Corporate Governance and Credit Institutions

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This article examines the concept of corporate governance and provides an overview of the current state of legislation at the European and Austrian level, highlighting the crucial importance of transparency and disclosure requirements as components of corporate governance. A comparison of legal bases in Austria and the EU reveals that Austria's national implementation of the Banking Directive and its financial market reform in 2007 brought about significant advances in this area for Austrian credit institutions. Good corporate governance at credit institutions is a key factor in maintaining a stable financial market.

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Corporate governance issues essentially involve questions on how to manage a business in an optimal manner and how to design its internal organization in such a way that adverse developments can be detected and avoided as early as possible. As regulations on corporate governance for credit institutions are also an especially important part of the legal framework for a stable financial market, this article examines how Austrian legislation has responded to these issues.[1]

1 Definitions and Objectives of Corporate Governance

Among the many available definitions of corporate governance, two in particular appear to reflect the content of the term with sufficient clarity. According to Nowotny (2000), corporate governance refers to a legal and de facto framework of rules and policies for the management and supervision of a company. Corporate governance thus refers to the relationships between the company's various stakeholders. Haberer (2003) defines corporate governance as the legal organization of company management and control in an entrepreneurially optimal manner.

Definitions of corporate governance become more precise when the specific characteristics of individual industries are taken into account. A legal definition of corporate governance which is tailored to credit institutions can be found in Directive 2006/48/EC of the European Parliament and of the Council of 14 March 2006 relating to the taking up and pursuit of the business of credit institutions (referred to in this article as the "Banking Directive").

Home Member State competent authorities shall require that every credit institution have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

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This definition very clearly structures the essential components of good "internal" corporate governance for credit institutions:[2] organization, rules of good conduct for decision makers, internal (risk) control and transparency. Omitting one of these elements of good corporate governance may precipitate the collapse of a credit institution. For this reason, three pillars form the basis of financial market stability under the New Basel Capital Accord (Basel II). Pillar 1 governs the calculation of minimum capital requirements. In implementing Pillar 2 of the Basel II framework, the directive incorporates organizational requirements under the term "governance". Pillar 3 calls for transparent and timely reporting to the general public. The Basel Committee on Banking Supervision acted on the conviction that market discipline among credit institutions should be reinforced by disclosure requirements and thus by enhancing transparency.

Corporate governance for credit institutions entails responsible management and control which aims to ensure financial stability as well as sustainable long-term value creation. This objective best serves the interests of the real economy and job security.

In the past, corporate governance reforms were necessary in order to ensure market discipline and ethics in a global and volatile environment by implementing uniform standards throughout the EU. Profit expectations should not be the only motive for corporate action. The harmonization of legal frameworks constitutes a substantial contribution to financial stability and, in addition, promotes fair competition within the EU. Various aspects of the legal definition above lead to the achievement of these objectives: First, rules of good conduct require management bodies to ensure sound corporate management. Second, organizational measures as well as intensive control measures – also supported by qualified and independent supervisory boards – serve to reduce the risks involved in banking transactions. These standardized benchmarks support the work of national banking supervisory authorities in the EU.

Credit institutions are important intermediaries in an economy, and their risk must be captured in a special manner. The Commission has designed broad initiatives to improve corporate governance in the EU.

2 Legal Bases in EU Legislation and Recommendations of Other Institutions

2.1 European Commission Action Plan to Improve Corporate Governance

Various accounting scandals, such as those at Parmalat in Italy, Ahold in the Netherlands and the ENRON Group in the U.S., contributed to making management issues the subject of European Commission legal initiatives in the field of company law. In 2002, an expert group led by Professor Jaap Winter presented a report in which they recommended harmonizing the national legal bases with respect to corporate governance and defining clear and uniform disclosure requirements instead of creating a single European code of corporate governance. In order to implement the group's recommendations, the Commission approved the action plan "Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move

[2] *"External" corporate governance refers to supervisory authorities, external auditors and market participants. Transparency plays a key role in internal as well as external corporate governance.*

Forward" (COM/2003/0284)[3] in 2003. This initiative focuses on strengthening the rights of shareholders, enhancing the protection of employees and creditors, and increasing the efficiency and competitiveness of businesses.

