

EPFSF Breakfast Discussion
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“Crisis Management and Corporate Governance”

Speech from David Grounsell
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Good morning. I am David Grounsell, general counsel of Goldman Sachs International and I am delighted to be at this meeting today to provide a perspective on best practices for corporate governance in financial services firms, and to offer my personal thoughts on policy proposals for crisis management in the banking sector.

Turning first to crisis management ...

Despite all the work that is underway, it is accepted that we cannot eliminate the risk of future bank failures. We therefore need a crisis management framework for financial institutions, so that they can be allowed to fail; and so that in the event of failure, there is orderly resolution with limited impact on the wider financial system and broader economy.

This has been a topic of great focus at a national and international level and I support much of what has been said. But there are some differences in approach, so I will focus on those points where I think the emphasis might be greater.

First, I agree with the IMF that Governments and regulators must be given a wide range of powers to intervene and deal with financial institutions in difficulty. This menu of options should be the same across all member states to promote convergence and legal certainty and should be broadly the same across different types of financial institution.

Importantly, government and regulators must have sufficient flexibility to use these powers. Concerns have been expressed about the possibility of these powers being used too quickly resulting in additional harm to shareholders and creditors. These are valid concerns but, if we are in the middle of a crisis of the type just seen, the priority will be to take action to deal with the crisis: the debate about whether shareholders or creditors deserve compensation should be left for calmer times. It follows that any rules designed to protect shareholders in normal times (such as the need to launch a full takeover bid once a threshold has been crossed) should be capable of being disapplied during a crisis.

The authorities must also be able to act quickly and decisively. With this in mind, we fully support the increasing cooperation of regulators, including through the work of supervisory colleges and the new discipline of macro prudential supervision. This should help give warning of increased stresses and mean that the authorities are better informed as to the unique circumstances of any institution in danger.

As we have all seen, insolvency laws work on a national basis. Some have argued for harmonisation of insolvency laws across the EU but I share the view of the European Central Bank that this does not seem likely to occur at any time soon. And even if insolvency laws were to be harmonised in Europe, that would deal with only part of the picture for the many financial institutions with global activities. I also have real concerns about the adoption of any "group interest" principle which would allow assets to be transferred between entities in an attempt to stave off insolvency.

I believe, therefore, that we should work on the assumption that national rules will continue to apply. If that is the case, then it is probably premature to be considering a fully-fledged European Resolution Authority, although there is clearly room for a body to promote practical pre-crisis information-sharing, cooperation and coordination between national resolution authorities.

Let me spend a couple of minutes on the topic of rescue and resolution plans, or living wills.

I know that some in the industry believe that living wills should be put in place at a group level and that may be sensible for groups using a branch structure. However, where a group operates through subsidiaries, there will be a need to consider whether any particular subsidiary is sufficiently material that it needs its own living will (as well as the parent having one).

One of the main aims of a living will is to aid a resolution of the institution, should that be necessary. In the same way that I want the authorities to have flexibility as to what action to take, I would be concerned if supervisors wanted to pre-wire all actions that will be taken in distress: I don't think such an approach is realistic. Also, we should be careful that the benefits of advance planning are not overwhelmed by the day-to-day burden of maintaining a living will and that scope is maintained for diverse structures. The essential point is that institutions have the systems and procedures in place to provide relevant information on a timely basis if insolvency becomes likely, including for example data on counterparty exposures and valuations. It shouldn't be necessary to have a data room full of such information and to keep this continually updated.

One of the lessons made clear from the Lehman collapse is that financial institutions are complex and it is incredibly difficult (and therefore time-consuming and expensive) for an insolvency official to get up-to-speed and feel comfortable to take any actions. I believe that the only realistic way to improve this situation is to retain as many employees as possible for an initial hand-over period in order, for example, to return client assets and to help wind down trading positions. To this end, I would recommend that firms contractually agree in advance to retain employees at all levels of the firm, for example for a 90 day period, if the firm goes into default.

It would also make sense to consider whether the duties and liability standards of insolvency officials are set at the appropriate level and whether it makes sense for such officials to be able to go to court to have their proposals blessed.

And finally on this topic, whatever is done, the rights of creditors and existing contractual rights and obligations should be protected as far as possible. If resolution processes are seen to arbitrarily violate creditor rights or override existing contractual agreements, the goal of orderly wind down could be compromised and the resulting precedent could easily become a source of ongoing uncertainty.

Having said this, it is probably sensible to allow a short delay to promote the continuity of market functions and to see whether a full or partial rescue can be put in place. In any event, permitting any delay likely would require a change to the Financial Collateral Directive.

I would now like to turn briefly to the policy debate on corporate governance and share a few thoughts on the core tenets of an effective, post-crisis corporate governance framework:

1. Recognition that risk management and corporate governance are never achieved, but are continuously evolving.

2. Culture is key. There needs to be emphasis on training, supervision and encouragement of people to identify and escalate issues; firms should consider risk management a core competency with each and every employee conceiving of themselves as a risk manager and part of a "challenge" culture within the firm.

3. Senior management must participate actively in a continuous process of identifying and mitigating key risks across the firm, including direct regular participation in risk and product committees to ensure that risk is viewed on an integrated, horizontal and vertical basis.

4. A framework of strong and independent control departments that monitor risk. I am firmly convinced that control departments that are staffed by senior members of a firm and fully independent from all revenue-producing business units are critical.

Before concluding I would like to raise two points arising from the recent UK debate on corporate governance:

First, the role of Non-Executive Directors

I support proposals for additional financial training for Non Executives and calls for more candidates to have financial industry expertise. However, we need to be wary of over reliance on Non Executives as I am concerned that it is unrealistic to think that there is a large enough pool of suitably qualified individuals willing to take on the expanded role proposed.

I would argue that having the right culture throughout an organisation is likely to prove more important than having a majority of Non Executives on the board, particularly for subsidiaries.

Second, there has been significant discussion on the requirement for a risk committee at board level chaired by a Non Executive director with a majority of its members being Non Executives. My concern here is that risk monitoring and management is a very complex area, and it is essential that such a committee can add value on a timely basis. A risk committee comprised primarily of Non Executives may fall short of these requirements.

I would also urge that policy makers recognize that one size does not fit all. Requirements should be proportional, dependent upon whether the entity is a parent, a subsidiary (and in the latter case, whether the subsidiary undertakes a limited or full range of businesses).

I recognise that I have only touched on issues but I would be happy to take questions on any particular elements. Thank you.