

Nordic Financial Unions

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NFU reply to the Basel Committee Guidelines on Corporate governance principles for banks

Main points

- The guidelines should promote employee representatives in company boards
- The guidelines should emphasize whistle-blowing systems as a key feature to prevent future crisis
- In principle, to reduce or reverse any compensation should not be a tool to handle risks by a company. Furthermore, the responsibility to ensure that internal policies and legal requirements are followed should be on the employer, not the employee

General remarks

NFU welcomes the opportunity to the Basel Committee's consultative document on the guidelines for corporate governance principle for banks. In light of the recent crises, corporate governance is indeed a vital tool to curb harmful short-termism and excessive risk-taking.

The problem with weak corporate governance is at the heart of the financial crisis. It is also central for long-term oriented businesses and economies.

The consultation and solutions proposed focus chiefly on prohibition. The means of reducing consumer risks should not be limited to prohibition of policies that create perverse incentives. It is equally important to seek the introduction of policies that create the proper incentives.

Increased effort should be made in order to seek mandatory mechanisms that make company objectives perform in line with interests of government and society as a whole.

Employees should be considered as a key stakeholder in corporate governance and the work to handle risks. The Guidelines in the consultative document should further promote the importance of employees. To further elaborate on appropriate whistle-blowing systems is crucial in this regard. To promote a role for employees in risk- and compensation committees as well as in boards is also important.

Diversity on the board of directors is a key issue in sound and long-term oriented corporate governance. The value of employee input in this context cannot be overestimated. Employees have a crucial part to play in corporate governance, either as members of the board or as providers of information to the board. It is of utmost importance that any legislation or guidelines in this area takes the employee dimension into account, not least from the perspective of systemic stability. Employees are an asset for any company, providing

experience, knowledge and expertise to corporate governance. Creating structures for employee involvement in the management of a company is a win-win measure that benefits all stakeholders.

Further remarks on how to create corporate guidelines that will ensure a more sustainable financial sector could for example be:

- Make sure that there are efforts made to stimulate research and innovation in order to generate more knowledge on how financial markets behave. This knowledge can be used to increase ethics in corporate governance
- Focus on sustainable investments. These products should be easily accessible to the consumers
- Companies must look at the consequences of their corporate guidelines both for society as a whole and their employees
- Banks must invest in their employees in order to obtain long-term wealth creation. These principles should be applied to all actors in the financial sector

Introduction

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Employees have an important role to play in supporting a strong risk culture in the organisation. This should of course be fulfilled by a close and constructive dialogue between management and the employees. There is a need to promote good constructive dialog between management and the employees through formal structures. Constructive cooperation between management and elected union representatives on boards is conditional upon knowledge and understanding on both sides. The elected representatives to the boards have considerable knowledge on the day-to-day operations that takes place in the enterprise. This dialogue could be realised within formal structures, e.g. by employee representatives in boards and risk- and compensation committees and in similar functions.

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NFU would like to introduce a “fourth line of defence” in order to identify risks in the organisation – so called whistle-blowing systems. Appropriate whistle-blowing systems could work as a complement to the control functions that is mentioned in the consultation paper. For further information about such systems, see point 30 below.

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NFU strives for a “level playing field” on the financial markets. The same requirements should apply in all countries and for the same type of organisations, to avoid distortion of competition.

One of the key issues would be to identify a set of principles that companies could as a minimum be subject to. A certain element of flexibility (one of which may be the size of the company) could be built into these principles. These principles would represent a minimum level of compliance; Member States would be at liberty to implement more stringent requirements where they feel this is appropriate. The principles should also be subject to regular review and updating.

Furthermore, the growing financial shadow sector needs to be in the same scope of regulation as the established financial sector, otherwise a level playing field will not be a reality.

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NFU agrees that international governance principles should not advocate for any specific board or governance structure in terms of one-tier or two-tier structures. Different countries have different systems, an autonomy that is important to keep.

