From checks and controls to changing the core culture

Response to the European Commission's GREEN PAPER Corporate governance in financial institutions and remuneration policies

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1 Introduction

> We can't solve problems by using the same kind of thinking
> we used when we created them.
>
> \- *Albert Einstein*

Purpose of this document

The European Commission has adopted a Green Paper[1] accompanied by a Staff Working Document on corporate governance in financial institutions and remuneration policies. The Green Paper launches a public consultation on possible ways forward to improve corporate governance mechanisms in financial institutions with a view to preventing future crises.

This document serves to contribute to the Commission's public consultation and aims at *providing new perspectives and ideas for creating a sustainable European financial services sector for all stakeholders (shareholders, citizens, tax payers, banks, governments, supervisory authorities, employees and society as a whole). It also serves to promote good practices in banking that can provide inspiration for the development of new models of thinking and building blocks for a sustainable banking system.*

Authors have not only addressed the questions formulated in the Green Paper but also identified questions that have not been asked in the Green Paper but should have been posed. In general, proposed solutions for the banking industry are built on what is known, relying on finding the answers within the current system. However, we believe that the causes of the financial crisis also included unknown factors and knock-on effects. Therefore we are

[1] COM (2010) 284 final

convinced that the most important debate should be focused on the fundamental questions underlying our financial system. Our document calls on the European Commission to start a fundamental debate on these issues. Such debate with representatives from the various stakeholders should take place first, before further legislative action is taken. We feel that the main issue to address is to changing the core culture of financial institutions, rather than introducing more rules.

This document consists of an *Executive Summary*, in which the *starting points, main conclusions and ten key recommendations* are described (Chapter 2). Chapters 3 to 9 provide *detailed responses* to the individual questions posed in the Green Paper.

About the authors

This document has been composed by a multidisciplinary Think Tank of 10 senior international financial services professionals, based in The Netherlands[2]. The group's expertise and experience in the international financial services industry encompasses all major areas, including risk management, general management and supervision, reporting and accounting, legal matters, corporate governance, leadership development, sustainability and academia. The views and opinions expressed in this document are those of the individual authors. Not all authors necessarily support all the views and opinions expressed herein. Furthermore, the views and opinions expressed herein do not (necessarily) represent the official views and opinions of any of the employers of the respective authors.

[2] Please refer to chapter 10 for information on the authors.

2 Executive summary

2.1 Starting points

We express agreement in principle with the European Commission's analysis of the causes of the financial crisis set out in the Green Paper and the Commission Staff Working Document. However, we emphasize that the role of corporate culture in the developments leading up to the crisis has been understated in the European Commission's analysis. We have observed that a culture of excessive risk-taking has gradually developed and that the control mechanisms (internal and external) have not been able to sufficiently contain its consequences.

Since the banking system is not 'just an industry' but forms an integral part of all industries and is crucial for the recovery of European economies, in practice the future banking structure should take into account a much wider group of stakeholders than before. The prevailing focus on shareholders (and their returns) should give way to behaviours that explicitly take into account the interests of other stakeholders as an intrinsic value in conducting business, in particular:

- Retail customers, who depend on banks and supervisory authorities to protect them from inadequate and expensive financial products and advice;
- Tax payers, who depend on their governments and supervisory authorities to take timely and appropriate action to protect them against high costs for bail-outs of failed banks;
- Borrowers, who depend on sufficient liquidity in the system for their business.

Despite the impressive number of initiatives taken, we express serious concerns about the fact that all measures have been geared to strengthening control over institutions and mechanisms by introducing further regulation and reporting. We are convinced that this one-sided approach – *reliance on control* – will not bring about the fundamental shift in culture and behaviour needed to create a sustainable financial services sector. More checklists and rules will only provide a "superficial sense of security".

At the same time, the initiatives lack focus regarding the banking system's special status in society. Banks form the lifeblood of our economies by providing services to citizens and companies. Their (potential) collapse led to rescue operations by governments, resulting in significant bills for tax payers and liquidity crunches for both private citizens and companies. By not strengthening the mindset of social responsibility of banks, the current measures taken fall short of creating a sustainable future.

Banking has become an increasingly international industry in terms of cross-border business and the internationalisation of client and shareholder bases (institutional investors, hedge funds). The impact of the crisis has led to previously unimaginable and ultimately unfair consequences for citizens of smaller countries that were home to international banks.

The abolition of the U.S. Glass-Steagall Act has led to a worldwide growth of banks that combine the activities of investment banks with those of deposit banks. This development has been said to have contributed significantly to the financial crisis. However, we believe it is not *per se* the structure of banks executing a variety of activities that may lead to seemingly contradictory risk profiles (where investment banking activities generally carry a higher risk than retail banking). The main issue in this development has been the fact that banks have become more and more commercial institutions and that their natural distance from the commercial sector in the past has diminished slowly but steadily. This development has further caused banks to lose sight of their responsibility towards society as a whole. Banks have become too much like their wholesale clients, commercial companies.

How to redefine a new equilibrium between banks' commercial and social responsibilities based on the current legislative frameworks should be a question that tops the agenda of the European Commission.

2.2 Main conclusions

The measures proposed so far to strengthen corporate governance in the financial services industry have been characterised by the introduction of further regulation, additional reporting and control mechanisms. We are convinced that this one-sided approach – reliance on control – will not bring about the fundamental shift in culture and behaviour needed to create a sustainable financial services sector. Organisations need to find a desirable balance between hard controls and soft controls, the invisible factors in culture and behaviour, which highly influence the effectiveness of internal control measures and procedures.

Regarding the specific areas addressed in the Green Paper, we wish to emphasise the following conclusions. In our view the best manner to promote these conclusions is by best practice and regulatory supervision based on broad principles, rather than through introduction of new legislation.

Board of Directors

Board diversity and independence will promote procedural fairness by providing a means of ensuring that a wider group of interests is more directly represented in corporate decision-making, leading to an improved quality of decision-making. The role of the chairperson and the establishment of an inclusive corporate culture are crucial elements in ensuring that diversity is utilized to achieve a better performance. Regular evaluations should be carried out to assess the performance of the individual board members and the board as a collective.

Risk-related functions

The focus should be on ensuring that the current rules and regulations, like the Basel II Framework, are strongly embedded in the culture[3] of the banking institution rather than expanding the current frameworks. This means that in practice management should not only focus on the hard controls, but also on, and in some cases more on, the soft controls

[3] Another example of embedding culture into the organisation is provided by Principle 8 of ISO 31000 " Risk Management takes human and cultural factors into account".

(amongst others, involvement, transparency, tone at the top, clearness, communication) and the corporate culture control environment.

External auditors

Current laws, rules and guidelines provide sufficient room for cooperation between external auditors and supervisory authorities. However, the manner in which these guidelines are adopted in practice is more a matter of mindset and trust than that it is a matter of non-compliance with these rules by both the external auditor and the supervisory authority. External auditors need to be encouraged to express themselves on the quality of the soft controls within the company.

Supervisory authorities

There is yet little experience with the Supervisory Review and Evaluation Process (SREP). Going forward the SREP should provide a valuable platform for regulators to address the presumed shortcomings in financial institutions' corporate governance. It is essential that regulators across Europe not only improve the processes to share their findings in order to learn from each other's experiences. We need to seriously review if the current procedures, culture and expertise of the regulators are up to standard to deal with the ever-increasing complexity of the financial industry. If executed correctly, this information sharing can lead to the early identification of new developments and trends that might otherwise pose a significant risk in the (near) future.

Shareholders

We do not think that as a general rule disclosure of voting practices and policies should be compulsory. For institutional investors whose shareholding in the company exceeds a certain threshold and thus can have an impact on the voting in the general meeting of shareholders, it could be considered to require more openness in the future.