The action plan was essentially implemented in Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006. In order to promote credible accounting processes, the directive requires the management board and supervisory board to assume collective responsibility for annual financial statements and annual reports. The responsibilities of the supervisory board were also expanded, and exchange-listed companies are required to publish a corporate governance statement.

In order to amplify the external effect of the action plan, the European Commission established the European Corporate Governance Forum. This forum performs an advisory function on the one hand and works to promote the harmonization of national corporate governance codes on the other.

2.2 Corporate Governance and Transparency in the Banking Directive

Article 22 and Annex V ("Technical Criteria Concerning the Organization and Treatment of Risks") of the Banking Directive fundamentally address the issue of corporate governance. In order to ensure the uniform interpretation and application of these provisions in the EU, the EU legislature assigned the Committee of European Banking Supervisors[4] (CEBS) the task of drawing up clear guidelines for the sound governance of credit institutions; those guidelines are discussed in section 2.3 below.

A separate annex to the Banking Directive (Annex XII, "Technical Criteria on Disclosure") is likewise devoted to transparency as a key component of corporate governance, providing for a comprehensive control system for credit institutions. In addition to banking supervisors, external auditors, supervisory boards and in-house control departments, the financial market itself are to serve as a mechanism of supervision. The general conditions for banking transactions will become more secure if market participants can assess the risk situation of other credit institutions and draw conclusions as to the overall market situation on that basis. In order to attain this objective, the necessary information must be made available to the financial market. For this purpose, specific disclosure obligations have been created for credit institutions regardless of their size and legal form of business organization. This raises the question of which disclosures can be used to mitigate asymmetries of information, which have an adverse effect on financial market stability. According to Annex XII to the Banking Directive, external reporting obligations also include risk management objectives and strategies as well as the amount of impaired and past-due exposures and own funds.

Despite its key importance for financial stability, the disclosure of corporate information is a sensitive topic and frequently conflicts with competitive strategies and confidentiality obligations. As a result, the application of

[3] *http://ec.europa.eu/internal_market/company/modern/index_en.htm*

[4] *CEBS was established in 2003 in order to advise the European Commission on issues related to banking supervision. The guidelines on internal governance can be found in Appendix 1 to the CEBS Electronic Guidebook (http://www.c-ebs.org).*

transparency obligations is subject to a broad limitation: Information is not to be disclosed in cases where confidentiality obligations apply or where such disclosures would undermine a credit institution's competitive position. However, none of the arguments militate against the disclosure of remuneration and incentive systems.

2.3 Depiction of Good Corporate Governance in CEBS Guidelines

CEBS has developed 21 guidelines which are subdivided into four sections according to the areas addressed in the definition under Article 22 of the Banking Directive. In legal terms, these guidelines can be classified as non-binding recommendations. However, as they are based on the EU legislature's intention to guide interpretations of the directive's content, these guidelines should be used as a benchmark for transposition into national law and for uniform application by national supervisory authorities. The guidelines create EU-wide standards with regard to organizational structures within a credit institution, risk management as well as internal reporting and control, thus their significance should not be underestimated.

The guidelines on internal corporate governance focus on the duties of the management body in their management and organization of the credit institution, in addition to providing information on effective internal control. The management body is assigned responsibility for corporate governance and for conducting regular assessments of its governance arrangements. The same applies to risk management. Transparency (Guideline on Internal Governance (IG) 20) in business policy and in remuneration and incentive structures is mentioned only as a desirable addition in the explanatory remarks.

