

**CORPORATE GOVERNANCE AND THE CHALLENGE OF
INTEGRATING IRISH REQUIREMENTS WITH GROUP
STRUCTURES**

**TIM SCANLON
MATHESON ORMSBY PRENTICE
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CONTENTS

	Page No
1 General	3
2 The Consultation Paper	5
3 Scope of the Code	6
4 General Requirements	8
5 Composition of the Board	9
6 Number of Directorships	11
7 Chairman	13
8 Chief Executive Officer	15
9 Independent Non-Executive Directors	16
10 Role of the Board	17
11 Meetings	18
12 Committees of the Board	20
13 Audit Committee	21
14 Risk Committee	23
15 Annual Compliance Statement	24
16 Additional Obligations on Major Institutions	25

1 GENERAL

The Corporate Governance Code for Credit Institutions and Insurance Undertakings (the “Code”) was introduced in January 2011 and has been broadly welcomed as an important step in the enhancement of the corporate governance of credit institutions in Ireland.

The backdrop to the Code is unfortunately all too familiar. The domestic Irish banking system descended into crisis in 2008 and recovery is still some way off. The catastrophic lending practices of certain domestic institutions were the primary reason for the collapse and inevitably attention has turned to the governance structures and procedures in those institutions, which singularly failed to identify and address the risks which were being run.

The two major reports commissioned to investigate the reasons for the crisis identified governance failures as a contributory factor:

“The question can legitimately be asked as to how much difference more resolute action by the Central Bank would have made. At the micro-prudential level, a cap on property-related lending would have curbed the worst excesses.... accompanied by a more aggressive stance on governance in the case of one or more specific institutions.”¹

“It appears clear, however, that bank governance and risk management were weak- in some cases disastrously so. This contributed to the crisis through several channels. Credit risk controls failed to prevent severe concentrations in lending on property- including notably on commercial property- as well as high exposures to individual borrowers and a serious overdependence on wholesale funding. It appears that internal procedures were overridden, sometimes systematically. The systemic impact of the governance issues crystallised dramatically with the Government statements that accompanied that nationalisation of Anglo Irish Bank.”²

Ireland has also suffered significant reputational damage as a result of the fallout from the crisis. The picture which emerged in the aftermath was of a regulator which was overly passive in its dealings with certain institutions and of certain banks and building societies which had become institutionally arrogant, to the point of foolhardiness, in their business dealings. None of the parties with primary responsibility for oversight of the institutions in question (internally or externally) seem to have had any sense of the potentially seismic consequences of what they were doing. A complete systems failure ensued.

While equivalent problems emerged elsewhere throughout the world, the difference in Ireland has been the scale of the impact, which has left us with a banking system which is incapable of functioning without support from State and the ECB and a huge bill for fixing the problem which has necessitated a bailout from the IMF and the EU.

The Code can be seen in context therefore as a necessary step to address the very serious governance issues in the domestic institutions which were exposed by the crisis and as reputationally essential given the connection being made between a regulatory system which was avowedly “light touch” and regulated institutions which had been managed deficiently.

Matthew Elderfield has stated that the Central Bank consciously decided in the wake of the financial crisis that it did not simply want to match best corporate governance practice internationally but rather the Central Bank wanted to set a higher standard.³ The reasons

¹ The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008, A Report to the Minister for Finance by the Governor of the Central Bank, 31 May 2010

² A Preliminary Report on the Sources of Ireland’s Banking Crisis, Klaus Regling and Max Watson,

³ Address by Matthew Elderfield to the Association of Compliance Officers in Ireland, 22 November 2010

behind the desire to set the bar so high are readily apparent. Nevertheless, the Code needs to be workable and it is important to bear in mind that, while initiatives to raise governance standards generally are to be welcomed, the primary objective ought to be to ensure that institutions do not conduct their business so as to pose an undue risk to themselves or the system generally.

Putting in place a code which is more stringent than anything similar to be found elsewhere does not achieve this of itself. Creating a culture which places a high priority on maintaining governance standards is arguably more important and more likely to achieve the desired outcome. Mr Elderfield has indicated that the “spirit” of the Code is as important as the letter of the Code. The Code however sets out a multiplicity of requirements having the status of legislation and requires an annual statement that they have all been complied with. It also adopts a “one size fits all” approach to all institutions other than those classified as major institutions. The danger with this approach is that it may lead to a “box tick” attitude, where institutions are less focused on the appropriate governance requirements for their business and structure and more on whether the annual compliance statement can be signed off.

In this regard, an important difference between the Code and similar codes in other jurisdictions is that breach of it can constitute an offence. This is notwithstanding that it is not written as legislation and often speaks in generalities and abstract language. While it is expected that the administrative sanctions procedure will be more regularly used to deal with breaches, it is not clear where the dividing line is and institutions may have little option but to take a very conservative and literal approach to compliance. An alternative approach, which could perhaps have achieved a preferable balance, would have been to clearly identify core requirements where breach is likely to lead to criminal or administrative sanctions and to apply a “comply or explain” approach to the remainder.

