

EUROPEAN INVESTMENT BANK

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BOARD OF DIRECTORS

PROGRESS REPORT TO THE BOARD OF GOVERNORS ON

THE GOVERNANCE OF THE BANK

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EUROPEAN INVESTMENT BANK

BOARD OF DIRECTORS

Progress Report to the Board of Governors on *The Governance of the Bank*

1. Introduction

At their Annual Meeting on 5 June 1998, as part of their decision approving the Strategic Framework, the Board of Governors invited the Board of Directors "to initiate a review of the governance of the Bank, in anticipation of the prospective enlargement of the Union, and present a progress report to the Board of Governors for its Annual Meeting in 1999".

The purpose of this note by the Management Committee is to summarise the background to this question and to suggest the main considerations that now arise as a basis for a discussion by the Board of Directors and subsequent preparation of a progress report to the Board of Governors.

2. General Background

It is assumed that the principal issues to be addressed are the responsibilities and composition of the main governing bodies of the Bank, viz. the Board of Governors, the Board of Directors, the Management Committee, and the Audit Committee, and, where relevant, the relationships between them. All these bodies were established under the terms of the original Statute in 1958, and no substantive changes have subsequently been made to this, except those necessary to accommodate the entry and share participation of new Members. Attached for convenience at Annex 1 are the principal relevant provisions of the Statute.

The question of governance was last considered by the Governors in 1992 on the basis of proposals presented to them in July and October 1991 by the then President on behalf of the Board of Directors. In coming to their conclusions, the Board of Directors had received among other things a report commissioned from the consultancy, Coopers & Lybrand. The only decisions taken by the Governors were (to summarise): -

- (i) That increased individual responsibility should be given to members of the *Management Committee*, under which they would have greater responsibility, under the authority of the President and within the collegiality of the Management Committee, for the formulation and presentation of important and policy-oriented proposals in their areas of competence.
- (ii) That the role of the President in relation to the selection of future Vice-Presidents should be strengthened with a view to putting forward an agreed candidate to the Boards of Directors and Governors.

The first of these decisions has been implemented by attributing to Vice Presidents specific areas of both geographical and functional supervisory responsibility; and in the case of the second, some appropriate consultations have taken place but the ultimate responsibility and decision on candidates in practice will always rest with the nominating governments.

3. Reasons for change

The request by the Governors to the Board of Directors is specifically related to future enlargement. It is assumed, therefore, that just as is the case with other Community institutions, the principal question to be addressed is, against an expectation of up to 11 more Members of the European Union, who would expect to become shareholders of the Bank, what if any changes need to be made in the governance of the Bank in order to ensure that it can continue to play an efficient and effective role in support of Union policies.

There is no doubt that some changes will be required to achieve this. As is shown below, simple enlargement of the Bank's governing bodies in accordance with past precedent would make its governance unacceptably cumbersome and the decision process extremely difficult, if not impossible. Furthermore, although it will no doubt be some time before the enlargement negotiations lead to the first actual accessions, there is a strong case for reaching at least decisions in principle on governance changes in good time before that happens. Preparations for the next Intergovernmental Conference are due to begin in the latter half of 1999, and it might be sensible to aim to move from the progress report to a final position for the Governors to adopt at least in principle at their Annual Meeting in 2000 or 2001.

The timing of decisions will, however, need to have close regard to decisions being taken in respect of other Community institutions, such as the composition and voting procedures of the Commission. But subject to that the objective would be to establish a clear policy, at least in principle, before new Members sought to negotiate their terms of membership of the Bank. The following sections therefore review briefly the governing bodies of the Bank, the possibilities for changes both with and without amendment of the existing Statute, and the main considerations relevant to any change.

Although this note, as requested, is primarily addressed to the implications of enlargement, it is, of course, possible to consider modifications to the present governance structure for other reasons, for example relating to the Bank's efficiency and effectiveness on its present membership and governance basis. The Management Committee does not, however, believe that the present situation calls for any radical changes, but neither is a "do nothing scenario" a tenable option. In general, the Bank "works" and its governance structure is certainly more economical and cost effective than those of many other comparable international institutions. The relationship between the Management Committee and the Board of Directors has also in practice evolved over time and, with the approval last year of the Strategic Framework and the subsequent first Corporate Operational Plan, the foundations are now being laid for a constructive forward looking partnership between the Board of Directors, the Management Committee and the other organs of the Bank. It has also proved possible to strengthen substantially the audit arrangements of the Bank within the present statutory structure.