2.4 Guidelines of the Organisation for Economic Co-operation and Development (OECD) and the Bank for International Settlements (BIS)

The concept of corporate governance for credit institutions has also seen further development at the international level. The OECD developed its "Principles of Corporate Governance" as a guideline for national legislators. The Financial Stability Forum included these principles among the 12 key standards for financial market stability.[5]

On the basis of the OECD principles, the Basel Committee on Banking Supervision drew up a practical guide in February 2006 entitled "Enhancing Corporate Governance for Banking Organisations," defining eight principles to support the work of supervisory authorities.

These principles essentially refer to the responsibility of qualified and experienced management for corporate governance; the definition and communication of strategic corporate objectives and values for the external presentation of the credit institution and as guidelines for employees; the definition of clear responsibilities within the bank's organization; ensuring the appropriate qualifications and independence of supervisory board members, including a periodic self-assessment process; effective internal control functions, also for monitoring compliance with corporate governance provisions; appropriate remuneration policies which are consistent with the bank's

[5] *See www.fsforum.org/cos/key_standards.htm*

objectives, strategies and values; and transparency in corporate governance as a necessary prerequisite for assessing the performance of board members. This framework regards transparency as an essential element of effective corporate governance.

3 Legal Bases of Corporate Governance for Credit Institutions in Austria

In Austria, the implementation of the Banking Directive (2006/48/EC) in the amendment to the Austrian Banking Act (Federal Law Gazette I No. 141/2006) served to enhance the quality of national corporate governance regulations. In particular, this amendment affected Article 26 (Disclosure Obligations) and Article 39 (General Due Diligence Obligations) of the Banking Act, which are discussed in sections 3.1 and 3.2 below.

The subsequent reform of Austrian financial market supervision in 2007 (Federal Law Gazette I No. 108/2007) established specific corporate governance provisions for all credit institutions, with application thresholds defined in accordance with the principle of proportionality. Specific aspects of this reform are covered in section 3.3 (Cooling-Off Period), section 3.4 (Fit and Proper Test), section 3.5 (Audit Committee) and section 3.6 (Reporting Obligations).

Under the new heading "Special Requirements for Bodies of Credit Institutions" (Article 28a of the Banking Act), the importance of the supervisory board chairperson is clearly enhanced by the stricter requirements applicable to that position. Until the supervisory reform in 2007, there was an obvious deficit in this area of legislation. In line with CEBS guideline IG 11 and the principles defined by the OECD and BIS, the Austrian legislature for the first time concretely specified the independence and qualifications of the supervisory board chairperson for systemically important credit institutions, which require supplementary supervision. Article 28a paragraph 5 of the Banking Act provides for a threshold of EUR 750 million in total assets at the time when the supervisory board chairperson is elected; above that level, the chairperson is subject to additional requirements. This threshold, which is lower than that applicable to the audit committee (i.e., EUR 1 billion pursuant to Article 63a paragraph 4 of the Banking Act), underlines the importance of the supervisory board. This more stringent regulation serves to promote the stability of the Austrian banking system.

The sections below describe specific aspects of Austrian legislation on corporate governance.

3.1 Disclosure Obligations under Article 26 of the Banking Act and the Disclosure Regulation 2007

Through disclosure requirements, the legislature aims to contribute to improving risk control, market strategy and internal management. In its implementation of Annex XII to the Banking Directive, the Austrian Financial Market Authority (FMA) issued a regulation based on Article 26 of the Banking Act detailing the information to be disclosed. These disclosure obligations refer to the credit institution's organizational structure, own funds structure, minimum capital requirements, risk management, risk capital position, credit and dilution risk, internal market risk models, equity exposures not held in the trading book, securitizations and internal rating systems. In this context, risky positions are a topic of particular interest.

While the content of disclosures is defined precisely, the credit institution has a degree of discretion with regard to the medium used. Credit institutions may disclose information on the Internet, in newspapers or in magazines, but they are required to disclose all such data and information in the same medium.