It is also the practical reality that the domestic institutions have, in the circumstances, no standing to challenge whatever is required of them with respect to Governance. Irish subsidiaries of multinational financial services firms are not in the same position however and, as part of the consultative process initially and latterly as the Code has moved to the implementation stage, have legitimately questioned why they are being treated in the same way as domestic institutions under the Code. While a number of the key concerns of those institutions were addressed in the final version of the Code, concerns around certain provisions of the Code persist.

2 THE CONSULTATION PAPER

In April 2010 the Central Bank published Consultation Paper 41, “*Corporate Governance Requirements for Credit Institutions and Insurance Undertakings*” (the “**Consultation Paper**”). The Central Bank received over 130 responses to the Consultation Paper during the consultation process (the “**Consultation Process**”). One of the major concerns raised during the Consultation Process was that there was no specific delineation between domestic, systemically important credit institutions dealing with the retail public, and wholly owned, unlisted subsidiaries of multinational financial institutions (“**Subsidiaries**”). The Central Bank acknowledged some of the concerns raised during the Consultation Process by adjusting the standards set for Subsidiaries in the final draft of the Code.

We have set out below:

- (a) the key requirements contained in the Consultation Paper in respect of Subsidiaries;
- (b) certain key points made by stakeholders during the Consultation Process in respect of these requirements;
- (c) the requirements adopted in the Code; and
- (d) commentary on these requirements.

3 SCOPE OF THE CODE

3.1 Consultation Paper Requirement

The Central Bank considers that the requirements in this document are applicable to all credit institutions and insurance undertakings. Nevertheless, we recognise differences in the nature of business and risk characteristics of different institutions. The full extent of the requirements will apply to major institutions. Institutions with lesser economic significance and lower risk activities as well as those that are part of a larger financial services group within a comparable corporate governance framework will also be subject to the requirements but implementation will be applied proportionately.

Source: Section 1.4 of the Consultation Paper

A major institution is defined as an institution that has a sufficiently large presence on the local market or has large international activities.

Source: Section 1.5 of the Consultation Paper

3.2 Consultation Process

The majority of responses sought clarification on the definition of 'major institutions'. Similarly there were several requests for clarification on the principle of proportionality and how this would work in practice.

The Central Bank should expressly be given the flexibility to regulate and supervise each institution forming part of a cross-border financial services group, on the basis of an individual assessment of the regulatory needs of that institution in the context of its group circumstances, and to adapt as appropriate the application of the Code to such institutions. Express clarification as to the requirements which will not apply to institutions other than major institutions is required. Further clarity in respect of when an institution will be considered a major institution would assist institutions in being certain as to the applicability of the requirements.

Source: Matheson Ormsby Prentice

The Central Bank should provide a derogation from the requirements where there is a look-through to the corporate governance regimes of parent institutions. It is inappropriate to apply the same requirements to listed group entities and to wholly owned subsidiaries with few employees, little or no systemic risk, which are often highly capitalised. The requirements do not provide enough detail about what the proportionate requirements are for non-systemic institutions. Minimum standards should be set for all institutions and different standards should be set for major institutions on a case by case basis. For subsidiary institutions the requirements should be framed on a 'comply or explain' basis which is the approach used under the Combined Code.

The categorisation of 'institutions of lesser economic significance must be very clearly defined so as to provide certainty to subsidiary institutions that the full extent of the requirements do not apply. In this regard:

- (a) the categorisation of institutions of lesser economic significance should include reference to wholly-owned subsidiaries;
- (b) the meaning of "lesser economic significance" should be clarified, as should "smaller institutions or those involved in less complex business models";
- (c) the reference to "comparable corporate governance framework" should explicitly include the corporate governance frameworks of the EEA, the US, and Canada;
- (d) the reference in the definition of 'major institution' to "large international activities" should be clarified so as to encompass the international activities of the Irish-based institution only and to exclude any large international activities of group entities.

Source: Federation of International Banks in Ireland ("FIBI")

3.3 Code Requirements

The Code imposes minimum core standards upon all credit institutions and insurance undertakings licensed or authorised by the Central Bank. The Code imposes additional requirements upon entities which are designated as major institutions by the Central Bank (“**Major Institutions**”) so as to ensure that appropriate and robust corporate governance frameworks are in place and implemented to reflect the risk and nature of those institutions. There is no bar on institutions deciding to implement the additional requirements should they wish to do so and indeed institutions are encouraged to do so.¹

Source: Section 1.1 of the Code

Institutions will be informed in writing by the Central Bank where the Central Bank considers that they are a Major Institution for the purposes of the Code.

Source: Section 1.3 of the Code

A Major Institution is an institution that in the Central Bank’s view has any or all of the following features:

- (i) a significantly large presence in the local market; and/or
- (ii) carries on significant international activities outside the State; and/or
- (iii) is significant (including, but not limited to, by reference to size, substitutability and reputation).

