



September 2010
AK Position Paper

Green Paper: Corporate Governance in Financial Institutes and Remuneration Policies

About us

The Federal Chamber of Labour is by law representing the interests of about 3.2 million employees and consumers in Austria. It acts for the interests of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore the Austrian Federal Chamber of Labour is a part of the Austrian social partnership.

The AK EUROPA office in Brussels was established in 1991 to bring forward the interests of all its members directly vis-à-vis the European Institutions.

Organisation and Tasks of the Austrian Federal Chamber of Labour

The Austrian Federal Chamber of Labour is the umbrella organisation of the nine regional Chambers of Labour in Austria, which have together the statutory mandate to represent the interests of their members.

The Chambers of Labour provide their members a broad range of services, including for instance advice on matters of labour law, consumer rights, social insurance and educational matters.

More than three quarters of the 2 million member-consultations carried out each year concern labour-, social insurance- and insolvency law. Furthermore the Austrian Federal Chamber of Labour makes use of its vested right to state its opinion in the legislation process of the European Union and in Austria in order to shape the interests of the employees and consumers towards the legislator.

All Austrian employees are subject to compulsory membership. The member fee is determined by law and is amounting to 0.5% of the members' gross wages or salaries (up to the social security payroll tax cap maximum). 560.000 - amongst others unemployed, persons on maternity (paternity) leave, community- and military service - of the 3.2 million members are exempt from subscription payment, but are entitled to all services provided by the Austrian Federal Chambers of Labour.

Herbert Tumpel
President

Werner Muhm
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Executive Summary

The AK welcomes the fact, that in the analysis of the Commission the shortcomings of Corporate Governance within financial institutes, which were exposed because of the financial crisis, were addressed in a very clear and open manner.

The AK welcomes the analysis of the Commission concerning the causes of the financial crisis. The shortcomings of Corporate Governance within financial institutes, which were exposed because of the financial crisis, were addressed in a very clear and open manner. In addition to the already known weaknesses in the area of "checks and balances", the role of shareholders has also been critically assessed for the first time. The continuously growing shareholder category with an extremely short investment horizon (three to six months) is more and more becoming a problem, as this group is only interested in short-term capital gains for which it accepts even greater risks. In connection with the shareholder value approach, which has been enforced for years - also by the Commission - namely the alignment of interests of shareholders and management through remuneration models, which are increasingly oriented towards share prices, the ground had been prepared for increasingly riskier business models.

In the present Green Paper, the Commission for the first time recognises that the one-sided orientation of corporate management towards the interests of shareholders is contradictory to a Corporate Governance, which plans and pursues sustainable and long-term goals. Also for the first time,

it has been pointed out that the interests of other stakeholders (employees, depositors, etc.) have to be incorporated in corporate decisions. Also emphasised should be the statement of the Commission that recommendations without a binding duty to comply (e.g. voluntary Corporate Governance codices) cannot be effective because control and the option to impose sanctions are missing.

The weak points of Corporate Governance in financial institutes, which have been stated in the Green Paper, are a first important analytical step, which must soon be followed by implementation in order to achieve a strengthening of Corporate Governance. The principle of voluntariness in the area of Corporate Governance for example, must be replaced by clear standards and sanctions. It is not sufficient to criticise the shareholder value concept; with regard to corporate management and corporate governance, the administrative board resp. the board of directors and the supervisory board must be obliged to focus and observe the interests of all stakeholders. The variable remuneration structures may no longer be oriented towards the development of share prices but have to be focused on sustainable, social and employment related objectives. From the point of view of the AK, the measures addressed are

not only relevant to financial institutes, but to all listed companies.

The AK urges the Commission not to be satisfied with just analysing and exposing deficiencies and weak points, but to act decisively and to take measures quickly.

Often, the Commission acts initially in an offensive and courageous manner; however, in the negotiations, which follow, the recommended measures are all too frequently softened or put on hold (e.g. Banking regulations, Green Paper Private Enforcement). Therefore, the AK urges the Commission not to be satisfied with just analysing and exposing deficiencies and weak points, but to act decisively and to take measures quickly. Only if the Commission introduces clear actions to strengthen Corporate Governance, will the Member States and the financial institutes we prepared to implement these. However, it does little for the implementation of concrete measures, if the Commission, already at this early stage, announces that the solutions to be prepared have to be proportionate or that the competitiveness of the European finance industry had to be preserved.

The AK position in detail

General Questions:

(1) Interested participants are invited to give their opinion on the recommended solutions with regard to the structure, the role and the functioning of the administrative board and perhaps to name further measures, which they regard as necessary.

A general criticism is that only the administrative board has been addressed although the Question is also relevant to the supervisory board in a dual system. In general, however, the AK welcomes the solutions recommended as part of the first question.

From the point of view of the AK, a restriction of the mandates of members of the administrative board or the supervisory board (**Item 1.1.**) seems to make sense as the supervisory and control tasks are becoming increasingly more complex and time-consuming. A reduction of mandate functions, for example to max. three mandates could result in the fact that office-holders have more time to exercise their mandate and that more diligence is ensured.