Disclosures are limited by confidentiality interests, meaning that a credit institution may omit disclosures if they could undermine the institution's competitive position. Moreover, information which the credit institution deems "immaterial" need not be published.

The credit institutions themselves are responsible for the content of their disclosures. In order to ensure that information relevant to financial stability is disclosed despite the limitation under Article 26 paragraph 5 of the Banking Act, credit institutions are required to ensure the adequacy of the disclosed information by means of binding internal policies. Moreover, credit institutions are required to verify their disclosures and to publish information relevant to the financial market more frequently if necessary.

The decisive question is how these disclosure obligations are enforced in Austria. The Basel Committee was aware that national supervisory authorities may use different enforcement methods. These methods vary from country to country, ranging from moral suasion of a bank's managing directors to warnings or even monetary fines. The FMA verifies compliance with disclosure obligations in its ongoing monitoring of credit institutions, which is also carried out in the form of management meetings. There are no provisions for a specific mode of or for specific sanctions in the FMA's monitoring activities, and as a result the supervisory authority generally has recourse to all the instruments described under Article 70 of the Banking Act. In cases where a credit institution violates disclosure obligations, Article 70 paragraph 4 of the Banking Act may be applied. Under this provision, the FMA is to issue an administrative ruling which instructs the credit institution on pain of penalties to restore legal compliance – mainly by disclosing the relevant information – within a reasonable period of time. Violating disclosure obligations does not constitute an administrative offense. Although the possibility of responding directly to non-disclosure by increasing own funds requirements was explicitly omitted in the conception of Pillar 3 of the Basel II framework, in cases where credit institutions use the internal ratings-based approach (IRB), the advanced measurement approach (AMA) or credit risk-mitigating techniques (Articles 16 to 18 of the Disclosure Regulation), such failures to disclose information bring about an immediate penalty because the lower risk weights or special methods may no longer be applied (Urbanek, 2007).

3.2 General Due Diligence Obligations under Article 39 of the Banking Act

Article 39 of the Banking Act contains the key provisions regarding corporate governance and was expanded considerably in the implementation of the Banking Directive. However, the Banking Act still does not specify the characteristics of good corporate governance. For this reason in particular, the detailed recommendations of CEBS are especially significant.

These provisions address the managing directors of a credit institution, not the members of its supervisory board. In managing the credit institution, directors must exercise the diligence of a prudent and conscientious manager and ensure sound corporate management with due attention to the overall economic situation. The concept of due diligence implies that the directors must possess the subjective abilities and expertise required in order to perform their duties. Naturally, they also have to comply with all applicable laws.

The purpose of these provisions is to safeguard the credit institution's assets, to protect depositors, and more generally to maintain confidence in the banking system. The Austrian legislation therefore places special emphasis on establishing appropriate and effective risk management systems, which is the responsibility of the managing directors. Credit institutions are required to have in place administrative, accounting and control mechanisms for the capture, assessment, management and monitoring of risks arising from banking transactions and banking operations. In this context, the principle of proportionality must also be taken into account. For lack of more detailed descriptions, risk monitoring is interpreted to mean that the extent of risks is sufficiently known and the risk strategy is observed (precise monitoring of limits, independent reviews, separation of functions and clear organizational structures). The instruments of risk management include the definition of limits, transaction hedges, collateral and the rejection of certain transactions. Furthermore, the Banking Act requires risk management to be designed in such a way that it also accounts for future risks (stress testing). Administrative mechanisms include the bank's internal rules, articles of association, rules of procedure and communication systems (stress tests) as well as precise compliance codes. The appropriate accounting mechanisms should yield as precise a calculation of the credit institution's risk position as possible. Control mechanisms designed to prevent errors as well as the "four-eyes" principle serve to enhance the quality of risk management. In this regard, reporting systems with ad hoc reporting obligations are closely associated with these control mechanisms (Höller and Puhm, 2007).