Source: Section 2 of the Code

3.4 Commentary

Rather than seek to elaborate on what was meant by “lesser economic significance” or “lower risk activities” those phrases have been removed. Also, the approach decided upon was to apply a common set of standards to all institutions (but to make allowances on certain matters for Subsidiaries) and impose higher standards on certain institutions which the Central Bank considers to be major institutions. This approach is clearer and allows institutions to determine more precisely which provisions of the Code apply to them. This will be further assisted by the publication by the Central Bank of a “Frequently Asked Questions” document which is expected shortly. The downside perhaps is that the greater flexibility which might have been facilitated by the concept of “proportional “ application has been removed.

4 GENERAL REQUIREMENTS

4.1 Consultation Paper Requirement

An institution shall comply with these requirements on an individual basis. Accordingly while an institution may adopt policies or procedures developed at a group level, the institution shall satisfy itself that such policies or procedures meet all of these requirements.

Source: Section 3.8 of the Consultation Paper

4.2 Consultation Process

A significant distinction should be drawn, in the application of the requirements, as between domestic retail banks and Irish subsidiaries of cross-border financial services groups. The requirements should expressly recognise that institutions which are part of a cross-border financial services group are required to have regard in their operations to group context.

Source: Matheson Ormsby Prentice ("MOP")

Basel Committee Consultation on Principles for Enhanced Corporate Governance provides an example of how proportionate requirements should apply for subsidiary institutions. Principle Four allows for a lesser structure and obligations for the Board of a regulated subsidiary than for a group Board.

Source: FIBI

4.3 Code Requirements

An institution shall comply with the Code on an individual basis. Accordingly, while an institution may adopt policies or procedures developed at group level, the institution must satisfy itself that such policies or procedures meet all of the requirements of the Code.

Source: Section 6.8 of the Code

4.4 Commentary

Subsidiaries have a significant structural challenge in meeting the requirements of the Code, derived from the fact that they have relatively limited autonomy from their parents. This is in the nature of group structures and, for example, Principle 4 of the Basel Committee on Banking Supervision's "*Principles for enhancing Corporate Governance*" provides that, in general, the board of a regulated banking subsidiary should adhere to the corporate values and governance principles espoused by its parent company. There is nothing untoward or inherently risky in being structured in this fashion. It is simply not realistic to expect the Boards of Subsidiaries to adopt separate policies or procedures from those which have been adopted for use by a multinational across all of its businesses internationally. From the perspective of a multinational such regional autonomy potentially creates risk as it can weaken central management. A clear acceptance of this reality on the part of the Central Bank in implementing the Code would be welcome.

5 COMPOSITION OF THE BOARD

5.1 Consultation Paper Requirement

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 may be appropriate. The Board shall have a majority of independent non-executive directors (this may include the Chairman). The following exceptions apply:

- (a) Where an institution is a subsidiary of an entity regulated by the Central Bank, or an equivalent competent authority, the Board of the institution shall have a majority of non-executive directors, but they need not all be independent. They may include directors or senior management of group companies other than executives of the institution or its subsidiaries. However, in such cases there shall be an independent chairman and a balance between independent and other directors. Independent directors on the boards of other group companies may sit as independent directors on the board of an institution.
- (b) Where an institution is a subsidiary of an entity not regulated by the Central Bank, or an equivalent competent authority, independent directors on the boards of other group companies may sit as independent directors on the board of the institution.

Source: Section 4.1 of the Consultation Paper

5.2 Consultation Process

Employees from group banking institutions or publicly listed holding companies are independent of the management of the subsidiary and able to independently oversee the operations of the subsidiary. If the level of independence gives the impression to parent entities that they face a loss of control of their subsidiaries, this could provide an unacceptable barrier to firms locating or continuing to operate in Ireland.

Source: FIBI

It is not clear whether a sufficient number of appropriately qualified individuals exist to fulfil the independence requirement. It may be the case that less qualified or experienced individuals become directors, given a limited pool of suitably qualified individuals, an outcome at odds with the intention to achieve the highest standards of governance. The restriction on the number of directorships should be removed from the Code. Alternatively, any directorships above the prescribed number should be subject to approval of the Central Bank.

Source: FIBI

5.3 Code Requirements

The majority of the board shall be independent non-executive directors (this may include the Chairman). However in the case of institutions that are subsidiaries of groups the majority of the board may be group non-executive directors, provided that in all cases the subsidiary institution shall have at least two independent non-executive directors or such greater number as required by the Central Bank. Group directors are required to act critically and independently so as to exercise objective and independent judgement.

Source: Section 7.2 of the Code

5.4 Commentary

The clarification as to the requirements in this regard is welcome. There is clearly however a lingering concern that “Group Directors” will in some way be compromised by their relationship to the parent. They are required to act “independently” and to exercise “independent judgement”. Independence in this regard presumably means independently of the institution concerned because it would be simply unworkable for it to mean independently of the group generally. These directors are nonetheless likely to be executives of other entities in the group or directors of those entities. As such their perspective on the business of the institution in

question is quite different from an independent director external to the Group. That is entirely normal and will hopefully be acknowledged and accepted by the Central Bank.