Effective implementation of corporate governance principles

The implementation of corporate governance principles will only be effective if the Board of Directors firmly ensures that the spirit of good corporate governance is part of the cultural DNA of the organisation; only when this is realized the implementation of corporate governance principles will effectively contribute to the desired culture and behaviour. We are convinced that setting more rules will not necessarily contribute to the effective implementation of corporate governance principles; however, a visible and recognisable approach to the principles of the business and the performance management system will.

Remuneration

An important element that is missing in most discussions on this matter is that in order to realise the required cultural change, the reward strategy of a financial institution should focus on sustainable growth and promote the interests of its clients and other stakeholders.

2.3 Key recommendations

We are convinced that fundamental changes in the financial services sector are required in order to create a long-term sustainable system and regain the trust of all stakeholders. We call upon the European Commission to facilitate the debate on these changes and to provide guidance in this process of far-reaching transformation and propose that the Commission takes into account our ***10 key recommendations.***

Recommendation 1: Changing the core culture

Changing the core culture in the financial services industry, including the supervisory authorities, is a long-term process that starts with serious reflection on the negative impacts of the current culture. Four elements form the building blocks to develop a more responsible culture for the future:

- Clarity about desired behaviours and clearly defined sanctions of violations;

- Effective and consistent implementation of the current rules and the sanctions;
- Transparent communication about desired behaviours and violations;
- Leadership that is able to create a culture of transparency, openness and accountability. The key characteristic of this culture is that differences of opinion are valued and embraced in the conviction that they lead to a better quality of decision-making.

We recommend that the assessment procedures by national Central Banks for members of the Board of Directors and senior management are made transparent and that Central Banks themselves adhere to the same principles of transparency in communication regarding the desired integrity and behaviours of their directors in the future and communicate openly and transparently about these processes. Central Banks need to walk the talk and set examples for the desired behaviour that is required in the new financial system.

Recommendation 2: Start a fundamental debate on social responsibility

The sustainable growth of the financial services industry has been seriously compromised by short-term decision-making, driven by financial and stock market behaviour and shareholder pressures on short-term returns. The European Commission should therefore engage in a fundamental debate about the desirability of continuance of the current situation, in which banks are considered to be the same as any other commercial company. The issue of banks' social responsibility towards their primary clients, individuals and corporations, and the consequences for their corporate culture, behaviour and governance structure should be the focus point in this debate. In the Netherlands this debate has already started upon the initiative of leaders from a wide variety of financial services companies under the name FIER (see textbox below).

This debate should include the issue of whether it is appropriate and desirable, from the point of view of banks' social responsibility, that the roles of CEO (as leader of the executive board) and Chairman (as leader of the non-executives or Supervisory Board members) can be fulfilled by one person in some legal systems. We believe that, given the natural distance the Chairman has from the executive team and his or her mandate to take into account the interests of all stakeholders, a division of these roles would be better for a healthy financial services industry in the future.

Good practice in The Netherlands: FIER

Grass roots initiative
A group of ten young bankers from various national and international banks started the FIER initiative early 2009. FIER stands for Financial Institutions Enhancing Responsibility. Their objective was to restore pride in the banking sector following the 2008 crisis. FIER composed a document that highlights the four most important areas for banks to focus on in the future:

Service-orientation – Transparency – Diversity – Sustainability
First of all, banks should develop a **service** mentality, serving both their clients to the best of their ability as well as serving the real economy.
Secondly banks should be clear and **transparent** about their products as well as their governance structure. This means that banks should not sell products to clients that are not understood by bankers themselves. In addition, banks need to realize that they have more stakeholders than only shareholders.
Thirdly banks should embrace **diversity** in various ways. Diversity in the composition of their staff and management boards will lead to inviting different views into decision-making processes and board rooms. Embracing diversity in products and activities means that banks should offer the whole array between a savings bank and an investment bank.
Fourthly, banks must contribute towards a **sustainable** world not only financially but also from an environmental, social and governance perspective.

Prerequisite for achieving these four main objectives is a fundamental change of behavior of the banking community. FIER therefore emphasizes the need for a **principle and not a rule based change**.

Dialogue sessions
FIER has engaged with the CEO's of nearly all Dutch banks as well as with bank employees and interested people from society (such as NGO's, consultants, religious leaders, entrepreneurs etc.). Two dialogue sessions with CEO's were organized providing them with the opportunity to reconsider and debate the role of banks in society and to have a meaningful discussion on the future of banking that went beyond the day to day activities and competition. In addition, FIER organized dialogue sessions with bank employees and interested people from society to get their input on the role of banks and to understand what changes they wish to see in the future.

The FIER participants are convinced that it is not an easy process to try to **change the system from the inside**. However, the initiative is a powerful step in the right direction because it has already made possible that the banking community engages in meaningful dialogues that they would have otherwise never had.

FIER can be found on LinkedIn Groups.

Recommendation 3: Balancing between rules and behaviour

We recommend refraining from developing new regulations and control mechanisms without addressing the need to strike a balance between these hard controls and so-called soft controls: the invisible factors in culture and behaviour which highly influence the effectiveness of internal control measures and procedures.

The financial crisis has led to initiatives which focus on more rules and regulations with the purpose of strengthening control over financial institutions to mitigate risks. Although scandals and bankruptcy cannot be prevented completely, we believe a fundamental shift in behaviour and therefore in culture, together with feasible rules and regulations, will help to create a sustainable financial sector in order to regain the trust of all stakeholders. The quality of the soft controls in individual financial institutions can be subject to regulatory supervision based on broad principles.

The aim of rules, regulations and procedures is to give direction and to define the preconditions and boundaries which the organisation wants its management and employees to act within. It is important that management and employees comply with them, not just according to the letter, but even more so, to the spirit. Too many rules, regulations and procedures can create an environment where people hide behind them, don't exercise common sense and take no responsibility for their actions.

To be successful in achieving their goals and meeting the expectations of their stakeholders, organisations need to find a desirable balance between hard controls and soft controls for their control environment. It is important that organisations understand their control environment, which soft controls should be an integral part of. The organisational culture influences the quality of those soft controls significantly.

The organisational culture provides an atmosphere in which people conduct their activities and carry out their control responsibilities. Soft controls set the tone of an organisation by influencing the control consciousness of its people. Soft controls together with hard controls form the internal control framework, providing discipline and structure. Factors include the integrity, ethical values and competences of the entity's people, management philosophy and operating style, the way management assigns authority and responsibility, the way management organises and develops its people and the attention and direction provided by the audit committee and Board of Directors.

Good Practice : Examples of Soft controls

Clarity:	the degree to which the rules and procedures are accurate, concrete and complete, so employees understand what is expected with regard to ethical conduct within the organisation.
Role modelling:	the degree to which management sets a good example for the organisation and their employees.
Achievability:	the degree to which organisation targets correspond to predetermined values and norms.
Commitment:	the degree to which employees endorse the proper use of corporate assets and the active realisation of the interests of the organisation and its stakeholders.
Transparency:	the degree to which employee conduct and the effects thereof are manifest within the organisation.
Openness to discuss:	the degree to which employees can discuss ethical dilemmas within the organisation.
Openness to report:	the degree to which employees are held accountable for unethical behaviour within the organisation.
Enforcement:	the degree to which employees are punished for irresponsible conduct and rewarded for responsible behaviour.

Kaptein, M (1998), Ethics management: Auditing and developing the ethical content of organizations, Dordrecht: Kluwer Academic Publishers.

The behaviour of members of the Board of Directors and senior management has a direct effect on the effectiveness of implemented controls. Employees look to their management for direction. If they see management "walk like they talk", they are more inclined to comply with the same rules. Tone at the top is a key soft control. Creating a culture where people dare to speak about their dilemmas and worries and feel comfortable in addressing inappropriate behaviour will also contribute to an open and trusted banking environment.