Article 39 of the Banking Act is also the fundamental provision which directly governs any damage claims that the credit institution may assert against its directors. The FMA may even make use of supervisory powers enabling it to prohibit a credit institution from continuing its business operations (cf. Article 70 et seq. of the Banking Act). Under Article 70 paragraph 4a of the Banking Act, the FMA may also impose additional capital requirements. Within the scope of its competence, the FMA has issued several sets of minimum standards based on Article 39 of the Banking Act (e.g., minimum standards for internal auditing).

As it was necessary to adapt Austrian legislation to international standards, the reform of financial market supervision in 2007 brought about the following new provisions and thus also the required specifications regarding internal corporate governance at Austrian credit institutions.

3.3 Cooling-Off Period (Article 28a Paragraph 1 of the Banking Act)

In order to ensure the independence of the supervisory board chairperson, the new legislation prohibits managing directors from switching directly from the management board to the position of supervisory board chairperson. Directors may not take up activities as the chairperson of the supervisory board within the same undertaking in which they previously served as directors until a period of at least two years has passed since the termination of their function as directors (cooling-off period).[6] Conflicts of interest may arise if the chairperson of the supervisory board is involved in ex-post reviews of decisions taken by the management board to which s/he previously belonged. Should a managing director nevertheless take on the function of supervisory board chairperson before the cooling-off period has passed, his/her election is to be considered ineffective.

In this context, it is important to point out that the two-year period does not apply to the deputy chairperson or other regular members of the supervisory board. Managing directors may switch to those positions and contribute their expertise in that capacity immediately upon leaving their positions on the management board.

3.4 Fit and Proper Test (Article 28a Paragraph 3 of the Banking Act)

The FMA has been assigned a new responsibility with regard to reviewing qualifications. The position of supervisory board chair may only be occupied by a person who fulfills certain economic, personal and professional qualification requirements on an ongoing basis. For example, the chairperson must find himself/herself in an orderly economic situation. The reasons for exclusion therefore include not just bankruptcy, but even a disorderly financial situation (Schmidbauer, 2008).

Article 28a paragraph 3 item 1 of the Banking Act stipulates that the chairperson must possess the professional qualifications as well as the experience necessary to perform this function. The relevant professional qualifications refer to expertise in the fields of bank finance and accounting as appropriate to the credit institution in question. In addition to theoretical knowledge, the supervisory board chairperson must also possess personal practical expertise, which in particular includes having a sound knowledge of actual workflows, and thus a "knowledge and reflection capacity" (Ruhm and Schopper, 2007).

The law's explicit reference to the chairperson of the supervisory board does not eliminate the requirement that the other members of the supervisory board must also have the expertise necessary to perform their functions[7] (Schmidbauer, 2008).

After a supervisory board chairperson is elected, the credit institution is to provide the FMA with certification that the chairperson fulfills the requirements mentioned above. However, if the FMA concludes on the basis of available information that those requirements are not fulfilled, the FMA is required to raise an objection to the election of the chairperson in question. In the case of such an objection, the chairperson's function is suspended until a legally effective ruling has been handed down by the competent court. Until that time, the provisions of the law apply to the deputy chairperson.

In the case of a supervisory board chairperson of a credit institution established in another EU Member State, the law provides for some relief in that the FMA can assume that the qualitative requirements are fulfilled as long as no indications to the contrary become known. The situation is slightly different in the case of persons who are not Austrian citizens. In such cases, no reasons for exclusion from the position

[6] *Corresponds to C Rule 55 of the Austrian Corporate Governance Code.*

[7] *Cf. IG 11 of the CEBS Guidelines and C Rule 52 of the Austrian Code of Corporate Governance.*

of supervisory board chairman related to the criteria mentioned above may exist in that chairperson's country of citizenship. This must be confirmed by the banking supervisory authority in the chairperson's home country. However, if this confirmation cannot be obtained, then the chairperson concerned must at least provide credible evidence to that effect and certify that none of the above-mentioned reasons for exclusion apply.