Also pointed out should be **Item 1.4.:** corporations should no longer forego different points of view, skills and problem solution competences, which are associated with internationality, gender and age structures. In this context,

the AK - following the example of Norway - demands an obligatory women quota of 40 % and emphasises the necessity to increasingly fill leading positions with women.

Apart from that, we regard **Item 1.13.** at the end of the question as being of particular importance: from our point of view, it is absolutely essential to abandon the shareholder value approach and to commit the organs (administrative board resp. board of directors and supervisory board) to equally consider the interests of employees, depositors and other stakeholders in the corporate decision-making process.

On the other questions: it is necessary to conduct an annual self-evaluation of the supervisory boards with the involvement of an external auditor. The annual efficiency audit and critical reflection will improve the achievement of objectives and the efficiency of the actions of the supervisory board. The procedures in the supervisory board, the information flow between the Committees and the Plenum as well as the in-time and adequate supply of information of the supervisory boards have to be given special consideration.

With regard to publishing the results, it is to be feared that formal criteria (frequency of meetings, duration, number of committees etc.) might dominate

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the issue **(Item 1.5.)**. The Chair of the Risk Committee should be the Chair of the supervisory board. In the administrative board model the position of Chair should be filled by a non-executive supervisory board member. A reporting duty towards the general meeting is regarded as positive **(Item 1.8.)**. In a monistic system, the administrative board has to determine the corporate strategy including risk strategy and risk profile. With regard to the dualistic system, the corporate strategy should be prepared by the board of directors and submitted to the supervisory board for discussion and approval **(Item 1.9.)**. Any explanation regarding the control of risks is probably of little significance as it can only be positive. Otherwise the company would suffer a serious economic disadvantage **(Item 1.10.)**. Only if the supervisory board understands a product it will be able to fulfil its control function. Therefore, new financial products should be subject of the approval of the administrative board resp. the supervisory boards; the involvement of external experts should become normal practice **(Item 1.11.)**.

to the administrative board as managing body in the monistic system. The responsibility for the failing of the risk management during the latest crisis therefore lies with the administrative board resp. the board of directors in its entirety and not with individual members (e.g. risk manager).

If the technical conditions for quality risk do not exist, any infringement of due diligence lies with the entire board of directors resp. the administrative board. A direct reporting duty of the risk manager to the supervisory board or the administrative board **(Item 2.3.)** is basically sensible. A lot of catching up is in particular necessary with regard to the communication within the administrative board or between the board of directors and the supervisory board: written information regarding the risk management has to be provided within the scope of quarterly reporting duties. Apart from that, a clear organisation of risk management and "risk causing" organisation units would be desirable. This needs clear legal provisions; also sensible appears to be a risk committee in the supervisory board.

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(2) Interested participants are invited to give their opinion on the recommended solutions with regard to risk management and perhaps to name further measures, which they regard as necessary.

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(3) Interested participants are invited to give their opinion on the recommended solutions with regard to the structure, the role of external auditors and perhaps to name further measures, which they regard as necessary.

The AK welcomes the recommenda-

tions provided in the Green Paper (**Item 3.1. to 3.3.**). In order to strengthen the independence of external auditors it is necessary to introduce a mandatory external rotation (e.g. every three to five years). This would also stimulate competition in the highly concentrated auditor market.

(4) Interested participants are invited to give their opinion on the recommended solutions with regard to the structure, the role of regulatory authorities and perhaps to name further measures, which they regard as necessary.

It is absolutely vital to strengthen the regulatory authorities: this means more control rights for the regulatory authorities within the scope of internal Corporate Governance of financial institutes on the one hand; on the other hand, regulatory authorities must have effective sanction instruments. Only if additional control rights are accompanied by clear and transparent sanctions, a step in the direction of more quality in Corporate Governance of financial institutes has been achieved. An idea would be an annual evaluation of the administrative board resp. the board of directors and supervisory board with regard to organisation and efficiency of risk management with the involvement of external auditors.

From the point of the AK, it has to be ensured already at this point that board members, who could be selected at the general meeting have the neces-

sary technical and professional qualifications (**Item 4.3.**).

(5) Interested participants are invited to give their opinion on the question whether any control of financial institutes by shareholders is still realistic. In case of approval we ask for recommendations as to how to involve shareholders more in practice.

The financial crisis has shown that increasingly more shareholders favour shorter and shorter investment horizons and that they are exclusively interested in maximising a short-term yield. These investors regard a company as a "commodity", which is bought or sold. They are not interested in complying with sustainable Corporate Governance rules. The question therefore arises whether and to which extent these shareholders or groups of shareholders should be granted the right to govern. It should also be considered to grant long-term investors a stronger voting right (e.g. double or triple vote).