In addition, the financial incentives and bonus plans strategies are typically driven by hard controls. Setting realistic business goals which do not conflict with compliance requirements and include non-financial KPIs in the performance agreements, such as risk management and duty of care, can foster a positive change in the culture and behaviour. It's important that people are actually also rewarded for realizing the non-financial goals.

Good Practice : Examples of Non-financial Key Performance Indicators (KPI's)

Client focus:	customer satisfaction results, number of complaints, number of incidents duty of care.
Reputation:	reputation of trusted bank according to stakeholders.
Business with respectable clients:	number of high and unacceptable risk classifications.
Incidents:	number of major incidents.
Openness:	number of staff positive over the degree of openness in the organisation.

Changing the organisational culture and the soft controls cannot be achieved overnight. Old mind sets and practices are deeply ingrained. This is a long-term process which has to be initiated by the Board of Directors and moreover it has to start within the Board. This requires a new form of leadership which celebrates dialogue, demonstrates transparency, welcomes engagement and is based on informed trust.

Recommendation 4: Promote establishment of stakeholder committees

The European Commission should recommend financial services companies to create stakeholder committees that operate at various levels in the management structure, including at top level. The mandate of this committee is on the one hand to review practical situations for violation with the company's values or code of conduct, like ethics committees do[4]. The committee communicates about desired behaviour and infringements in the organisation. By establishing clear norms and communicating openly about violations and dilemmas, the committee becomes a crucial element in creating an atmosphere in which ethical and responsible behaviour is recognised and valued. On the other hand the stakeholder committee develops decision-making policies which take into account the interests of all stakeholders in decision-making and creating a platform to discuss dilemmas. In this way the stakeholders committee provides a counterbalance against the prevailing behaviour of decision-making aimed at reaching short term goals (profits) at the expense of long term objectives (sustainability and social responsibility).

The composition of the committee should reflect the diversity of expertise in relevant functional areas like risk management, finance, sales and marketing, and should include hierarchical decision-making levels and, preferably, independent outside experts. Transparency should be ensured by publishing the minutes of the committee on the organisation's intranet. By including open and transparent communication about possible and implemented sanctions on infringements of ethical rules and solutions to long term – short term dilemmas, employees will develop a clear understanding of the desired culture and the consequences of their behaviour.

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[4] A good practice example of an ethics committee can be found on:
http://www.rabobank.com/content/csr/ethics_and_issues/ethics/index.jsp

Recommendation 5: Strengthening Directors' skills

The implementation of a Bankers Exam may prove to be an effective way of ensuring (future) directors have the necessary skills and capabilities to take decisions within a financial institution. Directors should be required to prove their knowledge is still up to date through periodic reassessments of their skills and capabilities. To increase the level of acceptance of the idea of a Banker's Exam, it would be helpful if the European Commission would set transparent criteria for such Exam. Furthermore, in most countries the Supervisory Authorities already have requirements to demonstrate the suitability and integrity of a Board Member before he or she may take his or her place on the board of a financial institution. A Bankers Exam could create more transparency in this process as well.

Recommendation 6: Publication of joint management letters

Following the good practice of the Dutch accountants' organisation NIVRA[5] of developing and publishing a joint management letter for the insurance industry, we recommend that the European Commission promotes and encourages adoption of this good practice widely across the European Union. We believe that a joint Management Letter for the financial services industry in the European Union as a whole, as a joint effort by all auditing firms that are involved in auditing financial institutions, might help detect systematic risks within the industry. The process of establishing this joint management letter should be coordinated by the national associations of banks, and in close collaboration with the external auditors involved and the financial institutions themselves.

Recommendation 7: Debate on the role of states as shareholders of financial institutions

An important issue that should be subject to debate is the manner in which states that hold shares in financial institutions should exercise their shareholders' rights. Across the European Union state shareholding in banks has different causes and serves different objectives, ranging from historic and political reasons to shareholdings as mere

[5] http://www.nivra.nl/ readfile.aspx?ContentID=41502&ObjectID=386569&Type=1&File=0000030587 _Englishfactsheet_July2010.pdf (English)

consequences of necessary bail-out plans (like in the Netherlands). The view of states as shareholder is therefore important to take into account when considering to introduce new rules for shareholders of financial institutions, which in principle will apply to any shareholder, including these states.

Recommendation 8: Effective implementation of corporate governance principles

It is advisable that the European Commission starts the dialogue whether compliance with corporate governance principles should be included in the overall management system, such as business principles, reward and performance management systems and in what manner this can be achieved.

Recommendation 9: Redirecting the debate on remuneration

The European Commission has adopted several recommendations relating to remuneration. In light of the desired culture change within the financial industry the discussion on remuneration needs to be redirected from a focus on absolute and variable (long and short term) pay towards a focus on reward and talent management systems.

Recommendation 10: Strengthening regulatory authorities´ skills

As has been witnessed over the last decades, the financial system is becoming ever more complex. Therefore it is essential that the regulatory authorities demonstrate to the public they have sufficient expertise to regulate this complex industry. A Regulatory Exam for supervisors, along the lines of the Banker's Exam as we suggested in recommendation number 5, including periodic reassessments, could be very helpful in this respect. Furthermore, enough exchange between the banking sector and the regulator should be encouraged, so that the regulatory authorities have ample access to the banking sector practices as opposed to primarily relying on theoretical knowledge. For this exchange of personnel a good framework needs to be developed to avoid too close ties between the banking sector and its regulators.

3 Boards of Directors

General Response[6]:

"*With the increasing importance of broadening the domain of corporate governance beyond major shareholders to other stakeholders, board diversity and independence will promote procedural fairness by providing a means of ensuring that their interests are more directly represented in corporate decision making*"[7]

Most Dutch financial institutions use the two-tier governance model consisting of a Supervisory Board and Management Board. Although in the Netherlands the terminology of executive and non-executive directors is not used, for international comparison reasons we will refer to the directors in the Supervisory Board as the non-executive directors (NEDs) and the directors in the Management Board as the executive directors. In answering the questions and providing our response, unless indicated otherwise, we shall read non-executive board where Board of Directors is mentioned.

The fact that NEDs themselves are not always sure what exactly their role and tasks are, or how their performance should be evaluated, is not surprising when one considers the vast amount of research on the (discussed) role of NEDs or the many differences in the internationally applicable governance codes and models. The internationally applicable governance codes have different perspectives on the role fulfilled by NEDs in our society. In the classical Anglo-Saxon governance model the shareholder is the most important stakeholder to consider (shareholder model), whereas in the continental European governance model all relevant stakeholders should be taken into account without setting a hierarchy of such stakeholders.

[6] This chapter refers to section 5.1 of the Green Paper.

[7] Luoma, P. and J. Goodstein (1999), "Stakeholders and corporate boards: institutional influences on board composition and structure." Academy of Management Journal 42(5): 553-563.

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)?

Limiting the number of boards on which a director may sit can – but will not necessarily – prevent individual directors devoting insufficient time to the fulfilment of their duties. It is likely to contribute to a need to recruit from a wider circle of candidates for functions and thus could enhance the diversity of directors available. Another way to increase diversity on the board is to limit the maximum tenure and the maximum number of renewals. As a standard, the number of boards on which a director may serve should be limited to such an extent that the proper performance of his/her duties is assured. A board member should be sufficiently available to properly perform his/her tasks. Whether a board member has indeed performed his or her duty properly could be measured by way of an objective annual evaluation. Therefore, it is not advisable to set a fixed number in legislation.