Under a transitional provision (Article 103g item 3 of the Banking Act), this set of requirements does not apply to previously appointed supervisory board chairpersons until the expiration of their term of office, at the latest, however, until the end of 2010.

Other special legal restrictions on the appointment of supervisory board members[8] are not affected by this provision.

3.5 Audit Committee (Article 63a Paragraph 4 of the Banking Act)

The efficiency of the supervisory board's activities is increased by subgroups which are assigned specific areas of responsibility. Borrowing from the Austrian Stock Corporation Act and Article 41 of Directive 2006/43/EC, special legal provisions have been introduced to establish an audit committee within the supervisory board. At credit institutions whose total assets exceed EUR 1 billion or which have issued transferable securities that are admitted to listing on a regulated market, the credit institution's supervisory board (or other supervisory body competent according to applicable law or the articles of association) must appoint an audit committee. This committee is to consist of at least three members of the supervisory body.[9] Moreover, the committee must include one financial expert who possesses special expertise and practical experience in the fields of bank finance, accounting and reporting as appropriate for the credit institution in question. The law does not stipulate the specific professional qualifications (such as those of an external auditor) through which this experience is gained. In order to ensure independence, the chairperson of the audit committee or the financial expert may not be a person who has acted as a director, executive or bank auditor in the last three years, or a person who has signed the credit institution's audit certificate in the last three years (cooling-off period).

In order to ensure that this committee can perform its duties efficiently, its obligations are listed explicitly in the Banking Act:

1. monitoring accounting;
2. monitoring the effectiveness of the internal control system;
3. monitoring external audits of financial statements and of group financial statements;
4. reviewing and monitoring the independence of the bank auditor, especially with regard to additional services rendered for the undertaking audited;
5. auditing and preparing the approval of the accounts, the proposed appropriation of profits, the annual report and, where applicable, the corporate governance report, as well as submitting the report on audit results to the supervisory body of the parent institution;

[8] *Article 33 of the Nationalbank Act, Article 4 et seq. of the Incompatibility Act, Article 63 of the Federal Act on Judicial Service.*

[9] *Cf. L Rule 40 of the Austrian Code of Corporate Governance.*

6. where applicable, auditing the group financial statements and annual report as well as submitting the report on audit results to the supervisory body of the parent institution;
7. preparing the supervisory body's proposal for the selection of a bank auditor.

The duties indicated under numbers 4 and 7 are not to be performed by the supervisory board's audit committee in cases where the institution's bank auditor is a legally competent auditing organization (e.g., auditors, the auditing unit of the Sparkassenverband savings banks association).[10]

3.6 Expanded Reporting Obligations for Internal Audit Units and the Supervisory Board Chairperson (Article 42 Paragraph 3 of the Banking Act)

Reporting obligations are especially important in fields which are subject to government supervision and are characterized by an asymmetry of information. As control bodies, both the supervisory board and the banking supervisor must receive sufficient information to be able to perform their monitoring functions. To this end, the new Austrian legislation has expanded the reporting obligations of internal audit units in terms of content and recipients. The internal audit unit now plays a key role within the framework of internal control mechanisms.

Two principles were defined in the law: First, instructions involving the internal audit unit must be made jointly by a minimum of two managing directors. Second, the internal audit unit must report to *all* managing directors.[11] In addition, this unit must report on audit areas and the material results of audits *directly* to the chairperson of the credit institution's supervisory board (or other supervisory body competent according to applicable law or the articles of association) and to the audit committee. Such reports are to be submitted on a quarterly basis. Subsequently, the supervisory board chair is to inform the entire supervisory board about the internal audit unit's reports; this signifies an expansion of the chairperson's reporting obligations.[12] This provision considerably enhances the flow of information to and within the supervisory board. It also serves to eliminate opaque or "shadow" structures within a credit institution.

