

Corporate Governance

Prudential Policy Unit,
International Credit Institutions,
Financial Regulator,
PO Box 9138,
College Green,
Dublin 2.

30 June 2010.

Re: Response to Consultation Paper CP 41 – Corporate Governance Requirements for Credit Institutions and Insurance Undertakings issued by Financial Regulator (FR)

Dear Sir/Madam,

Firstly, we would like to welcome the opportunity given to members of the financial and insurance business community in Ireland to provide comment on your governance paper, CP41. At Deloitte we feel that a comprehensive and thorough paper will be a valuable tool for credit institutions and insurance undertakings in designing their requirements for corporate governance frameworks.

As part of our review of the consultation paper we sought input from our clients and also consulted widely within the Deloitte network of international firms.

The matters set out in this letter represent a collection of the feedback we received.

Our comments are set out in two parts. Part A includes comments on the conceptual framework presented in CP41. Part B represents detailed comments on individual aspects of CP41 as currently drafted. At your request we include where possible the rationale for comments made.

PART A: CONCEPTUAL FRAMEWORK A WIDER PERSPECTIVE

Corporate Governance requirements apply to all corporate entities across all industries. A fundamental question arises as to whether in Ireland we should have individual corporate governance frameworks for industries or instead a framework for all sectors with provisions for proportionate application based on size, risk and specific other factors.

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The review of corporate governance at this point arises as a response to failures of the past. Whilst it is clear that financial institutions must bear a significant element of the criticism, it is also true that governance weaknesses at customers of financial institutions also existed. We understand however that in the absence of a general code, the Financial Regulator needs to take a lead.

As financial services in Ireland is a small part of an open global financial services industry it is paramount that we operate within, and are consistent with, relevant codes and practices in place or being developed across other related jurisdictions and EU bodies. Therefore CP41 needs to be benchmarked with the EU Commission's Green Paper on "Corporate governance in financial institutions and remuneration policies". We note that a core principle of that framework is that the principles in the Green Paper focus primarily on large financial institutions and the principles should be adapted so as to be applied effectively to smaller institutions.

The Drivers of this Review and the Rational for Widespread Change

Corporate Governance weakness and failure in financial institutions have had a role in the current crisis. However there are (over 200) companies which will come within the scope of the new requirements set out in CP41. A question arises as to whether in a risk based structure, significant change in governance is required for the vast majority of entities. The paper does not indicate how many and in what segments the failures arose and thus does not justify applying such major change to all regulated entities.

Furthermore, no regulatory or industry impact assessment appears to have been undertaken.

As a result, indiscriminate changes may have unintended consequences on the financial services sectors in Ireland. This will impact on the industry but also on the role and resourcing requirements within the Financial Regulator. In the absence of a stratified approach, the volume of extraneous returns, declarations and requests for derogations may become unmanageable for both the respondent and the Financial Regulator. This may push the regime far from the intended risk based approach to regulation. While the paper recognises the need for a proportionate application of standards based on size and risk profile of each entity, it also recognises that a singularly applied framework is not appropriate. However this proportionality is not set out in the proposed framework.

Three alternatives are therefore suggested;

- (1) Implement a new framework with an initial focus on high risk/complex and large entities only.
- (2) Provide a tiered framework with a scoring system for entities allowing them to classify their institution into for example high/medium/low categories, with different levels of governance rules for each category. (e.g. 12 meetings required in the high category but 3 as a minimum in the low category)
- (3) Present a 'comply or explain' regime which would allow entities of lower risk/complexity explain why certain provisions of a general framework have not been complied with.

Deloitte and the stakeholders who we engaged with felt that these explicit approaches should be strongly considered if a one size fits all approach is to be applied.

Overall, the level of interactions that may be created from a number of the requirements set out in the consultation paper would be a significant operational burden on the Financial Regulator which would distract it from other more significant roles.

Finally, in relation to International Financial Services entities, if such entities were constantly seeking derogations or to be regularly in non compliance with governance provisions designed for more complex/higher risk domestic entities, such reputational issues would be viewed with great concern and perhaps misunderstanding by Group Compliance Officers and Boards, resulting in a risk of a reduction in the level of activity placed in Ireland or withdrawal completely from Ireland.

The Role of the Shareholder

The Code of Corporate Governance must make explicit provisions for the role of the shareholder. For Irish regulated entities these will include retail, institutional domestic group and international group shareholders. Different requirements would apply to each category.

CP41 makes little reference to the role of the shareholder. Therefore there needs to be a broadening of the framework to include, for example;

- Communications with shareholders
- Voting by shareholder
- Application of group practices/regulations (as mandated by a group shareholder)

Conclusion

From the review of the conceptual framework we recommend that a:

- Benchmarking to ensure consistency with EU developments be undertaken
- Review of the structure of the document be performed to identify areas that could be deemed guidance or best practice and areas of the documented framework which would be rules based
- Regulatory impact assessment be presented
- Clear framework for categorisation of entities with a linked tiered implementation framework for governance obligations be drafted
- Consultation with parent companies of major international financial services groups be undertaken
- Broadening of framework to include the role of the shareholder

PART B : DETAILED COMMENTS AND OBSERVATIONS

This part of our response takes individual provisions of CP41 and documents comments on those provisions.