It should be taken into account that the role and activities of boards differ widely, and consequently the demand on the time of their directors. A distinction could be made between boards of listed and non-listed companies, since the legal responsibilities for the first group are more extended and may therefore require more time from the directors. In many countries best practice limitations to the number of board positions have been included in corporate governance codes already, which we think is a good manner to provide for this topic. The Dutch Corporate Governance Code[8] includes a best practice provision (II.1.8) prescribing that a management board member may not hold more than two Supervisory Board positions in listed companies. For Supervisory Board members the recommended limit is a maximum of five memberships of listed company boards, for which purpose the chairmanship of a Supervisory Board counts double (III.3.4). In order for such arrangement to be effective, we advise that its implementation will be effectively monitored.

[8] http://www.commissiecorporategovernance.nl/page/downloads/DEC_2008_UK_Code_DEF__uk_.pdf

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

Indeed, this requirement could very well serve to reflect the social responsibility of financial institutions compared to other industries in which combination of these roles is quite common. Since the Supervisory Board carries ultimate responsibility weighing all interests of stakeholders, including the community at large, the proposed prohibition would better ensure that the social responsibility of banks is more firmly embedded in the corporate governance system. Taking into account that the governance models differ in the various Member States, a combination should not be strictly prohibited, but rather be laid down in governance codes to allow flexibility for exceptional situations. A further debate in the industry on this topic, should take place.

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?

Preparing a profile of both the Supervisory Board and the individual NED is essential. Objective criteria should form the basis for determining whether a candidate NED conforms to this profile. Recruiting new board members from outside the existing network, possibly with the help of external specialists, may contribute to achieving greater diversity on Supervisory Boards.[9]

Examples of criteria: character traits and genuine motivation (directors will have different motivations, depending on whether he/she is at the beginning or end of his/her career as a director).

1.4. Do you agree that including more women and individuals with different backgrounds on the board of directors could improve the functioning and efficiency of boards of directors?

We agree that there are good business arguments to promote more diversity – including women – on boards. A homogeneous board is more likely to operate as a group and may

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[9] Lückerath-Rovers, M. and A. De Bos, Code of conduct for non-executive directors and supervisory directors, available at SSRN: http://ssrn.com/abstract=1586305.

experience the symptoms of groupthink, be they conscious or subconscious. Groupthink brings with it three risks: excessive self-esteem, the creation of tunnel vision and a strong pressure within the group to come to an agreement.[10] All three risks threaten the independent and critical view needed to maintain good governance (the Supervisory Board) and provide good management (the Board). Countries have different or no approaches in their corporate governance codes to address the issue of homogeneity of directors.[11]

On the other hand, we need to acknowledge that boards with more "diverse" board members do not automatically utilise the diversity in viewpoints and experiences from their diverse members. Research[12] among 700 banks has shown that if team members are so diverse that they lack sufficient commonalities they will have difficulty communicating and the decision-making process will even be hindered by diversity. Therefore, the role of the chairperson, being an inclusive leader, and the establishment of an inclusive corporate culture are crucial elements in ensuring that diversity is utilized to a better performance. Regular evaluations should be carried out to assess the performance of the individual board members and the board as a collective in reaching its objective to utilize diversity to the fullest. Also, in organisational units in which decision making primarily relies on procedures and rules, diversity has relatively little impact on the quality of decisions. In dynamic environments in which quick and creative decision-making is required, diversity plays an important role in generating the best outcomes. This distinction is especially important looking at bank cultures in which some units will benefit from a large degree of diversity. Given the dynamic environment the banking industry is operating in, the impact of diversity on decision-making in the future will be crucial. This may require a change in the culture of financial institutions.

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[10] Janis, I. 1972, Victims of groupthink; a psychological study of foreign-policy decisions and fiascoes. Boston: Hougthon, Mifflin.

[11] Lückerath-Rovers, Mijntje, A Comparison of Gender Diversity in the Corporate Governance Codes of France, Germany, Spain, the Netherlands and the United Kingdom (April 6, 2010). Available at SSRN: http://ssrn.com/abstract=1585280.

[12] O.C. Richard e.a., "Cultural diversity in management, firm performance and the moderating role of entrepreneurial orientation", Academy of Management Journal 2004, 47 (2).

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?

An objective evaluation may serve both an internal aim (increase of self-efficacy) and an external aim (the need for transparency in relation to stakeholders). Although evaluation of the board's functioning is often described as necessary, empirical research shows that in practice board evaluation is not yet commonly applied in practice.[13] Moreover, in the Netherlands little use is made of outside experts for such evaluation.[14] It is also difficult to develop a satisfactory evaluation instrument, because NEDs are generally people who have an impressive track record and resumé and are therefore not accustomed to being assessed.

It is important that the evaluation should not be perceived as a farce but as having a genuine purpose: the board must take responsibility for its own operation. This also entails that there are consequences associated with the improper functioning of (individual) NEDs and that action is taken when necessary.[15] However, the difficulty with this issue is: who determines whether action should be taken? Do external evaluators, supervisory authorities and shareholders have sufficient knowledge and experience to determine whether action is required based on the information they receive? Therefore, we feel that at this stage an evaluation carried out by an external evaluator should not be compulsory. Rather more experience in such a process should be obtained by financial institutions and external evaluators in this respect to develop best practices.

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?

We also refer to our answer on question 2.3 of the Green Paper. In principle, all members of the board should be fully aware of the risks the institution is exposed to and how these influence the (long-term) performance of the institution. However, given the specific nature of the risk information, it could be helpful if a separate risk committee is established in order

[13] Huse, M., 2007, Boards, Governance and Value Creation. Cambridge University Press p.204.

[14] De Bos, A. and Lückerath-Rovers, M., 2009, Nationaal Commissarissen Onderzoek 2008. Erasmus Universiteit Rotterdam.

[15] Lückerath-Rovers, M. and A. De Bos, Code of conduct for non-executive directors and supervisory directors, available at SSRN: http://ssrn.com/abstract=1586305.

to help better understand the risk information provided to the Board of Directors. Also, by constituting a separate committee for risk issues, it is warranted that more time can be devoted to risk at board level. E.g. audit committees already have many topics to deal with, which may leave too little time for risk issues. In this respect, we refer to the fact that, as a consequence of the implementation of the Dutch Banking Code[16], most Dutch banks have set up a risk committee as a subcommittee of the Supervisory Board which prepares all discussions about risk management in the Supervisory Board. The Supervisory Board shall supervise the risk policy pursued by the executive board. As part of their supervision, the Supervisory Board shall discuss the bank's risk profile and assess at a strategic level whether capital allocation and liquidity impact in the general sense are in line with the approved risk appetite. Sound knowledge of the financial aspects of risk management, of the products of the bank and expertise in making risk assessments is required. It should be stressed, however, that setting up a risk committee in itself is not a guarantee for a more robust decision-making process, because it needs to be part of the whole business process.

Setting up a risk committee has important advantages. However, whether a risk committee is actually needed in individual financial institutions will depend on the circumstances, e.g. the nature and complexity of the business. Therefore, we feel that such a risk committee should not be compulsory. Whether a risk committee has been set up or not can, however, be a relevant circumstance to be taken into account by the regulatory supervisor upon review of the corporate governance.

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?

Having members of the audit committee be part of the risk committee will enhance a more informed decision-making, because various subjects cannot be strictly labelled as topics for either the audit committee or the risk committee.

It follows from our conclusion on question 1.6 above that a risk committee should not be compulsory and that no mandatory rules should be introduced with respect to the composition of the risk committee.

[16] http://www.nvb.nl/scrivo/asset.php?id=534018

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

With reference to the answers to questions 1.6, 1.7, 2.2 and 2.3, we note that the key issue in our opinion is not who should report to the general meeting. In a system with collective responsibility of the board, a risk committee merely prepares the decision-making process of the board. The conclusions of the risk committee should be part of the general report of the board on risk. It is at the discretion of the board of each company to decide in what manner and which person will report on this issue during the general meeting of shareholders. Therefore, no mandatory rules should be introduced in this respect.