With that said, NFU would like to mention the advantages with the one-tier structure in order to show why it is so important not to restrict this structure. The one-tier system, as used in the Nordic countries, provides the company with valuable assets. The company gets an insight on how different issues are perceived from the employee perspective, and the employees get an overview on what the company is doing and how. An employee board-level representative can provide very valuable insights from a supervision perspective. He/she is not only involved in the decision-making of the company, but also has access to direct information on the situation in the company on the "shop floor", i.e. from the employee perspective. Also, being elected for the board by a different group of people than the rest of the board members, employee representation ensures a bigger versatility of independence in the board.

Principle 1: Board's overall responsibilities

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NFU is delighted to see the wordings stating that "Employees should be encouraged and able to communicate, confidentially and without the risk of reprisal, legitimate concerns about illegal, unethical or questionable practices." It is crucial that employees do not suffer from any reprisals or unfair treatment, to ensure this anonymity is key.

Secure channels for the reporting persons are the basis for protection against unfair treatment. The employees must feel secure that their identity is protected. Appropriate whistle-blowing systems should be that channel.

NFU has also held that the internal procedures can include the possibility to notify your employee representatives/trade union of potential infringements.

Competent authorities, for example national financial supervisory authorities (FSA), should also set up whistle-blowing systems. It is crucial that employees can report potential or actual

breaches to the competent authority without the requirement to report to the internal whistleblowing system first. The foremost reason why people do not chose to report potential or actual breaches is the fear of retaliation.

Regarding forms of unfair treatment as retaliation measures, we find that the most common ones are; dismissal, degradation, freeze in pay, ostracism, bullying at the work place and denial of development or promotion which would otherwise have been granted. Due to the problems of proving a connection between whistleblowing and unfair treatment it should be considered to reverse or ease the burden of proof in relation to the whistleblower. This is also known from several countries in relation to, e.g. unfair treatment of pregnant employees. Likewise, compensation must be sufficient to compensate the unfairly treated whistle blower, and at the same time deter employers from unfair treatment of whistleblowers.

With regard to this, it is important that financial institutions are prohibited to investigate who has made a report to the internal and/or external whistleblowing system.

Principle 2: Board qualifications and composition

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Regarding the balance of skills, diversity and expertise NFU would like to emphasize two important aspects that should be included in the wordings on board composition.

First of all, by a balance of skills, diversity and expertise, employee representatives are necessary stakeholder and this should be explicitly mentioned in the guidelines.

It is necessary to strengthen the role of management bodies of investment firms in ensuring sound and prudent management of the firms, the promotion of the integrity of the market and the interest of investors. The management body of an investment firm should at all times commit sufficient time and possess adequate knowledge, skills and experience to be able to understand the business of the investment firm and its main risk. To avoid group thinking and facilitate critical challenge, management boards of investment firms should be sufficiently diverse as regards age, gender, education and professional background to present a variety of views and experiences.

Employee representation in the management board, in view of their long-term interest in the sustainable management of the institution and because of their experience and knowledge of its internal structures, can contribute to this aim and thus to better risk management in the institution.

NFU has gained support of this view by the EU, and a result of that can be seen in the Markets in Financial Instruments Directive II (MiFID II), that states: *Employee representation in management bodies could also, by adding a key perspective and genuine knowledge of the internal workings of firms/institutions, be seen as a positive way of enhancing diversity.*

Similar wording can be seen in the Capital Requirements Directive IV (CRD IV).

Employees are the core of financial companies everywhere, and are the single most important factor for the success or failure of a financial institution. It's the employees that embody the corporate culture, business strategies, risk behaviour.

These qualities of the employees improve management decisions and thereby the company's (economic) performance, not least because of the long-termism encouraged by the employee perspective. Employee representation in company boards also gives the employees the possibility to be informed and consulted on the governance of the company, thereby ensuring work-life democracy.

The Nordic models for employee involvement and participation in the financial sectors are strong and efficient. At the same time, and maybe partially as a result, most Nordic banks and insurance companies withstood the financial crisis in a very solid manner. One of the reasons for this is the fact that the Nordic models for employee involvement in companies give optimal conditions for stability and long-term sustainability. Employees' views are taken into account and the employees share the responsibility of decisions with management.