From the point of view of the AK, behavioural codices for institutional investors as recommended in **Item 5.2.** do not present a suitable means for implementing qualitative Corporate Governance rules. The external control of financial institutes is primarily the responsibility of regulatory authorities and external auditors. It is their responsibility to ensure that legally binding Corporate Governance standards

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are adhered to. Corporate decisions must no longer just be orientated towards shareholders' interests. The management bodies must be obliged to consider the interests of other participants (employees, creditors, depositors) in the corporate decision-making process.

(6) Interested participants are invited to specify, which measures in their opinion could effectively improve the use of Corporate Governance principles.

Only legally binding rules create more transparency and achieve the desired success. As practice has shown, no progress is made with codices that are based on self-commitment. In the opinion of the AK, the principle of voluntariness has to be abandoned: what are needed are clear binding standards and - in case of non-compliance - effective sanction options for management bodies. The Commission should introduce these as soon as possible.

(7) Interested participants are invited to recommend methods to increase the coherence and effectiveness of EU measures with regard to the remuneration of managers of listed companies.

We would like to make the basic statement that clear and binding standards are particularly necessary with regard

to manager remuneration to achieve any improvement and development of Corporate Governance. As has been clearly demonstrated in the past, voluntary recommendations are not suited to guarantee decisive developments. This is also shown by the Corporate Governance practice in Austria: as studies conducted by the Chamber of Labour confirm, managerial salaries in Austria have grown enormously in the last ten years. They have increased from being 20 times as much the salary of an average employee to 48 as much in the year 2008. In the crisis year of 2009, an ATX Board of directors still earned on average almost a million Euro, in spite of a significant reduction in bonus payments. The already existing Corporate Governance rules with regard to an orientation of the remuneration towards sustainable and long-term corporate goals so far have not resulted in a change of the remuneration structure.

In the financial year 2009 resp. 2009/2010, the performance-related part of the salary of the boards pursuant to Comply Rule 27 of the Austrian Corporate Governance Codex in ATX companies is not at all a long-term and sustainable performance criteria, as recommended by the codex. The most frequent performance criteria are still EBIT, annual net profit and ROCE. The transparency rules - such as the individual publication of board of directors salaries - are also ignored to a large extent: from the ATX Groups examined, only ten companies; i.e. half of the Groups publish the individual salaries of their Chairs. A long overdue

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corporate transparency can obviously only be achieved by the legislator.

The AK is therefore in favour of a binding directive, which regulates the minimum standards with regard to the amount and structure of the remuneration components. Apart from that it would be desirable that the individual remuneration components for the board of directors are provided clearly and detailed in accordance with the following scheme:

- fixed and variable salary components;
- Shares and stock options or other participation in profits
- Contributions to additional pension schemes;
- Loans, advance payments or guarantees
- Amount of termination claims in case of early rescission of contract (settlements, pensions, payments to dependants or similar payments);
- other remuneration components (e.g. company car, travel expenses, insurance premiums)

With regard to the salary components share options' (**Item 7.2.**) it should be noted that the Chamber of Labour is in favour of not providing any share options for the board of directors. A general ban of stock options or shareholdings for executives should also

solve the existing problem with insider dealing.

With regard to **Item 7.5.**, i.e. the salary component 'settlements', we would like to remark the following: settlements are normally paid if manager contracts of limited duration are terminated prematurely. Apart from the already existing termination conditions, additional termination options (e.g. worsening of the economic situation, breach of duty of the board of directors) should be integrated in the law, which do not lead to any or only to a reduced settlement. In case of a premature termination of the management contract, the settlement must not exceed one annual salary.

Variable remuneration components should not contain any non-financial criteria: instead of being coupled to share prices, corporate goals should be linked to social and employment related criteria as well as ecological guidelines. Apart from that, variable salary components should be capped in relation to the salary and only then paid if the respective targets have been achieved.

The total amount of the remuneration of the board of directors has to be in proportion to the performance of the board of directors, to the situation and development of the company as well as to the usual remuneration, whereby the amount and development of the wages and salaries within the company also have to be considered.

(7a) Interested participants are invited to state whether they regard additional measures to structure and control remuneration policies in the financial services sector as necessary. If yes, what could respective measures include?

The variable remuneration component should be oriented towards sustainable criteria (e.g. creation of jobs, qualification measures). We reject stock options as a remuneration instrument because not least this incentive mechanism has been a significant cause for the latest crisis and because share options do promote the exploitation of insider information.

mission to include also rating agencies within the scope of treating conflicts of interest.

The AK therefore values the intention of the Commission to regulate conflicts of interest by clear legal provisions and to supervise these accordingly.

(8) Interested participants are invited to state whether they share the assessment of the Commission that in spite of the existing transparency obligations with regard to conflicts of interest the sheer monitoring of conflict of interest situations by the markets is not always possible or effective.

There are a large number of conflicts of interest in particular in the area of financial institutes. The AK therefore values the intention of the Commission to regulate conflicts of interest by clear legal provisions and to supervise these accordingly. In this context one should also look critically at the role played by the rating agencies and to question why this has been completely ignored in the present Green Paper. The AK therefore asks the Com-

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