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

In a well-functioning financial institution, the institution's strategy and risk profile (as laid down in its risk appetite statement) are logically connected to each other – even intertwined – as well as to the capital plan. Therefore, the role of the Board of Directors should be to ensure that the business plan (strategy), the capital plan and the risk profile are developed and decided upon in relation to each other.

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

See our answer to question 2.5.

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

Approval of new financial products which have a significant impact on the company's bottom line or capital requirements should be part of the normal decision-making processes of the Management Board. In the Dutch Banking Code[17] a special provision has been included which requires the Management Board to set up internal systems to manage the product approval process. It is, however, not specifically required that new products require the up-front approval of the Supervisory Board. Based on an annual risk analysis, the in-house auditor checks whether the product approval process has been designed properly and

[17] http://www.nvb.nl/scrivo/asset.php?id=534018– see art. 4.5.

informs both the Managing Board and the relevant Supervisory Board committee on the outcome thereof.

1.12. Should an obligation be established for the board of directors to inform the supervisory authorities of any material risks it is aware of?

Informing the supervisory authorities should primarily be a duty of the executive directors. However, in certain circumstances, there may be a need for supervisory directors to notify supervisory authorities. In order to answer this question, a clearer view needs to be obtained on the situations in which such need would arise and in what manner the materiality of risks to be notified could be defined.

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")?

Under Dutch law, the Supervisory Board has a duty to take into account all interests of all stakeholders, including depositors and others. It would be recommendable to include this duty specifically in corporate governance codes. The current Dutch Banking Code does not refer to this specific duty of the Management Board or the Supervisory Board. It refers in different places to the bank's role in society. However, it does specify that the Management Board is responsible for creating a corporate culture in which the duty of care towards clients is firmly embedded in all decision-making procedures.

4 Risk-related functions

General Response[18]:

With the introduction of the Basel II Framework[19], both the risk function and the finance function are becoming more directly involved in the general decision-making within financial institutions (banking). A well-functioning Internal Capital Adequacy Assessment Process (ICAAP) is one of the major requirements of the Basel II Framework. The essence of this process is the establishment of a risk appetite framework (lead by the risk function), which is in line with the capital plan (lead by the finance function) and the business plans (lead by the commercial functions) of the organisation. The business plan, capital plan and agreed risk appetite levels should be continuously aligned with each other, so that changes in one part of the equation should lead to adjustments in the other parts.

For a well-functioning ICAAP it is hence essential that all disciplines within the financial institution work in tandem to achieve the strategic objectives of the bank. Although the lead for the different aspects (business plan, capital plan and risk appetite) will generally lie with the different functions, all board members should be able to comprehend the key issues of these different aspects. It is essential for a well-functioning process that the final decisions on the business plan, the capital plan and the risk appetite are taken collectively.

As a response to the collapse of the financial system, the focus should be on ensuring that the current rules and regulations, like the Basel II Framework, are strongly embedded in the culture[20] of the banking institution rather than expanding the current frameworks. This means that management should not only focus on hard controls but also on – and in some cases more – on soft controls (amongst others involvement, transparency, tone at the top, clearness and communication) and the corporate culture and control environment. This focus and embedding can be achieved in a number of ways:

- Focus on continuous education of the (senior) management and Board of Directors on all aspects of the ICAAP, including setting performance targets and reward

[18] This chapter refers to section 5.2 of the Green Paper.

[19] See www.bis.org/publ/bcbsca.htm

[20] Another example of embedding culture into the organisation is provided by Principle 8 of ISO 31000 " Risk Management takes human and cultural factors into account".

programmes that also incorporate the level of risk taken and behavioural aspects in achieving the performance targets.

- A thorough and challenging discussion between the regulators and the board on the ICAAP, as is foreseen in the Supervisory Review and Evaluation Process (SREP)[21].
- Establishing a process to continuously identify new risks that could potentially impact the strategic objectives of the financial institution that should lead to adjustments in the business plan, the capital plan and the risk appetite.

Please refer to chapter 2.3 of this document under Key Recommendations 3, where we address the issue of the need for changing behaviour and more focus on soft controls in that respect.

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?

With reference to the general response above, a well-functioning ICAAP should already ensure that the status of the chief risk officer (CRO) is on a par with that of the other executive directors so that the risk function is included in the highest management body of the financial institution. It should, however, be clear that risk is such a fundamental part of a financial institution's business that it is not a one man show for the CRO in that respect but an overall responsibility of the whole executive committee or Management Board.

A well-functioning board ensures that all of its members add value to the decision-making process in the organisation. Therefore, it is essential that the team of board members is well diversified in terms of working experience, areas of expertise and backgrounds to ensure that a well-balanced decision-making process is achieved. Please refer to chapter 3 on our views to improve the performance of the Board of Directors.

[21] Reference is made to the Supervisory Review and Evaluation Process (SREP), which is part of the Basel II Framework.

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?

It is evident that all information provided should meet general criteria on completeness and transparency. However, for any type of information to be correctly interpreted, it is necessary for the sender of the information to be aware of the information requirements and the background of the receiver of the information. Thus, in this specific situation, the risk management function should understand the issues the Board of Directors is dealing with and make sure that the information provided adequately addresses these issues. Given the sometimes complex nature of the risk information to be provided, the risk management function should ensure that the individual board members are adequately assisted in interpreting the information provided. In this respect, the continuous education of board members plays a vital role in ensuring that the right information is being delivered and that the message the information conveys is understood correctly.

On the other hand, the expertise of the directors in relation to dealing with risk issues may improve if some of them form part of a specialised risk committee.

In general, escalation procedures are already well established within banking institutions. The issue potentially impeding sound decision-making is far more the corporate culture – do all parties feel free to address conflicts and/or problems and is staff signalling these types of issues taken seriously. Establishing a new mandatory procedure for resolving conflicts/problems will not have any positive effect if the corporate culture is not open enough to address conflicts and/or problems. Hence corporate culture is also extremely important from an information exchange perspective.

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

With reference to the above, the main concern should be whether the CRO feels that his or her views and concerns are taken seriously by the Board of Directors. In theory, the manner in which the process is organised should be less relevant for organisations with a culture that values criticism at the right level.

In practice, it can strengthen the position of the CRO if he or she has the ability to escalate certain issues to the level of the Board of Directors. Where a risk committee has been set up, such committee would be the best body for such escalation, because it is best placed in terms of expertise and experience to deal with such issues.
Please refer to chapter 3 of this document (Board of Directors) on our views on how the performance of the Board of Directors could be improved.

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?
This question seems to imply that current IT tools are inadequate to fulfil the information requests of the Board of Directors. Although this may hold true for some institutions (in which case these systems do indeed need to be upgraded), the main concern should be in correctly identifying the type of information the Board of Directors requires to adequately fulfil its duties and the capacity of the board to understand the information provided to it. In this respect, we refer to the answer to question 2.2. In any case, it should be noted that state-of-the-art IT in itself is not sufficient for sound decision-making.

2.5 Should executives be required to approve a report on the adequacy of internal control systems?
Implicitly this question assumes that executives will have extra focus on internal controls if they are required to approve a report on the adequacy of the internal control systems. It is questionable whether this will promote the right attitude of executives in the organisation. Such requirements have been in place for U.S. listed companies under the Sarbanes-Oxley Act and, for example, article 46bis (1) (c) of Directive 2006/46/EC dated 14 June 2006 also provides for such an "in control" statement. These requirements have not prevented the financial crises from occurring and in practice have hardly contributed in remedies against the executives that signed these statements.