6 NUMBER OF DIRECTORSHIPS

6.1 Consultation Paper Requirement

Directorships of Credit Institutions and Insurance Undertakings

The number of directorships held by directors of institutions shall be limited. The Central Bank requires that the number of directorships of credit institutions and insurance undertakings held by a director shall not exceed three. This restriction does not apply to multiple directorships within a financial services group.

Source: Section 4.5 of the Consultation Paper

Directorships held outside of Credit Institutions and Insurance Undertakings

Where directorships are held outside of credit institutions and insurance undertakings, the Central Bank considers that an individual holding more than 5 directorships creates a rebuttable presumption that the director has insufficient time available to fulfil his role and functions as a director of a financial institution. However, the nature of the directorships and the time commitments required is also a factor, hence fewer than five directorships may also indicate a possible constraint on the ability of a director to comply. Where it is proposed that a director of an institution hold more than five directorships, the institution shall satisfy itself as to whether this is appropriate and seek the prior approval of the Central Bank. The institution shall also provide the Central Bank with a detailed rationale together with supporting documentation as to why it considers the number of directorships does not constitute an inordinate constraint on their time. Factors that shall be covered in such a submission include the degree to which the directorships held are with respect to companies actively trading, the degree of complexity of the operation of such companies and whether such companies are part of a group.

Source: Section 4.6 of the Consultation Paper

6.2 Consultation Process

While clearly it is an absolute requirement that each director has sufficient capacity to appropriately discharge their duties it also needs to be considered that there are small sized banks and insurance companies, like Barclays entities here, where the level of commitment is not comparable to that of holding a directorship with a larger more complex company. We would request that a 'one-size fits all' approach be avoided and that discretion be allowed for directors of smaller, less complex credit and insurance entities to hold more than three directorships, particularly as this obligation may result in having to exclude suitably qualified directors resident in jurisdictions where the same rules do not apply.

Source: Barclays Bank Ireland Plc ("Barclays")

6.3 Code Requirements for non-Major Institutions

Directorships of Credit Institutions and Insurance Undertakings

The number of directorships held by directors of institutions shall be limited. The Central Bank requires that the number of directorships of credit institutions and insurance undertakings held by a director shall not exceed five. This restriction does not apply to other directorships within a financial group. The Central Bank considers that an individual holding more than five directorships of credit institutions and insurance undertakings creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of a financial institution. However, the nature of the directorships and the time commitments required are also factors, hence fewer than five directorships of credit institutions and insurance undertakings may also indicate a possible constraint on the ability of a director to comply. Where it is proposed that a director of an institution holds more than five directorships of credit institutions and insurance undertakings, the institution shall satisfy itself as to whether this is appropriate and seek the prior approval of the Central Bank. The institution shall also provide the Central Bank with a detailed rationale, together with supporting documentation, as to why it considers the number of directorships does not constitute an inordinate constraint on their time. Factors covered in such a submission shall include the degree to which the directorships held are with respect to companies actively trading, the degree of complexity of the operation of such companies and whether such companies are part of a group.

Source: Section 7.7 of the Code

Directorships held outside of Credit Institutions and Insurance Undertakings

Where directorships are held outside of credit institutions and insurance undertakings (i.e. “non financial directorships”) the Central Bank considers that an individual holding more than eight such directorships creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of a financial institution. However, the nature of the directorships and the time commitments required are also factors, hence fewer than eight non financial directorships may also indicate a possible constraint on the ability of a director to comply. Where it is proposed that a director of an institution holds more than eight non financial directorships, the institution shall satisfy itself as to whether this is appropriate and seek the prior approval of the Central Bank. The institution shall also provide the Central Bank with a detailed rationale together with supporting documentation as to why it considers the number of directorships does not constitute an inordinate constraint on their time. Factors covered in such a submission shall include the degree to which the directorships held are with respect to companies actively trading, the degree of complexity of the operation of such companies and whether such companies are part of a group.

Source: Section 7.8 of the Code

6.4 **Commentary**

A concern which has been repeatedly expressed is that this requirement will reduce the pool of INEDs available for appointment to the Boards of credit institutions and insurance undertakings. The regulator has countered by making it clear that it is desirable that a more diverse group of people participate as INEDs on the boards of domestic institutions. If this means looking beyond candidates in the traditional mode and looking internationally for candidates then so much the better. Whether this approach is successful in achieving the desired outcome remains to be seen. There is some evidence that Subsidiaries are finding it more difficult to engage local INEDs for their Boards but it is too early to tell what the impact of this requirement will be.

7 CHAIRMAN

7.1 Consultation Paper Requirement

The Chairman shall be an independent non-executive director. If a deputy Chairman is required, the role shall be taken by an independent non-executive director.

Source: Section 5.6 of the Consultation Paper

The Chairman shall be proposed for election or reappointment on an annual basis.