Question / Rationale	Comments
<p>21.0 Compliance Statement</p> <p>Section 21.1 requires each institution to submit an annual compliance statement specifying in accordance with any relevant guideline whether the institution has complied with “These” regulations during the period to which the statement relates.</p> <p><i>{Rationale too broad/unclear}</i></p>	<p>From a review of codes issued by other countries (list attached at Appendix 1), this does not appear to be a regulatory requirement for other countries. Respondents ask the Financial Regulator to consider clarifying whether the compliance statement to compliance with CP41 only.</p> <p>More significantly it was felt that further guidance on the process for content of the Compliance statement would be welcome, by the industry before implementation.</p> <p>In particular it is felt that a statement that an entity has undertaken all reasonable endeavours designed to ensure compliance rather than a fully compliant statement would be requested.</p>
<p>The Role of the Shareholder in Corporate Governance</p> <p>It was felt that further details should be included in CP41 on the role of the shareholder in financial institutions.</p> <p><i>{Rationale; to make consistent with other equivalent Codes}</i></p>	<p>The Financial Regulator is asked to consider including wording on the role of shareholders and their rights in CP41, specifically on areas such as how they should communicate with the Board at general meetings and to also include specific AGM requirements for shareholders.</p> <p>It was found, from a review of the codes from jurisdictions outlined in Appendix I, that some jurisdictions allow for a formal policy for shareholders to communicate with the Board at general meetings or to strengthen their cooperation through the creation of discussion platforms.</p>

Question / Rationale	Comments
<p>4.0 Composition of the Board</p> <p>Section 4.3 notes that ‘An institution shall ensure a majority of its directors are reasonably available to meet the Financial Regulator at short notice, if so required’.</p> <p><i>{Rationale: Unsympathetic to international groups}</i></p>	<p>We understand that short notice is deemed to be 24 hours notice.</p> <p>Without provision for conference calls, we would consider this timeframe of 24 hours notice to be unyielding and would ask the Financial Regulator to consider five working days to be an acceptable timeframe unless exceptional circumstances dictate a shorter timeframe. An indication of ‘exceptional circumstances’ should also be explained in CP41.</p>
<p>11.0 Meetings</p> <p>Section 11.1 requires that a Board shall meet at least once each calendar month, noting the exemption for a Board of an institution with lesser scope and low risk profile to meet less frequently than one calendar month once the Financial Regulator has given its prior written consent.</p> <p><i>{Rationale: Quantitative rather than qualitative. Disproportionate in lower risk entities.}</i></p>	<p>It is felt that the requirement to hold twelve meetings per annum is excessive for financial institutions and insurance undertakings and we would ask the Financial Regulator to reconsider its position on this requirement to reduce the requirement to a lesser number of meetings per annum for all financial institutions and insurance undertakings. To ensure sufficient time is given to all relevant topics, a requirement on Boards for an agenda calendar might be considered.</p>
<p>3.0 General Requirements</p> <p>Specifically 3.7 Any director who has any concern about the overall corporate governance of an institution shall report these concerns promptly to the Financial Regulator.</p> <p><i>{Rationale: Classification on the consistency with company law required.}</i></p>	<p>Directors have a duty of care to the company. One would expect that reporting would primarily be done by the company and that any obligation on individual directors be clarified.</p>
<p>4.0 Composition of the Board</p> <p>Specifically 4.4 – Each member of the Board shall have sufficient time to devote to the role of director and associated responsibilities. This is particularly important in the case of non executive directors. The Board shall indicate a time commitment expected from directors in letters of appointment.</p> <p><i>{Rational –Further classification on amount of time}</i></p>	<p>The Financial Regulator should consider timeframes relevant to the scale of the operations of the entity.</p>

Question / Rationale	Comments
<i>to be spent required. }</i>	
<p>9.0 Appointments Specifically 9.3 The Board shall be responsible for appointing non-executive directors and the Board shall ensure that non-executive directors are given adequate training about the operations and performance of the institution. The Board shall routinely update the training as necessary to ensure that they can make informed decisions.</p>	<p>Should the Financial Regulator consider providing guidance as to 'adequate training' and as to what level of training non executives are given and should this training also be expected of directors of the Board also.</p>
<p>4.0 Composition of the Board Specifically 4.5 and 4.6 The number of directorships held by directors of institutions shall be limited. The Financial Regulator requires that the number of directorships of credit institutions and insurance undertakings held by a director shall not exceed three.</p> <p>4.6 – When directorships are held outside of credit institutions and insurance undertakings, the Financial Regulator considers that an individual holding more than 5 directors creates rebuttable.....</p>	<p>The absolute restriction of three directorships contained in Section 4.5 does not take into account the personal circumstances of the directors or the existence or absence of time commitments. There are a limited number of directors in Ireland who have the experience necessary for such a role and by restricting the number of directorships an individual may hold, it may increase the expense for companies due to the difficulties in finding directors who can fulfil the role.</p> <p>This will also increase the remuneration for directors of high calibre and companies of lesser economic resources will not be in a position to attract Non Executive Directors to the role, thus creating a two tiered system whereby only the largest firms can afford the highest calibre of directors.</p>
<p>4.0 Composition of the Board. Specifically 4.1 The Board of an institution shall have a minimum of five directors and shall be of sufficient size and expertise to oversee adequately the operations of the institution. For major institutions, a larger board maybe more appropriate. The Board shall have a majority of independent non executive directors.</p>	<p>Whilst the requirement to have a majority of independent non executive directors will not pose any difficulties for larger independent institutions, would you consider that it may act as a disincentive to the large number of international firms who have a subsidiary in Ireland due to the potential difficulties in sourcing the appropriate number of candidates</p>