Control systems are put in place to ensure that known risks are adequately managed and are thus an instrument to assist executives in fulfilling their role and responsibility. However, as we have learned from the recent turmoil in the financial system, the most devastating risks come from unforeseen events or events that developed differently than generally anticipated. To really address the risks inherent in the financial system, it is far more effective to develop a process to continuously evaluate the current risks already identified by the institution and how these are managed, together with actively seeking signals that may reveal new types of risk that may have a major impact on the financial stability of the financial institution.

5 External Auditors

General Response[22]:

The role of the external auditors of financial institutions has gained the interest of stakeholders over the past years. Especially in relation to financial institutions where misconduct has taken place and in relation to the financial services industry as a whole after the credit crunch. In our opinion the external auditor is not appointed to detect fraud or misconduct. However, he or she needs to be alert when auditing financial statements in order to review signals that might point out that misconduct has taken place, or that major risks are underlying the financial reporting. It is our view that the performance of the external auditor is at its best when the values and the goals of the company and the auditor are aligned. The external auditor's knowledge of both the financial institution subject to their audit, and the financial service sector as a whole, is of major importance in detecting risks in the future.

Specific Questions:

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

The current laws, rules and guidelines give sufficient room for cooperation between external auditors and supervisory authorities. The way in which these guidelines are adopted in practice is more a matter of mindset and trust, than a matter of non-compliance with these rules by both the external auditor and the supervisory authority. However, the value of the external audit will improve when supervisory authorities use their right to talk to the external auditor without the presence of the Board of Directors. Furthermore, external auditors need to be encouraged to express themselves on the quality of the soft controls within the company. We encourage external auditors to examine the possibilities of auditing not only the hard controls that are part of the financial reporting framework, but also the soft controls that give a view on the culture within the organisation. The outcome of the audit of these latter soft controls should be reported to the Board of Directors.

[22] This chapter refers to section 5.3 of the Green Paper.

We believe that a joint Management Letter for the financial service industry in the European Union as a whole, as a joint effort by all auditing firms that are involved in auditing financial institutions, might help detect systematic risks within the industry. The process of establishing this joint management letter should be coordinated by the national associations of banks, in close collaboration with the external auditors involved and the financial institutions themselves. This joint Management Letter should be made public and accessible for everybody who is interested.

In the Netherlands, the Dutch Association for External Auditors (Nivra) published its first Joint Management Letter on 1 July 2010 for the insurance industry[23] as a whole. This joint management letter was based on written surveys among the external auditors involved in auditing insurance companies. The underlying principle of the Joint Management Letter is described as follows[24]: *"Accountants pry into the inner workings of organisations. They identify risks and any matter requiring special attention. This refers to both those risks which directly involve an accountant's core business – the provision of financial information through annual accounts – and other issues. These issues are flagged through a management letter, intended for executives and Supervisory Board only. However, sometimes it may also be advisable to identify those findings which span a sector or society as a whole, so as to facilitate a timely response by more parties; in an anonymous form which respects an accountant's duty to observe confidentiality".*

For 2011 the Nivra is investigating by asking the external auditors to submit anonymous abstracts from the management letters to their clients to the Nivra, on the basis of which the Nivra will draw up the Joint Management Letter.

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[23] http://www.nivra.nl/readfile.aspx?ContentID=62641&ObjectID=628531&Type=1&File=0000030496_collectieve%20man%20letter%20verzekeraars%20def%201juli2010.pdf (in Dutch)
[24] http://www.nivra.nl/readfile.aspx?ContentID=41502&ObjectID=386569&Type=1&File=0000030587_Englishfactsheet_July2010.pdf (English)

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?

A number of European countries already have rules that contain duty of information towards regulators on certain issues. It should be reviewed to what extent these duties should be harmonised. E.g. in the Netherlands the current laws, rules and guidelines are sufficient. We believe that both financial institutions themselves, and the external auditor, have to live up to their responsibilities to present a true and fair view on the financial situation and stability of the financial institution. The external auditor plays a major role in the quality and reliability of the reporting process on the risk profile of a financial institution and should therefore always take into account the interests of all stakeholders. His or her objective should be to aim for the highest level of transparency on the way he or she has performed his or her duties as an external auditor.

As outlined in the chapter before, we also believe that the corporate governance framework of financial institutions should focus more on soft controls instead of hard controls. If a shift from hard controls to soft controls will take place in order to ensure the reliability of the financial data, it is only reasonable to expect that the auditor will give an opinion on the quality of the soft controls.

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

Risk-related financial information is based on hard data and on assumptions made by management (soft data). External auditors need to give comfort on the hard data of risk-related financial information by means of an assurance report, and give comfort on the accurateness of the soft data by means of a negative assurance opinion. The risk-related information should be part of the financial statements of the company. In order to be able to audit the risk-related information there should be a framework upon which this information can be audited. This framework could be based on the Basel II framework pillar 3, complemented with a framework for soft controls. We recommend that the Basel II framework is in line with reporting standards based on IFRS, especially with respect to risk-related information.

Furthermore, we recommend that financial institutions implement a process of review of their risk disclosures, including a benchmark with their peers. This reviewing process should also include a benchmark of the comparability of the financial data included in the risk disclosures. The external auditor should take this reviewing process into account in his audit of the risk disclosures, and form an opinion on the quality of the reviewing process. The outcome of his audit could be included in the Joint Management Letter as well, as outlined in our answer to the paragraph under question 3.1.

6 Supervisory authorities

General Response[25]:

Although the Basel II Framework has been implemented in Europe, given the short history of the introduction there is as yet little experience with the Supervisory Review and Evaluation Process (SREP). Going forward the SREP should provide a valuable platform for regulators to also address the presumed shortcomings in financial institutions' corporate governance. The SREP discussions will also provide the necessary insights to the current state of the financial institutions within their area of responsibility and create oversight on the banking industry in general.

It is essential that regulators across Europe share their findings in order to learn from one and other's experiences. If executed correctly, this information-sharing can lead to the early identification of new developments and trends that may impose a significant risk in the (near) future. This will enable regulators to better understand the impact of developments in the industry and increase their ability to adequately monitor and control these new developments.

Specific Questions:

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

Well-functioning internal governance is the prime responsibility of the individual financial institution. Within the Basel II Framework, the supervisory authorities – namely the regulators – already have the responsibility to critically challenge the internal governance of the financial institution. Currently regulatory authorities are building up their experiences with the SREP across financial institutions, which will provide them with a better view of which internal governance processes are superior in respect to risk issues and lead to better decision-making. These experiences will thus strengthen the regulator's capabilities to better execute the individual SREPs.

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[25] This chapter refers to section 5.4 of the Green Paper.

However, just as it is expected that Boards of Directors are well-equipped to perform their duties, this should also be expected from Supervisory Authorities.

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?

To a certain extent the regulatory bodies already have the duty and the power to check the correct functioning of the Board of Directors. In a professionally executed SREP, the regulatory authorities should be able to form an opinion on the ICAAP of the financial institution being reviewed. The quality of the individual institution's ICAAP will provide important signals for the supervisory authorities on the function of the internal governance, including the risk management function. It is advisable to evaluate, over the next two to three years, whether the current SREP provides supervisory authorities with adequate powers to check the correct functioning of the Board of Directors and the risk management function. Furthermore, Supervisory Authorities should be encouraged to evaluate their current working practice in exercising their duties and powers, to see whether a cultural change should also be established with the Supervisory Authorities.

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?