Source: Section 5.7 of the Consultation Paper

An individual who has been CEO, executive director or member of senior management of an institution, during the previous five years, shall not advance to the role of Chairman of that institution.

Source: Section 5.9 of the Code

The Chairman shall not hold the position of Chairman or CEO of a credit institution or insurance undertaking for more than one institution at any one time.

Source: Section 5.10 of the Code

7.2 Consultation Process

The requirement that the Chairman be independent non-executive directors is of concern. Given the central role of the Chairman of the Board, the requirement reinforces the suggestion that parent entities face losing control over their subsidiaries.

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Source: FIBI

The appointment of an executive from another business line or group company would bring a deeper understanding and knowledge of the organisation to the role of the Chairman.

Source: HSBC Ireland

The Chairman of subsidiaries should be allowed to act in the role of Chairman/CEO for other entities, subject to approval. It is often appropriate that the role of Chairman is filled by an employee or director of the parent/group as close alignment with the group can reduce risk.

Source: FIBI

7.3 Code Requirements

The Chairman shall be an independent non-executive director except in the case of a subsidiary where the Chairman may be a group director. If a deputy Chairman is required, the role shall be taken by an independent non-executive director or in the case of a subsidiary, may be taken by a group director.

Source: Section 8.7 of the Code

The Chairman of the board shall be proposed for election or reappointment on an annual basis.

Source: Section 8.8 of the Code

An individual who has been CEO, executive director or member of senior management of an institution during the previous five years shall not advance to the role of Chairman of that institution.

Source: Section 8.10 of the Code

The Chairman shall not hold the position of Chairman or CEO of a credit institution or insurance undertaking for more than one institution at any one time.

Source: Section 8.11 of the Code

7.4 **Commentary**

The acceptance that a Group Director can act as Chairman of a Subsidiary is to be welcomed and reflects the practical reality. The requirement that the Chairman be reappointed annually is perhaps more appropriate to a listed entity where director appointments are put to a vote of shareholders annually. Nevertheless it should not of itself be an overly burdensome requirement for Subsidiaries to comply with.

The restriction on executives and senior management being elevated to the role of Chairman if they have served as such within the preceding 5 year period is in line with the approach adopted in other governance codes.

The restriction on acting as Chairman or CEO of any other credit institution or insurance undertaking is interpreted by the Central Bank as meaning *any* such institution or undertaking whether in Ireland or elsewhere. This is driven by a view that the time commitment is likely to be significant. It is to be hoped that, if this becomes an issue in any particular case, the Central Bank will be open to allowing this requirement to be relaxed where it is clear that the necessary time can be committed by the relevant individual notwithstanding his other appointments. In other words, the requirement should not be interpreted *per se* but should be read in the light of the objective it is seeking to achieve. It would be counterproductive if candidates with relevant expertise were not eligible for appointment notwithstanding their ability to satisfy the required time commitment.

8 CHIEF EXECUTIVE OFFICER

8.1 Consultation Paper Requirement

The CEO shall not hold the position of CEO of a credit institution or insurance undertaking for more than one institution at any one time.

Source: Section 6.2 of the Consultation Paper

The renewal of the CEO contract shall be reviewed at least every 5 years.

Source: Section 6.4 of the Consultation Paper

8.2 Consultation Process

In practice the decision on the appointment of the CEO is taken within the context of the group of which a subsidiary institution is part. In order to ensure parents can retain control of their subsidiaries it is important that they have a role in determining who the board appoints to the role of CEO. Some subsidiary institutions do not have a CEO but two (or sometimes more) executive directors who act jointly, in most cases representing the 'front' and 'back' offices, thereby enhancing significantly corporate governance and risk control in the organisation. In such circumstances the Code should not oblige a board to appoint a single CEO.

Source: FIBI

8.3 Code Requirements

The CEO shall not hold the position of CEO of a credit institution or insurance undertaking of more than one institution at any one time.

Source: Section 9.2 of the Code

The renewal of the CEO contract shall be reviewed at least every 5 years.

Source: Section 9.5 of the Code

8.4 Commentary

This requirement will clearly present problems where there is currently no single CEO in an institution as in the scenario outlined in the extract above. It should be borne in mind that the scale of certain Subsidiaries may mean that it is not necessary to have a CEO in the conventional sense, particularly if there is a very close operational arrangement with the parent. Once again, a pragmatic approach to this requirement on the part of the Central Bank would be welcome.

9 INDEPENDENT NON-EXECUTIVE DIRECTORS

9.1 Consultation Paper Requirement

To ensure independence, an independent non-executive director shall be independent of management and large shareholders and not have any business or other relationship that could materially interfere with the exercise of independent judgement. Institutions shall seek to maximise both expertise and independence when selecting independent non-executive directors.