Question / Rationale	Comments
	<p>suitable to fill the non executive roles on their board.</p> <p>Secondly, there are a large number of professional full time non executive directors in Ireland who would have enough time to work with more than three institutions. In light of the above, perhaps you may consider expanding the number of directorships individuals who meet the above criteria may hold.</p>
<p>5.0 Chairman Specifically on the following points:</p> <p>5.5 – The Chairman shall be an independent non executive director.</p> <p>5.7 – The Chairman of the Board shall be proposed for re-election or reappointment on an annual basis.</p> <p>Section 5.10 – The Chairman shall not hold the position of Chairman or CEO of a credit institution or insurance undertaking for more than one institution at a time.</p> <p>5.3 – The Chairman shall have a financial background or maybe required to undertake relevant training and timely comprehensive training.</p>	<p>Whilst it is intended to apply the provisions of CP41 to ‘all credit institutions and insurers licensed or authorised by the Financial Regulator’, It would seem unnecessary to apply these rigorous standards to a Chairman of a company owned by larger financial services groups. The role of Chairman in the majority of international subsidiaries is taken by a representative of the parent company. The requirement for independence (as in 5.6) would cause difficulties for such firms. We would suggest applying these rigorous standards in respect of a Chairman to a major institution only. The word ‘major’ is used in CP41 but is not defined in the proposal document. A definition of ‘major’ would be beneficial to the Industry.</p> <p>With regard to the Chairman having a financial background, can you please clarify if you require the chairman to be a qualified accountant? As CP41 covers both credit institutions and insurers, an accounting qualification may not be essential for a chairman of a reinsurance/insurance company.</p> <p>Could you please clarify in the proposal the circumstances in which a Chairman may be required to undertake relevant and comprehensive training.</p> <p>With respect to the re-election of a Chairman on a yearly basis (5.7), this appears to be rather cumbersome for smaller institutions/international</p>

Question / Rationale	Comments
	subsidiaries and we would suggest that it is clarified that this principle applies to 'major' institutions only.
Remuneration, Audit, Risk and Nomination Committee to be established.	<p>Whilst, we note that it is necessary to have committees established, our delegates raised a number of important points as follows;</p> <p>For smaller firms, is it necessary to have separate nomination and remuneration committees?</p> <p>Secondly, for certain sectors, is there a possibility that some of these committees may be merged together.</p>

We believe that a corporate governance code for entities operating in Ireland is both welcome and necessary in light of the recent developments. Whilst this was not disputed by our delegate stakeholders, one of the main comments which our delegates wanted to convey was that there should be a greater element of proportionality noted for Credit Institutions and Insurance Undertakings in CP41.

We understand that the closing date is 30 June 2010 and we look forward to receiving a response from the Consultation Team in due course. To this end we would welcome the opportunity to engage further with you on this matter.

Yours faithfully,



DELOITTE & TOUCHE

APPENDIX I

UK :	'The Combined Code on Corporate Governance', (revised 2008)
Germany:	German Corporate Governance Code' (June, 2009)
Switzerland:	'Swiss Code of Best Practice for Corporate Governance' (published July 2002 and updated in 2007)
Austria:	'Austrian Code of Corporate Governance' (2010)
Poland:	'Code of Best Practice for WSE Limited Companies' (2007)
Sweden:	'The Swedish Code of Corporate Governance' (2010)
Denmark:	'Revised Recommendations for Corporate Governance in Denmark') 2010
Finland:	'Finnish Corporate Governance Code' (2008)
Norway:	'The Norwegian Code of Practice for Corporate Governance' (2009)
USA:	'Final NYSE Corporate Governance Rules' (2003) and 'Key Agreed Principles to strengthen Corporate Governance for US Publicly Traded Companies' (2008)
Spain:	Unified Good Governance Code' (2006)
France:	' Recommendations on Corporate Governance' (2010)
Netherlands:	'Dutch Corporate Governance Code' (2008)
Belgium:	'The 2009 Belgian Code on Corporate Governance' (2009)