are very heavily taxed.

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?

Stock options are very heavily taxed in Finland, actually equally with any salaries, and due to the heavy progression of the taxation system, taxes for stock options are very high. From our point of view, there is no relevance between taxation and risk management. For the company's point of view, the terms of the stock option scheme are the decisive factor.

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?

We already find the role of shareholders sufficiently strong considering remuneration issues. The current demanding disclosure rules combined with the demands to promote competitiveness and long-term financial success of the company and to contribute to the favourable development of shareholder value are adequate for the shareholder point of view as well as employees. Finland as well as many other Member States have recently updated their corporate governance codes. Now we should have time to monitor the functioning of the new codes. As for employees, we would like to point out that according to our legislation on employee representation, employee representatives may not participate in the handling of directors' appointments or remuneration.

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?

The issue of severance packages is already treated in the Commission's recommendation on directors' remuneration and in our national Corporate Governance Code. We see no need for further regulation.

General question 7a: Interested parties are also invited to express their views on whether additional measures are needed with regard to the structure and governance of remuneration policies in the financial services. If so, what could be the content of these measures?

Specific questions:

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

We would leave this issued to be decided by the organization giving the public funding. We find no need to address the issue on EU level and would like to express our

surprise if such funding has been awarded without setting the terms of remuneration in the receiving institution.

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.

Specific questions:

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?

We prefer uniform regulations in order to create a level playing field for different actors of the financial sector.

THE CENTRAL CHAMBER OF COMMERCE OF FINLAND

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