This does not mean that there are no further improvements and adjustments to be considered on their own merits both in relation to the governing bodies and the internal management of the Bank (some of which are mentioned below), but this does not seem to require any radical formal changes in the context of the present membership of the European Union. It should be remembered in any case that to make any statutory changes in advance of those related to enlargement would be a very heavy procedure, involving ratification by national parliaments.

4. The Board of Governors

The Board of Governors is the supreme political decision-making organ of the Bank, consisting of one Minister designated by each Member State (normally the Finance Minister), as is normal for such international institutions. Each Member State has the inherent right to be represented at this level, its relative participation in the Bank's capital being reflected in the weighting of its voting right (in turn broadly commensurate with the relative importance of its economy as a share of the Gross Domestic Product of the European Union). Although the Board of Governors only normally convenes once a year (at the Annual Meeting in June), extraordinary meetings are held from time to time as required, business is transacted when necessary by written procedure, and in practice most Governors attend the monthly ECOFIN Council and are able to discuss issues affecting the Bank informally there, if the need arises. Expansion of the Board of Governors to reflect enlargement should not seriously affect its ability to transact Bank business – in any case, each shareholder must have a right to be represented at this level – so for the purposes of the present exercise, issues of governance at Governing Board level are not deemed to arise. If, however, there were any change in the voting procedures for the Commission or the Council, it would be necessary to consider the implications of these for the Board of Governors.

5. The Board of Directors

The Board of Directors is non resident and normally meets monthly in Luxembourg, with one meeting a year traditionally held in another country in which the Bank has lending operations. Under Article 11.2 of the Statute, members of the Board "shall be chosen from persons whose independence and competence are beyond doubt" and "they shall be responsible only to the Bank". At present the Board consists of 25 Directors (including one from the Commission) and 13 Alternates, all of whom are expressly entitled under the Statute to attend Board meetings. Since a number of Alternates are appointed because of their specialist background (eg external development finance or financial markets), and therefore frequently attend Board meetings and participate in the discussions, Board attendance is generally high – averaging between 26 and 30. The Board usually has a very heavy agenda, covering policy issues, financial questions and projects. Its approval is required for all loan proposals submitted to it by the Management Committee, and in recent years the volume of projects has increased substantially, as also the number of policy issues laid before the Board for consideration and decision.

The discussion and decision making process in the Board is still manageable¹, and has progressively evolved, particularly with the development of a Corporate Operational Plan presented for the Board's approval, but there is no doubt that if on enlargement the number of Directors and Alternates was increased in accordance with past precedent, and the same attendance practices applied, the situation would become quite unmanageable. As the note at Annex 2 shows, after enlargement the Board could consist of as many as 55 members, comprising 36 Directors and 19 Alternates.

It would be possible by voluntary agreement to change the attendance and modus operandi of the Board of Directors within the present Statute. Among the possibilities for consideration would be limiting normal attendance to Full Directors, with Alternates attending as substitutes when Directors were unavailable; or an arrangement under which the Board might meet in more restricted compositions with, say, three or four meetings a year to consider the overall Board agenda and major policy issues (such as the annual Corporate Operational Plan) and other meetings in the intervals more dedicated to current operational business. A number of variations on such arrangements would be possible, some of which will need to be considered soon anyway in view of the increasing burden of paper and business. Indeed, there would be advantage in using the period between now and enlargement to test any such new internal rules or procedures, together with other means of streamlining the work of the Board (eg greater use of written clearance procedures) in order to secure greater efficiency.

There is no doubt, however, that with the increased membership after enlargement voluntary changes are unlikely to be sufficient and statutory amendments, which are necessary for any formal change in the size or composition of the Board, will have to be considered. New Members of the Bank will presumably be eager to exercise their membership rights to the full and reluctant to accept any voluntary self-denying ordinance.

If statutory changes were made, a number of further possibilities could be explored. These might include, for example, reducing the number of Directors and/or Alternates for the larger members, with a right for nominated Alternates to represent full Directors at meetings only in their absence. It would still be most important, however, to ensure that representation on the Board continued at at least its present high level and that a satisfactory balance was maintained between the official and banking sectors. This is very important both because of the specific expertise that the banking sector Directors can contribute and in order to maintain close alignment between the Bank and the financial and market sector. Any reduction in the overall number of Directors, however, would presumably require as a corollary a new form of weighted voting in relation to share capital, in accordance with the principle of the present system under which the larger shareholders command more votes².

¹ However, with most discussions, time usually allows only one main "tour de table", which is far removed from the deliberative process originally envisaged (16 members attending for a far shorter agenda and seldom more than 15 projects in the 1960s and 1970s, compared with up to 30 members now and as many as 50 projects).