Source: Section 7.6 of the Consultation Paper

9.2 Consultation Process

As Sir David Walker stated in his recent review of the corporate governance of banks in the United Kingdom (the “Walker Report”), the greater the complexity of the nature of the business, the greater the need for financial industry expertise. The Walker Report advocated that greater importance should be given to experience (when balanced against the independence criteria). The criteria for independence should be reviewed to bring them in line with the criteria specified in paragraph A.3.1 of the UK Corporate Governance Code. This would for example, determine that a former employee may be considered to be independent if they have not been employed by the institution within the past five years. A distinction between different types of institution should be drawn in the requirements with respect to the required composition of the board. It may not be necessary or appropriate for subsidiaries of cross-border financial services groups to have an independent chairman or a majority of non-executive directors.

Source: MOP

It is sufficient that group senior management, who are independent of line management of the subsidiary, are an effective alternative to independent non-executive directors, as they have a more detailed knowledge of the business and its operating environment.

Source: Bank of New York Mellon

9.3 Code Requirements

This requirement was deleted in light of the Chairman’s ability to be a group director under Section 8.7 of the Code. The requirements for expertise and to bring independent challenge are contained elsewhere in Code.

10 ROLE OF THE BOARD

10.1 Consultation Paper Requirement

Where a credit institution or insurance undertaking, being part of a larger group, applies group policies or uses group functions, the Board shall satisfy itself as to the appropriateness of these policies and functions of the institution.

Source: Section 8.4 of the Consultation Paper

10.2 Code Requirements

Where a credit institution or insurance undertaking, being part of a larger group, applies group policies or uses group functions, the board shall satisfy itself as to the appropriateness of these policies and functions for the institution and in particular that these policies and functions take full account of Irish laws and regulations and the supervisory requirements of the Central Bank.

Source: Section 12.5 of the Code

10.3 Commentary

I have commented elsewhere on the practical reality of the relationship between a Subsidiary and its parent. The Code clearly requires more than passive acceptance of group policies on the part of the Board of a Subsidiary but it would not be practical to expect the Board of a Subsidiary to materially adapt or alter such policies in a typical group scenario. Nevertheless, Boards will have to critically analyse the suitability of such policies and functions against the requirements of the Code, Irish law and any other requirements of the Central Bank. Just as importantly, the Board must be able to show that it has done so.

11 MEETINGS

11.1 Consultation Paper Requirements

The Board shall meet as often as is appropriate to fulfil its responsibilities effectively and prudently, reflective of the nature, scale and complexity of the institution. In any event, subject to the exception below, the Board shall meet at least once each calendar month. A Board of an institution with lesser scope and low risk profile may meet less frequently than once every calendar month if an institution believes the requirement for monthly meetings is disproportionate and the Central Bank has given its prior written consent.

Source: Section 11.1 of the Consultation Paper

11.2 Consultation Process

A requirement to hold board meetings of an institution at least once every month may be disproportionately burdensome for certain institutions. The board in the first instance should determine how often it needs to meet to appropriately discharge its functions. A minimum of four board meetings a year would be more workable. Institutions should be required to notify the Central Bank how regularly they intend to meet, and the Central Bank should have the power to require more frequent meetings if it considers this necessary in the circumstances of a particular transaction.

Source: MOP

The requirement should be for a Board to meet at least quarterly, with the Central Bank notifying institutions, following discussion, where it believes a greater frequency appropriate.

Source: FIBI

11.3 Code Requirements

The Board shall meet as often as is appropriate to fulfil its responsibilities effectively and prudently, reflective of the nature, scale and complexity of the institution. In any event, the board shall meet at least quarterly.

Source: Section 15.1 of the Code

Major Institutions shall meet at least 11 times during any calendar year and at least once per calendar month for 11 months of the year.

Source: Additional Obligation on Major Institution – Section 15.1 of the Code

11.4 Commentary

The acceptance of quarterly meetings as the minimum for non major institutions is welcome and reflects the practical reality for most Subsidiaries.

With respect to how the meetings are actually conducted, the Central Bank may insist that, unless there is a compelling explanation, directors of non-major institutions be physically present at the quarterly board meetings in Ireland. This is notwithstanding that attendance by videoconference or teleconference satisfies the relevant Irish company law requirements for attendance. Where a director cannot be physically present for a particular board meeting then there is likely to be a strong preference for attendance by videoconference as opposed to teleconference.

This approach may present practical difficulties for Subsidiaries who have directors based in locations geographically remote from Ireland. It is also questionable to what extent there is a material difference between the ability of a director to perform his role by attending a meeting

in person as opposed to by videoconference, particularly given the major advances which have been made in videoconferencing technology.

12 COMMITTEES OF THE BOARD

12.1 Consultation Paper Requirements

The Board shall establish, at a minimum, both an Audit Committee and a Risk Committee. Major Institutions are also required to establish Remuneration and Nomination Committees. Where an institution is part of a wider group where Remuneration and Nomination committees exist, they may not need separate such committees. The Central Bank shall be informed of this decision promptly and retains the discretion to require the establishment of these committees.

Source: Section 14.1 of the Consultation Paper

12.2 Consultation Process

The existence of a global governance structure needs to be recognised in local governance codes and local unlisted subsidiaries of foreign firms should not be required to duplicate all such committees of the Board which already exist in a global context.

