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MINISTER FOR ECONOMIC AND BUSINESS AFFAIRS

Green Paper - Corporate governance in financial institutions and remuneration policies

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General comments

The Danish government welcomes the initiative by the European Commission to review the adequacy of the corporate governance regulatory framework. The Danish government agrees that a sound corporate governance framework could enhance the stability of financial institutions and the financial system.

The Danish government finds, however, that the European Commission should await the outcome of the changes to the European supervisory framework as well as Solvency II and changes to the Capital Requirements Directive, e.g. CRDIII, which the European Commission has already initiated regarding remuneration, risk management and the role of supervisory authorities to ensure consistency and a smooth process.

As regards remuneration policies the Danish government stresses the importance of ensuring a responsible remuneration policy in financial institutions. Therefore, the Danish government has already taken steps to implement the revised capital requirements directive in this field.

At this stage of the process, the Danish government would recommend that the European Commission focuses on the role and composition of the board of directors (non-executive directors). Principles of diversity and competency should be at the core of the decisions when appointing the board of directors (non-executive directors).

The Danish government would urge the European Commission to consider the responsibility of the board of directors (non-executive directors) in subsidiaries as well and finds that subsidiaries should not be allowed to delegate this responsibility to the board of directors at group level. In general only focusing on the financial group level could be problematic when implementing the new corporate governance framework.

The Danish government finds that the main focus of corporate governance regulation should be the responsibility of the management of financial institutions instead of the financial authorities' supervision of the institutions.

The business areas of the financial institutions are of a great variety and complexity which means that it is the core assignment for the management to obtain the necessary level of skill and experience to be able to manage the institution in a responsible way.

The Danish government finds that this objective most suitably is obtained by a heightening of the managements' knowledge of and compliance with their duties as management on all levels and not by an increase of supervision from financial authorities. In order to ensure this it is important to improve the implementation of corporate governance principles and recommendations within the management of the institutions.

More specifically the Danish government finds that annual meetings, if not required more often, of the board of Directors (non-executive directors) with the focus of identifying and handling of risks for the year to come and an annual evaluation of the composition of the board of directors (non-executive directors) and the experience and skills of the day to day management is a fine initiative towards ensuring that any foreseeable risks will be evaded.

Specific comments

1. Board of directors (non-executive directors)

The Danish government welcomes the European Commission's initiatives to ensure a sound regulatory framework for the composition and role of the board of directors (non-executive directors). The Danish government agrees with the European Commission that principles of diversity and competency should be at the core of the decisions to appoint members to the board of directors (non-executive directors). The government also agrees that more women and individuals with different backgrounds in the board of directors (non-executive directors) could improve the efficiency of boards.

However, generally it would not be suitable to formulate detailed requirements regarding the role and composition of the board of directors (non-executive directors). This is due to the fact that business areas of institutions are of varying size and complexity and thus the requirements should reflect these differences. As an example the European Commission's proposal to make external evaluations of the board of directors (non-executive directors) compulsory should rather be optional for institutions. As should the establishment of risk committees on the board. The relevance of both external evaluations and risk committees would depend on the size, complexity and organisation of the institution. The Danish FSA recommends that the management of a financial institution annually initiates an internal evaluation of the experience and skills of the management in correlation with the future challenges of the institution.

Also the Danish government agrees that the division of responsibilities between senior management (executive directors) and the board of directors (non-executive directors) as well as the adequate independency of the board of directors (non-executive directors) is essential. Therefore, the government also finds that it should be prohibited to combine the functions of chairman of the board of directors (non-executive directors) and chief executive officer to ensure the independence of the board of directors (non-executive directors).

Further, the Danish government does not expect it will be effective to make it mandatory to transfer responsibilities from senior management (executive directors) to the board of directors (non-executive directors). As an example, daily risk management decisions and product development do not necessitate the involvement of the board of directors (non-executive directors), which should rather pursue a more strategic role. Also, it seems most effective that risk managers keep reporting directly to senior management (executive directors).

The Danish government agrees that sufficient time devotion is crucial for the well functioning of a board and therefore the number of boards on which a director may sit should be a criterion that should not be neglected when the competency of a potential board member is considered. The Danish government finds, however, that a strict limit on the number of boards will not obtain the intended purpose. Rather, both the number and scope of boards that a potential director sits on should be considered as well as other time constraints the potential director might have. This necessitates a qualitative evaluation of the potential director's time schedule rather than simply setting a strict limit.

In terms of external communication requirements, the Danish government finds that a risk control declaration is not needed. On the other hand, the Danish government very much agrees with the European Commission that institutions should inform the relevant supervisory authorities of risks, which are fundamental and material, whereas the daily risk management should not be subject to this requirement.

2. Risk management

As stated in our general comments, the Danish government finds that the European Commission should await the outcome of Solvency II and the changes to the Capital Requirements Directive that the European Commission has already initiated regarding risk management to ensure consistency and a smooth process. Please also refer to our comments above under paragraph 1 regarding risk management.

3. The role of auditors

The Danish government finds that it will be useful to analyse how best to articulate the existing cooperation between auditors and supervisory authorities and to examine the need for an adequate European legal framework. The Danish government would like to share a few of the Danish experiences in this regard below.