Financial institutions differ from general corporations in the event of a failure of a financial institution, in which case the negative spill-over effect is much more extensive within the banking industry as well as the general economy. Given that in such cases tax payers are likely to be requested to bail out the failed financial institution, it is more than reasonable that current and future directors show their competence in managing these types of institutions. In some countries, e.g. the Netherlands, discussions have been held on the value of requesting directors of banks to pass a so-called Bankers Exam. Such a Bankers Exam may prove to be an effective way of ensuring (future) directors have the necessary skills and capabilities to take decisions within a financial institution. Such an Exam programme should, however, be continuously evaluated and, once passed, directors should be required to prove their knowledge is still up to date through periodic reassessments of their skills and capabilities. Also it should in principle apply to the whole of the Board of Directors, whereby a distinction in the type of exam could be made between Executive and Non-executive directors. To increase the level of acceptance of the idea of a Banker's Exam, it would be helpful to set transparent criteria for such Exam. Furthermore, in most countries the Supervisory Authorities already have requirements to demonstrate the suitability and integrity of a Board Member before he or she may take his/her place on the board of a financial institution. A Bankers Exam could create more transparency in this process as well.

7 Shareholders

General Response[26]:

While it can be said that some shareholders failed to engage with boards of financial institutions, other shareholders of financial institutions have been said to have engaged too much. In the Netherlands there has been an ongoing discussion on this subject since the introduction of the Dutch Corporate Governance Code in 2003, which encouraged shareholders to engage in a more active manner in order to have proper checks and balances of the governance of companies.[27] After some Dutch companies like VNU, Stork and ABN Amro Bank N.V. had been brought "into play", the manner in which shareholders have engaged with those company has been questioned.

In such cases, the ability of boards to engage with shareholders was complicated by the fact that, after having been brought into play by hedge funds, the shareholders' base rapidly changed: institutional investors disposed of (part of) their shareholdings in such companies because the risk profile of the company had changed and no longer fell within the investment guidelines of the individual institutional investors. In the latter case it was not so much lack of engagement of shareholders with the board, but rather lack of engagement by the board with aggressive co-shareholders that changed the power balance in general meetings of shareholders. Since institutional shareholders have a primary duty to act in the best interest of their stakeholders – i.e. the ultimate beneficiaries – it is difficult to imagine how such behaviour could be prevented in the future.

Another issue that should be subject to debate is the manner in which states that hold shares in financial institutions should exercise their shareholders' rights. The view of states as shareholder is also important to take into account when considering to introduce new rules for shareholders of financial institutions, which in principle will apply to any shareholder, including these states. As a practical matter, states could lead by example in the way they act as shareholders.

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[26] This chapter refers to section 5.5 of the Green Paper.
[27] See D.A.M.H.W. Strik, "Greed might be good", *International Financial Law Review*, 2007, p. 25-37.

Specific questions:

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

We do not think that as a general rule such disclosure should be compulsory. For institutional investors whose shareholding in the company exceeds a certain threshold and thus can have an impact on the voting in the general meeting of shareholders, it could be considered to require more openness in terms of voting practices and policies. Information that would be provided by institutional investors should merely be regarded as a useful tool for the board to assess the positions of their shareholders. Companies should not be able to hold that against such investors if they decide to deviate from their previously published policies or practices. Institutional shareholders' primary duty is vested in the interests of their main stakeholders, their ultimate beneficiaries, e.g. the persons entitled to pension or the policy-holders.

We note that it could also be considered to introduce additional notification and other prudential requirements for shareholders in financial institutions, that exceed a threshold that allow them to convene general meetings of shareholders, or place items on its agenda.

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"?

In general, identification of shareholders can be helpful in enabling the board to engage with its shareholders. To the extent possible, abuse of "empty voting" should be prevented. Preferably a uniform set of rules would apply throughout the European Union.

Institutional investors could be encouraged to recall lent shares when there are important matters on the agenda for the shareholders' meeting and openness on the subject of control positions during dialogue with enterprises.

Moreover, it could be made mandatory that the agreements between lending and borrowing parties include the provision that it is not permitted for the shares to be used solely for the purpose of exercising the voting rights on these shares.

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

Shareholders should not be required to engage with the companies in which they hold shares. As set out above, the primary duties of the institutional investors lie with their beneficiaries. For institutional investors the exercise of voting rights is a tool to fulfil such duties. The decision of institutional investors to engage will be made in view of these duties.

A main driver in the dialogue between the board and shareholders is the openness of the board concerning the business of the company. As a practical matter, the board could consider putting more motions on important issues on the agenda as voting items, to actively and openly sound out the views of the general meeting of shareholders.

Institutional investors could also be encouraged to engage, if they are sufficiently able to communicate with other institutional investors on the strategy and other important issues of the company. In certain instances, shareholders have been reluctant to do so, in view of uncertainties in the legislation of some countries in relation to "acting in concert".[28]

Institutional investors could take measures to align the long-term interests of their beneficiaries with incentives for asset managers.[29]

[28] Eumedion, Position Paper Engaged Shareholdership, dated 12 March 2010. http://www.eumedion.nl/page/downloads/Position_Paper_Engaged_shareholdership_DEF.pdf, p. 11, 12.

[29] Eumedion, Position Paper Engaged Shareholdership, dated 12 March 2010, p. 9. http://www.eumedion.nl/page/downloads/Position_Paper_Engaged_shareholdership_DEF.pdf.

8 Effective implementation of corporate governance principles

General response[30]:

Existing rules and regulations determine that the Board of Directors can be held accountable for the effective implementation of corporate governance principles.[31] The board is accountable for this to the general meeting of shareholders. Supervisory authorities should according to existing rules and regulations establish whether adequate measures have been taken for the effective implementation of these principles. However, these rules and regulations did not prevent the financial crises from taking place.

Reinforcing criminal liability of directors will not in itself contribute to an effective implementation of the principles, but will create a culture that is driven by fear that results in "ticking the box" behaviour.

The implementation of corporate governance principles will only be effective if the Board of Directors firmly ensures that the spirit of good corporate governance is part of the cultural DNA of the organisation; only when this is realized the implementation of corporate governance principles will effectively contribute to the desired culture and behaviour. The Board of Directors should be fully clear and transparent about this by, among other things, reflecting the spirit of good corporate governance in the principles of the business. Next to that it should ensure that the principles are embedded in all policies and procedures of the organisation. The Board of Directors should act as a role model in this respect. Staff should be reprimanded or penalised for not complying with the policies and procedures and be rewarded for being role models; therefore the compliance with corporate governance principles should be included in the performance management system.

[30] This chapter refers to section 5.6 of the Green Paper.

[31] Best practice principle I of the Dutch Corporate Governance Code determines that the Management Board and the Supervisory Board are responsible for the corporate governance structure of the company.

Based on the above we believe that setting more rules will not necessarily contribute to the effective implementation of corporate governance principles; however, a visible and recognisable approach to the principles of the business and the performance management system will.

It is therefore advisable that the European Commission starts the dialogue whether compliance with corporate governance principles should be included in the overall management system, such as business principles, reward and performance management systems and in what manner this can be achieved.

9 Remuneration

General response[32]:

In light of the financial crises much has already been said and written about remuneration and many discussions on this matter have taken place. The European Commission has adopted several recommendations relating to remuneration. In addition we refer to the adoption by the European Parliament on 7 July 2010 of further regulation of banker's bonuses and special treatment for bonuses of directors of banks who were rescued by governments[33] (still to be ratified by Member States). Also, local regulators have already implemented rules and regulations relating to remuneration following the financial crises and have taken further initiatives to strengthen these rules and regulations to promote the integrity and soundness of the financial system. It is the responsibility of the European Commission to establish a level playing field for the financial industry and additional rules may contribute to this. However, the European Commission should also take into consideration that an overkill of local and European legislation will not contribute to the structure and governance of remuneration policies in the financial services sector due to a lack of clarity regarding which regulations apply.