Source: J.P. Morgan

12.3 Code Requirements

The board is responsible for oversight of each of its Committees. Subject to Section 18.2, the board shall establish, at a minimum, both an audit committee and a risk committee. Where the board comprises only 5 members, the full board may act as the Audit Committee and/or the Risk Committee. In such cases section 21.3 continues to apply (the Chairman of the Audit Committee shall be an independent non-executive director). Minutes of these meetings should reflect that the board was sitting as the Audit Committee or Risk Committee.

Source: Section 18.1 of the Code

Where an institution is part of a wider group which has a Group Audit Committee and a Group Risk Committee, it may rely on those committees provided that the board is satisfied that they are appropriate to the specific circumstances of the institution.

Source: Section 18.2 of the Code

The non-executive directors and in particular independent non-executive directors shall play a leading role in these committees or where the functions are carried out at group level, they shall play a leading role in satisfying the board that the institution's audit and risk functions are adequately carried out.

Source: Section 18.4 of the Code

12.4 Commentary

See the commentary above at section 10.3 regarding the requirement that the Board satisfy itself as to the appropriateness of Group Audit and Risk Committees.

13 AUDIT COMMITTEE

13.1 Consultation Paper Requirements

An Audit Committee shall be composed of non-executive directors, the majority of directors being independent.

Source: Section 17.1 of the Consultation Paper

The Chairman of the Audit Committee shall be an independent non-executive director.

Source: Section 17.3 of the Consultation Paper

Neither the Chairman of the Board nor the CEO shall be a member of the Audit Committee. Attendance of the CEO or Board Chairman at Audit Committees shall be by invitation and shall be managed to ensure the independence of the committee and the maintenance of appropriate relationships with other parties especially external auditors.

Source: Section 17.4 of the Consultation Paper

13.2 Consultation Process

For subsidiary institutions it should be possible for the Chairman and majority on the audit committee to consist of group employees who are non-executive directors. Subsidiary operations often come under the remit of group audit committees and these group committees are used in place of a separate committee for the subsidiary. Such a practice increases the level of independent oversight. In addition subsidiary operations should be able to have the board carry out the functions that would otherwise be delegated to the audit committee.

Source: FIBI

It might be appropriate to consider the provisions of the UK Corporate Governance Code around the composition of the audit committee. The UK Corporate Governance Code permits the company chairman to be a member of, but not chair, the committee in addition to the independent non-executive directors provided he or she was considered independent on appointment as chairman.

Source: Barclays

13.3 Code Requirements

An Audit Committee shall be composed of non-executive directors, the majority of directors being independent.

Source: Section 21.2 of the Code

The Chairman of the Audit Committee shall be an independent non-executive director.

Source: Section 2.13 of the Code

Subject to the provisions contained in section 18.1 (which provides that where the board comprises only 5 members, the full board may act as the Audit Committee) neither the Chairman of the Board nor the CEO shall be a member of the Audit Committee. The attendance by the CEO or board Chairman at Audit Committees shall be by invitation and shall be managed to ensure the independence of the committee and the maintenance of appropriate relationships with other parties especially external auditors.¹

Source: Section 21.4 of the Code

13.4 **Commentary**

This requirement necessitates a very formal approach on the part of the Audit Committee to the conduct of its functions and, while workable for large institutions, may present practical challenges for smaller institutions.

14 RISK COMMITTEE

14.1 Consultation Paper Requirement

Institutions shall establish a Board Risk Committee separately from the Audit Committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy. Smaller institutions or those involved in less complex business models may propose to the Central Bank that the Board itself carry out the functions which would otherwise be delegated to a Risk Committee. The Central Bank's prior approval in writing shall be obtained if an institution wishes to fulfil this requirement without creating a separate committee of the Board.

Source: Section 18.1 of the Code

The Risk Committee shall have a balance of non-executive and executive directors appropriate to the nature, scale and complexity of the business of the institution.

Source: Section 18.2 of the Code

14.2 Consultation Process

For small institutions it would be counter-productive to move the consideration of risk to a specific committee, it would be more appropriate if this function remains at board level.

Source: HSBC

14.3 Code Requirements

The board shall establish a Risk Committee separately from the Audit Committee with responsibility for oversight and advice to the board on the current risk exposures of the entity and future risk strategy. Institutions may propose to the Central Bank that the Board itself carry out the functions which would otherwise be delegated to a Risk Committee. The Central Bank's prior approval in writing shall be obtained if an institution wishes to fulfil this requirement without creating a separate committee of the board.

Source: Section 22.1 of the Code

The Risk Committee shall ensure that there is an appropriate representation of non-executive and executive directors which is appropriate to the nature, scale and complexity of the business of the institution.

Source: Section 22.2 of the Code

14.4 Commentary

These requirements are presumably subject to Section 18.1 of the Code, which provides that where the board comprises only 5 members, the full board may act as the Risk Committee.