As the internal audit unit is highly significant within the supervisory framework, the FMA already issued minimum standards for internal auditing in 2005. These minimum standards (which in legal terms only constitute recommendations) include enforcement measures as well as specific instructions regarding the duties of the internal audit unit.[13]

4 The Austrian Code of Corporate Governance

The Austrian Code of Corporate Governance[14] provides exchange-listed companies in Austria with a framework of rules for corporate management and monitoring. The flexible and voluntary

[10] *In the Austrian implementation of Directive 2007/44/EC, the duties of the audit committee will be adapted in accordance with the provisions of Article 92 paragraph 4a of the Stock Corporation Act.*

[11] *Cf. IG 14 of the CEBS Guidelines.*

[12] *Cf. IG 2 and 14 of the CEBS Guidelines and C Rule 18 of the Austrian Code of Corporate Governance on reporting obligations.*

[13] *http://www.fma.gv.at/cms/site/EN/einzel.html?channel=CH0081*

[14] *http://www.corporate-governance.at*

self-regulation of capital market participants is to build investor confidence and strengthen the Austrian capital market. In addition to causing financial damage to investors, corporate governance scandals can lead to a reluctance to invest capital and thus have a sustained adverse effect on the investment environment.

The code is only applicable where a company voluntarily commits to these corporate governance principles in their current version. However, a declaration of commitment to the Austrian Code of Corporate Governance is a requirement for admission to listing on the Prime Market of the Vienna stock exchange.

The Austrian Code of Corporate Governance is only applied to Austrian credit institutions if they are listed on the stock exchange as a publicly held corporation – as is the case with Erste Bank and Raiffeisen International – and (explicitly) commit to the code. The special rules for banks as discussed in chapter 3 are not affected by the code.

The most recent proposed amendments to the code in 2008 included the compulsory corporate governance report, diversity on the supervisory board, expanded transparency requirements with regard to remuneration systems (individual disclosure of managing directors' remuneration under C Rule 31), and an additional reinforcement of the independence of the supervisory board and its committees.

The code includes three categories of rules:

1. Legal requirement (L): These rules are based on applicable laws, which means that voluntary commitment would be superfluous. The presentation of the Austrian legal situation with regard to corporate governance helps foreign investors quickly obtain an overview of Austrian legislation in this field.
2. Comply or Explain (C): These rules, of which there are approximately 40, serve as a supplement to the legal requirements. With regard to the transparency of management board remuneration as well as the number of supervisory board committees (remuneration and nomination committee), for example, the code imposes stricter requirements than the law. Deviations from best practices must be explained and justified in order to ensure conformity with the code.
3. Recommendation (R): This category comprises non-binding recommendations. Credit institutions are not required to disclose or justify non-compliance with these rules.

5 Comparison of Austrian Legislation with European Legal Standards

A comparison of the current state of Austrian legislation with European standards reveals that the supervisory reform of 2007 brought about significant advances in Austria. The country's transparency regulations are also consistent with international standards. The obvious deficit in the field of internal control was eliminated by increasing the importance of the supervisory board and by expanding internal reporting obligations. The Financial System Stability Assessment published by the International Monetary Fund (IMF) in June 2008 suggests that Austria's application of "fit and proper test" requirements for supervisory board chairpersons be expanded to include smaller credit institutions which do not belong to a specific sector and thus cannot take advantage of sector-specific protection schemes.