An important element that is missing in most discussions on this matter is that in order to realise the required cultural change, the reward strategy of a financial institution should focus on sustainable growth and promote the interests of its clients and other stakeholders. It is therefore not advisable to focus only on the absolute amount of the remuneration package, but to start a dialogue about how to realize an integer and a sound reward and talent management system that focuses on the financial institution's long term interest and the desired culture of the organisation.

We recommend that in light of the desired culture change within the financial industry the discussion on remuneration is redirected from a focus on absolute and variable (long and short term) pay towards a focus on reward and talent management systems.

[32] This chapter refers to section 5.7 of the Green Paper.

[33] http://www.europarl.europa.eu/news/public/story_page/042-78554-190-07-28-907-20100709STO78534-2010-09-07-2010/default_en.htm

10 Information on the authors

Danielle Balen was appointed Deputy Company Secretary at ABN AMRO Bank N.V. in 2009 after having worked as an in-house legal counsel for over 9 years, advising on a broad range of major corporate transactions. In this position she primarily advises on corporate governance related matters. She was involved in setting up a new and transparent corporate governance structure for ABN AMRO in 2010 and advised on the development of a program of lifelong learning for both the Managing Board and Supervisory Board. In addition, she is a member of the working group of the Dutch Association of Banks (Nederlandse Vereniging van Banken) that drafted the Dutch Banking Code that became effective in January 2010. In her role as in-house legal counsel she specialized in corporate law, corporate governance and financial recovery & restructuring and managed a team of lawyers that was directly responsible for all legal matters relating to the legal demerger of ABN AMRO resulting from its take-over by a consortium of banks in 2007.

Astrid Belgrave holds a senior position at the Dutch Tax Office. She is part of the core team responsible for Financial Institutions. Her responsibilities include Horizontal Supervision, Tax Control Framework, profit tax and sales tax. She is also a project team member for Soft Controls. This team is investigating the relevance of Soft Controls within Horizontal Supervision. Her career includes 15 years of experience in (International) Financial Services. She held a manager's position at ING Group, based in Curaçao, Netherlands Antilles and also a manager's position at ING Group, based in Amsterdam, the Netherlands. Astrid is a chartered accountant. She serves as a member of the Advisory Group of Diversity of the Tax Office. On top of this Astrid is also a board member of the nationwide Federation of Dutch Business Women.

Nicolette Loonen-van Es is senior manager Advisory at KPMG Performance and Technology. In this role she has set up an advisory unit for Diversity Management, focusing on advising clients how to implement good diversity policies and procedures and helping them to develop an inclusive organisational culture where diversity prospers. She has broad experience with Behavioural Change Management and diversity-related culture programmes. Before this function she worked as an external auditor in the financial services industry for 15 years at KPMG, where she focused primarily on insurance companies and pension funds. Besides her role as adviser, Nicolette Loonen-van Es is also the chairwoman of the Female Capital Network at KPMG and the chairwoman of the Women in Financial Services Network (WIFS) in the Netherlands.

Dr. Mijntje Lückerath-Rovers is associate professor, Financial Markets and Supervision, at the Erasmus University Rotterdam, board member of the Erasmus Institute, Monitoring and Compliance and a Supervisory Board member with the largest Dutch sustainable bank. Until 2001 she worked with Rabobank International, in her last assignment as vice-president Project Finance. Her PhD research concerned the decision usefulness of operating lease disclosures but since 2007 her research primarily concerns behavioural aspects of corporate governance. Besides several scientific articles on this subject, she is also the author of the annual Dutch Female Board Index and co-author of the annual Dutch Non-Executive Directors Survey (more than 400 respondents) and of a Code of Conduct for non-executive directors.

Bartje Schotman-Kruiten recently joined ING Group as Chief Credit Officer Issuer Risk. Before joining ING in 2010, she worked at ABN AMRO Bank for over 16 years in various managerial positions, both in the commercial area as well as in risk management. Amongst others she has been responsible for developing the Internal Capital Adequacy and Assessment Process for ABN AMRO Bank. In her last position at ABN AMRO she was executive director corporate lending responsible for a loan portfolio of EUR 42 million.

Daniella Strik is a lawyer and partner of the international law firm Linklaters LLP. She heads the firm's litigation and arbitration group in the Netherlands. Daniella represents clients in disputes in the area of corporate law and banking and regularly advises clients on corporate governance issues. She engages in the academic debate by writing articles and lecturing. In 2009 she wrote a publication on liability for risk management failures and in 2010 her PhD thesis on directors' liability was published (Principles of directors' liability – A tailored suit for the board room). Daniella is recommended for dispute resolution in the Netherlands in *PLC's Cross Border Dispute Resolution Handbook*, *Chambers Europe's Leading Lawyers for business* and *The Legal 500*.

Gwendolyn van Tunen is the company secretary of ABN AMRO. She has experienced at first hand the take-over by a consortium of banks, the demerger of ABN AMRO and the merger with Fortis Bank (the Netherlands). She has worked with three different Boards of Directors in four years time, which she has advised on the appropriate corporate governance structures. Next to her role as company secretary she is the corporate governance counsel to the bank advising, amongst others, on the implementation of applicable corporate governance codes. Gwendolyn has experience as (Operational) Auditor at Corus, a Dutch Social Security institution and Philips. In 1997, she joined ABN AMRO where she held a variety of management positions in different business units of the bank. Next to her activities at ABN AMRO, Gwendolyn has worked as lecturer and course coordinator at the University of Amsterdam (now the Amsterdam Business School) where she lectured Management, Control & Governance for postgraduate students. At present, she facilitates workshops at the Governance University for the programme "the Professional Secretary to Managing and Supervisory Boards / Company Secretary".

Chantal Verkooy is manager Advisory at KPMG Forensic & Integrity. In this role she provides services in the area of soft controls, integrity, behavioural compliance, anti money laundering (AML) and anti bribery & corruption (AB&C), with a focus on the financial and real estate sector. Chantal has a broad experience with measuring and auditing soft controls. She provides practical advice to auditors (external and internal) and compliance officers how to integrate soft controls in their (audit) approach and delivers training in this area. Chantal advise organizations how to improve soft controls and help them raising awareness and change behaviour in the field of integrity and on compliance topics such as AB&C. She is an active member of the KPMG Trust team and KPMG global AML team. Chantal is a chartered accountant. Before joining KPMG, Chantal worked as an internal auditor with ING Group and in the external audit practice of PricewaterhouseCoopers.

Mirella Visser LLM is managing director of the Centre for Inclusive Leadership (2004), which aims at developing new leadership styles. She serves on various Supervisory and Advisory boards (including Royal Swets & Zeitlinger, European Leadership Platform). Her career includes 18 years of experience in international financial services. She held senior management positions at ING Group based in Hong Kong (regional director South East Asia) and KPMG (post-merger integrations financial services companies). She is author of "The Silk Road to the Top" (in Dutch; 2009) and "Women on Boards, Moving Mountains" (in English; 2007). Her English book "The Female Leadership Paradox" will be published in early 2011. For her work in promoting women's leadership, she was nominated among Europe's 50 most influential thinkers ("European of the Year") in 2007 by European Voice (the Economist). She is currently assisting the European Commission Equality Unit on the topic of women and decision-making in politics and the economy.

Marijn Wiersma is a social and environmental specialist for the financial sector at FMO, the Dutch Development Bank. She has fifteen years of international experience mainly in Africa and Latin America; having worked for the United Nations World Food Programme and for PharmAccess International. She adds value to the institutions she works for by creative problem solving, bringing different parties together and working from a concept of mutual benefit. Marijn is one of the co-founders of FIER (financial institutions enhancing responsibility), a Dutch group of bankers whose objective is to restore pride in the banking sector following the 2008 crisis.