Secondly, by a balance of diversity the gender issue must be addressed. Gender balance is of a particular importance to ensure adequate representation of demographical reality. NFU wants an equal balance between men and women in leading positions in the financial sector. In order to obtain this goal, conscious decisions need to be made when the issue of balanced gender representation in boards arises. We believe that gender balance will benefit both companies and the society as a whole.

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Regarding board member qualifications it is important to emphasize that the knowledge, skills and experience required should be on a collective basis, and should not hinder individuals that can give the board the necessary balance of skills, diversity and expertise. The educational and professional requirements must not lead to the exclusion of representatives of the social partners in the management structure.

Secondly, when it comes to ensuring that directors and board members have suitable skills and qualifications, it is not only a question of a selection process. It is also a matter of training. The board members', including employee board representatives, competencies must be continuously updated to fulfil any requirements that have been deemed appropriate or necessary for the task. NFU therefore strongly supports point 53 in the consultative document.

About board member selection, the employee board level representative should as a first choice be elected by employees' organizations or representatives, and as a second choice by the employees in general. This would ensure bigger versatility of independence in the board, which is a key factor for responsible corporate governance.

Principle 8: Risk communication

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NFU agrees that ongoing communication about risk issues is a key tenet of a strong risk culture. This communication should of course reach the employees on a continuous and formal basis.

Principle 11: Compensation

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NFU would like to highlight that remuneration policies do not necessary deal with the root of risk behaviour. It is rather about excessive sales targets, than about remuneration policies. It should be ensured that sales targets do not lead to incentives to sell a (more risky) product over another (less risky) product.

Excessive sales targets are a consequence of an excessive risk culture and short term perspective by certain companies. As mentioned above, NFU is of the opinion that a long term perspective should prevail in any financial institution, and employee representation in remuneration committees will be a mean to reach that goal.

That said, NFU believes that the issue of remuneration should be dealt with very carefully as this is one of national competence and culture. The issue of regulating remuneration is of particular interest to the Nordic countries, since this regulation may impose restrictions on the right to free collective bargaining which is unacceptable.

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In principle, to reduce or reverse any compensation should not be a tool to handle risks by a company. Risks should be dealt with on beforehand. Furthermore, the responsibility to ensure that internal policies and legal requirements are followed should not be moved from the employer side to the individual employee.

An employee that has followed the company's official or unofficial routines, rules, instructions or practices and thereby have failed to comply with legal requirements should not suffer from any sanctions, rather the employer needs to change its structure to handle future risks. The responsibility should be on the employer if routines, instructions, corporate culture, praxis, training, supervision or control are inadequate.

Furthermore, to be able to reduce and/or reverse compensation due to "erroneous assumptions" is too broad and must be changed in the guidelines.



It is the employer's responsibility to ensure that the individual employee has the adequate competences, is properly trained and has a thorough understanding of the internal policies and legal requirements. The employer should also be responsible to provide the individual employee with the resources and time needed to fulfill its task.

Furthermore, more focus should be on why there is a cause and need for commissions in remuneration policies. Bonuses are typically more prominent in positions dealing with decisions involving high risk. At the most extreme end are financial transactions with little effects on real value creation and close similarities to betting (zero-sum games).

In fact, it is the legality of activities involving skills but with similarities to betting in the financial world, that causes the need for bonus remuneration policies. Companies need to recruit a worker capable of beating the field, but cannot risk paying him a high salary if he or she fails. Therefore, while bonuses may lead to taking risks, it is just as true that allowing risks leads to the need for bonuses.

About NFU

Nordic Financial Unions (NFU) is the voice of the employees in the Nordic financial sectors. We are an organisation for co-operation between trade unions in the banking, finance and insurance sectors of the Nordic countries. Through our eight affiliated unions in Denmark, Sweden, Norway, Finland and Iceland we represent 150 000 members – a vast majority of the employees in the Nordic financial sectors. Together, we work for sustainable financial sectors.

Yours faithfully,

NORDIC FINANCIAL UNIONS (NFU)

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