The experience of the Danish government is that there is already an effective ongoing dialogue and cooperation between the FSA and the auditors, including a formal forum of auditors and supervisors meeting regularly to discuss new legislative initiatives. At the same time the division of responsibilities between the supervisory authorities and auditors should not be neglected, since a blurred division would be problematic.

The Danish government further receives a copy of the long form audit report to the board of directors (non-executive directors) and further information at request. Also, a Danish whistleblower mechanism for auditors is implemented, but very seldom applied.

According to the international financial reporting standards (IFRS) and Danish reporting standards for financial institutions, a description of financial risks has to be included in the financial statements of institutions and is therefore audited. Therefore, the Danish government does not find that there is an immediate need to extend the role of auditors to risk-related financial information that is not part of the financial statements.

4. The role of supervisory authorities

As stated in our general comments, the Danish government finds that the European Commission should await the outcome of the changes to the European supervisory framework.

As a part of the latest amendment of the Danish Financial Business Act the regulation regarding fit & proper evaluation of the members of an institution's management was tightened up. All members of the management will be evaluated in accordance with the regulations in connection with their entering of the management and during their time of service on the management.

The purpose of the fit & proper regulation is to prevent members of the management who do not have the necessary experience and skills and/or who may have a resume which makes them unfit for the position as member of the management.

Also the regulation enables the Danish FSA to order a member of the Board of Directors (non-executive directors) to resign from his or her position, if the person no longer complies with the regulation of fit and proper. If the person in question refuses to resign the Danish FSA is enabled to order the institution to dismiss the person in question.

The regulation regarding fit & proper is a very valuable opportunity in the work to ensure that the members of the management are conscious of their responsibility of the institution's compliance with corporate governance as well as other relevant legislation.

On the basis of the above mentioned the Danish government finds that the existing regulation is sufficient with regard to actual legislation and that any further regulation should be in the form of soft law and corporate governance recommendations.

5. The role of shareholders

The Danish government welcomes that the role of shareholders is considered as part of governance issues, since shareholders as owners are essential stakeholders in ensuring sound governance principles. The Danish government agrees with the European Commission that shareholders should be involved in the corporate governance of an institution.

However, the Danish government finds that shareholders should not be imposed certain standards, such as the International Corporate Governance Network. The standards are meant to be voluntary and will most likely be most effective if chosen by shareholders on a voluntary basis. As stated initially, the Danish government finds, however, that it could be relevant to encourage institutions to set the governance standards on the agenda of a general assembly to allow for shareholders' input.

Regarding the disclosure requirements, the Danish government finds that the initiatives proposed seem extensive and could in some cases be counterproductive, for example a shareholder's vote is in certain cases subject to confidentiality.

6. Effective implementation of corporate governance principles

As mentioned in our general comments the Danish government finds that the purpose of the European Commission's green paper is best obtained by an improvement of the corporate governance regulation in the form of recommendations instead of a detailed legislation and increase of supervision from the financial authorities.

Therefore it is crucial to find ways to improve the knowledge of the corporate governance recommendations within the institutions' managements and the Danish government finds that one of the objects of the future work from the European Commission should be with the focus of improving the implementation of existing and new recommendations.

Also it should be noted that the members of the management is recruited to lead the financial institutions and an increase of the supervision may challenge the management's inclination to do their job. Therefore it is very important to emphasize that the responsibility in the end lies with the management and they should be left with the necessary room for manoeuvre.

The knowledge of corporate governance regulation could be improved by increasing the number of institutions who are subject to a principle of "comply or explain".

7. Remuneration

As stated in our general comments, the Danish government finds it important that the European Commission awaits the outcome and implementation of the initiatives that the European Commission has already commenced i.e. the revision of the capital requirements directive (CRD III) before further initiatives are presented.

In Denmark a broad political agreement on the implementation of CRD III as regards remuneration policies has just been reached. The political agreement i.e. prescribes that the general meeting of shareholders will have a say on the financial institutions remuneration policy including guidelines on performance pay and severance packages.

The agreement also ensures that the main organisations representing the financial sector agrees on a binding code on remuneration policy in the financial sector with the aim of ensuring a remuneration policy which promotes efficient and responsible risk management and does not encourage excessive risk taking. The code should i.e. include a provision ensuring that financial institutions should make public the salaries of individual (executive and non-executive) directors.

Furthermore, for the board of directors (executive and non-executive) the following shall apply:

- a cap for variable remuneration at 50 percent of the non-variable remuneration
- stock options or similar instruments may only comprise 25 % of variable remuneration,
- at least 40 percent of variable remuneration (and at least 60 percent for larger variable payouts) is deferred for 4 years.

The agreement also prescribes that the board of directors in a financial institution receiving public support is subject to a cap on variable remuneration at 20 percent of non-variable remuneration. In addition there will be a ban on new stock option programmes or the continuation of existing programmes in institutions receiving public support.

The Danish Financial Supervisory Authority is empowered to supervise the remuneration policies of financial institutions with the aim of ensuring that they have in place a remuneration policy which promotes efficient and responsible risk management.