Practical Implementation of Corporate Governance and Transparency in Austrian Banks

Credit institutions[1]	Corporate Governance	Transparency
BA-CA	www.bankaustria.at External evaluation, description of criteria for verifying the independence of supervisory board members under „Investor Relations"	Annual report, quarterly results
Erste Bank	www.sparkasse.at Exact description of implementation, evaluation and criteria for verifying the independence of supervisory board members under „Investor Relations"	Annual report, quarterly report, extensive information with regard to the Austrian Disclosure Regulation, financial ratios and current investor information
RZB	No extensive description on the bank's website	www.rzb.at, annual report and „Company Info"
BAWAG	www.bawagpsk.com Description and evaluation under „Investor Relations"	Annual report and company information
Hypo Alpe Adria	www.hypo-alpe-adria.com Brief statement of commitment to corporate governance with reference to the bank's articles of association	Annual report
Kommunalkredit	No explicit mention on the bank's website	www.kommunalkredit.at Annual report, quarterly report
RLB OÖ	No explicit mention on the bank's website	www.geschaeftsbericht.at/rlbooe (annual report) and quarterly reports
RLB NÖ-W	No explicit mention on the bank's website	www.raiffeisen.at, annual report and current information
Investkredit	www.investkredit.at Statement of commitment to corporate governance	Ratios and annual report
Oberbank	www.oberbank.at Corporate governance statement in annual report	Annual report, newsletter and ad-hoc reports

Source: OeNB.

[1] *Information collected on the Internet as of August 2008.*

The IMF's assessment also stated that an annual corporate governance statement would be desirable. For exchange-listed credit institutions, this was introduced in the most recent reform (Federal Law Gazette I No. 70/2008) of the Austrian Company Code (UGB). Article 243b of the Company Code now stipulates that all *exchange-listed companies* are required to issue a corporate governance statement each year. In this way, it is possible to provide interested parties – especially shareholders – with essential information on the company's management and control.

Most of the CEBS recommendations are subsumed under the general provisions of Article 39 of the Banking Act, as the Austrian legislature chose not to specify each individual recommendation in concrete terms. However, written documentation requirements could be described more precisely.

According to IG 19 of the CEBS guidelines ("whistle-blowing"), employees should be provided with a risk-free means of communicating corporate governance concerns within the credit institution. The Austrian legislation does not contain any references to the topic of whistle-blowing, and therefore no internal or external reporting obligation exists in this area. External reporting would imply that employees could report such concerns directly to the supervisory authorities. Due to the influence of Anglo-Saxon legal systems, it appears that companies will have to become increasingly involved in the supervisory authorities' investigation processes. This topic is surrounded by considerable legal uncertainty, which generally brings about a situation in which companies and practitioners will often dismiss new and expanded obligations out of hand – which is understandable from their perspective (Kittelberger, 2007). Moreover, external whistleblowing may be subject to certain limits due to obligations under contract law and employment law (Gapp, 2007).

6 Overview of Practical Implementation of Corporate Governance and Transparency in Austria

A detailed examination of the extent to which fundamental corporate governance rules have been implemented by Austria's top banks and of the information disclosed would go far beyond the scope of this article.

In general, an evaluation of the websites showed that Austrian credit institutions attach great importance to corporate governance principles and also comply with transparency requirements. Compared to Credit Suisse, whose website can be considered exemplary with regard to corporate governance, certain banks could improve the placement of this topic on their websites. In some cases, the relevant information could be made more accessible to the public in a more up-to-date and compact form.

7 Conclusions

The reform of financial market supervision in 2007 helped to strengthen internal corporate governance in Austria. Membership in a supervisory board is more than an honorary appointment. The current legislation defines qualitative requirements for supervisory board chairpersons, ensuring that the supervisory board possesses the necessary qualifications and is able to perform (and actually does perform) its monitoring functions effectively in the credit institution. The supervisory authorities, which must ensure high quality in the performance of their duties, also bear responsibility for good corporate governance at credit institutions. Further improvements in corporate governance provisions could involve the remuneration systems for managing directors, with supervisors paying particular attention to risk-related factors of directors' salaries.

As transparency contributes to financial stability, supervisors are required to ensure the legally compliant and timely fulfillment of disclosure obligations. Credit institutions in turn must realize that good corporate governance and appropriate transparency help improve confidence and further enhance a bank's reputation.

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