The change in the language of the requirement from "balance" of non-executive and executive directors to "appropriate representation" of executive and non-executive directors is an acknowledgment that, so far as the composition of risk committees is concerned, expertise and experience is of paramount importance. The necessity for participation by individuals with relevant expertise and experience should not be compromised just because the appropriate composition for a particular institution does not involve a roughly equal number of executives and non-executives.

15 ANNUAL COMPLIANCE STATEMENT

15.1 Consultation Paper Requirement

An institution shall submit to the Central Bank a compliance statement specifying, in accordance with any relevant guidance issued by the Central Bank, whether the institution has complied with these requirements during the period to which the statement relates. This compliance statement shall be submitted to the Central Bank on an annual basis or with such other frequency as the Central Bank may notify to the institution from time to time.

Source: Section 21.1 of the Consultation Paper

15.2 Consultation Process

The requirement for an annual statement of compliance with the Code could become an industry in itself, for little real benefit. A full regulatory impact assessment should be published to assess the costs and benefits of requiring an annual statement of compliance. The Company Law Review Group ("CLRG") produced a report examining the costs and benefits of a legal requirement for Directors to produce an annual statement of compliance. The CLRG noted the negative effect the Directors' compliance statement would have on Ireland's national competitiveness. Any annual compliance statement should be structured to be as contained as possible, so as to minimise the costs of implementation. The concept of materiality should be considered in this context to avoid focus on trivial and inconsequential matters. Discretion as to whether a calendar year, financial year, or some other basis of 'annual' is used would be beneficial.

Source: FIBI

We would be grateful for clarification of the intended scope of the annual compliance statement and guidance as to whether this requirement is intended to apply to corporate governance guidelines only or has a wider application.

Source: J.P. Morgan

15.3 Code Requirements

An institution shall submit to the Central Bank a compliance statement specifying, in accordance with any relevant guideline issued by the Central Bank, whether the institution has complied with the Code during the period to which the statement relates. This compliance statement must be submitted to the Central Bank on an annual basis or with such other frequency as the Central Bank may notify to the institution from time to time. The first report will be for the year end 2011 and shall be submitted, with the institution's annual report. In the event of the institution deviating materially from the Code, the compliance report shall include a report on any material deviations, advising of the background to the breach and the actual or proposed remedial action.

Source: Section 25.1 of the Code

15.4 Commentary

Guidelines are awaited from the Central Bank and until they are published it is perhaps premature to comment. It is worth recalling however that when the Directors Compliance Statement referred to in the extract above was originally proposed there was real concern about the burden it would place on companies. In my experience of acting for companies which took steps to internally prepare for its introduction, the ability to make the annual statement could, in certain instances, have necessitated a complex internal structure of confirmations and reports which would have been very burdensome administratively. This has been broadly acknowledged and a less onerous obligation is anticipated in the Companies Consolidation and Reform Bill which is expected to be completed in 2012.

16 ADDITIONAL OBLIGATIONS ON MAJOR INSTITUTIONS

16.1 Code Requirements

The board shall have a majority of independent non-executive directors (this may include the Chairman). However in the case of institutions that are subsidiaries of groups, the majority of the board may be group non-executive directors, provided that in all cases the subsidiary institution shall have at least three independent non-executive directors or such greater number as is required by the Central Bank. Group directors shall act critically and independently so as to exercise objective and independent judgement.

Source: Section 7.2 of the Appendix to the Code

The number of directorships held by directors of institutions shall be limited. The Central Bank requires that the number of directorships of credit institutions and insurance undertakings held by a director shall not exceed three where one of the directorships held is in a Major Institution. This restriction does not apply to multiple directorships within a financial services group.

Source: Section 7.7 of the Appendix to the Code

Where directorships are held in a non financial institution the Central Bank considers that an individual holding more than 5 directorships in a non financial institution creates a rebuttable presumption that the director has insufficient time available to fulfil his or her role and functions as a director of a financial institution. However, the nature of the directorships and the time commitments required are also factors, hence fewer than five directorships in non financial institutions may also indicate a possible constraint on the ability of a director to comply. Where it is proposed that a director of an institution hold more than five directorships, the institution shall satisfy itself as to whether it is appropriate to seek the prior approval of the Central Bank. The institution shall also provide the Central Bank with a detailed rationale, together with supporting documentation, as to why it considers the number of directorships does not constitute an inordinate constraint on his or her time. Factors that shall be covered in such a submission include the degree to which the directorships held are with respect to companies actively trading, the degree of complexity of the operation of such companies and whether such companies are part of a group.

Source: Section 7.8 of the Appendix to the Code

Major Institutions are required to establish Audit, Risk, Remuneration and Nomination Committees. Where an institution is part of a wider group where Remuneration and Nomination Committees exist, it may not need such separate committees. The Central Bank must be informed of this decision promptly and retains the discretion to require the establishment of these committees.

Source: Section 18.1 of the Appendix to the Code

16.2 Commentary

The requirements above are a more onerous version of certain requirements which apply to all institutions and which have been commented upon earlier.