² The current weighting in the Board of Directors offers relatively greater advantage to the smaller Member Countries (one man/one vote = 4% of the suffrage) than to the larger ones (3 votes = 12% of the suffrage). In the Board of Governors, the capital contributions weighting for votes ranges from 0.125% (Luxembourg) to 17.77% (France, Germany, Italy, United Kingdom), which gives three "large" countries a simple majority.

6. The Management Committee

In accordance with Article 13 of the Statute, the Management Committee "shall be responsible for the current business of the Bank, under the authority of the President and the supervision of the Board of Directors". The number of Members is not prescribed in the Statute, but it currently consists of eight Members, including the President, four of whom have traditionally been appointed by the four largest shareholders (France, Germany, Italy, and the United Kingdom), with the other four from constituencies by political agreement between the other shareholder governments concerned. Although each Member of the Management Committee is formally appointed under the Statute for a period of six years, the latter arrangements have also included agreement on shorter terms of office to be served by Vice-Presidents representing constituencies. Under the Statute, members of the Management Committee "shall be responsible only to the Bank and shall be completely independent in the performance of their duties" (Article 13.8).

The Management Committee prepares proposals for consideration and decision by the Board of Directors. Its Members are resident at the Bank and normally meet formally as a Committee, with the attendance of relevant senior professional staff, once or twice each week. It reaches decisions on a collegial basis, usually by consensus, with voting by simple majority on occasions if this proves necessary. Since individual Members are nominated by shareholder governments, who expect them to represent their (or their constituency) interests, in a sense it brings a broader dimension to the overall management of the Bank's affairs. Individual Vice-Presidents do not have specific line management responsibilities, in a direct hierarchical sense, but they have supervisory geographical and functional responsibilities assigned to them by the President.

Any fundamental change in the Management Committee's responsibilities or working methods (eg its formal relationship with the Board of Directors or its voting procedures) would probably require an amendment to the Statute. Unlike the Board of Directors, however, changes to the numbers of the Management Committee can be made by the Governors under the present Statute (Art. 13), as can any realignment or consolidation of the system of constituencies used for the nomination of Vice-Presidents. There is, therefore, a good deal of flexibility under the present system. It should be remembered, however, that at the time of the last enlargement, despite a prior inclination to the contrary, the Board of Governors decided to increase the membership of the Management Committee from seven to eight in order to give separate representation at Management Committee level to the new "constituency" of Austria, Finland and Sweden.

Among the questions for consideration are the following: -

(a) The size of the Management Committee. If previous precedent were followed, its size (see Annex2) could grow to as many as eleven Members, including the President. An Executive Committee of this size would be too large and seriously threaten the effective working of the Management Committee. The present size and composition is probably near the limit if genuine participative collegiality is to be maintained;

(b) The nationality of Vice-Presidents. It is for consideration whether there should be a greater rotation, or any changes in the "constituencies" reflecting the weighting of the shareholders or other considerations such as other relevant shareholder representation (eg on the Audit Committee). A more radical change would be to dispense with nationality considerations entirely;

(c) The qualifications of Vice-Presidents. Members of the Management Committee have been chosen from a variety of backgrounds – public service, politics, banking, insurance and so on. It is for consideration whether more weight should be attached to specific professional or technical competencies, which could enable Vice-Presidents to assume more direct executive as opposed to supervisory responsibilities within the Bank. Any move in this direction would, of course, shift the balance away from the present "shareholder collegiality" to a more technocratic one, and have implications for the relationship between Members of the Management Committee and the senior professional managers of the Bank, who are the line managers in charge of the different Directorates.

7. The Audit Committee

Under Article 14 of the Statute, the Audit Committee consists of three Members nominated by the Governors. Any increase requires an amendment to the Statute. There is no stipulation as to nationality, but in practice nominations have been used to help maintain a fair nationality balance, taking into account the composition of the Management Committee. Thus, Members of the Audit Committee have normally been appointed from Member States not currently represented on the Management Committee. In 1996, in view of the increasing workload on the Audit Committee and the wish to strengthen, and be seen to strengthen, the audit capability of the Bank generally, the Governors agreed to the addition of an "Observer" to the three statutory Members.

Enlargement itself will not necessarily have direct implications for the membership of the Audit Committee. To keep the present numbers, however, would make it more difficult for the composition of the Audit Committee to help maintain an appropriate overall nationality balance; and in any case there is a case on merits for increasing the statutory membership of the Committee to four or five, given the present and prospective burden of work and the need to continue to demonstrate the self-sufficiency of the Bank's audit arrangements. If, therefore, as a result of the review of governance it were decided to make any changes in the Statute (ie beyond those strictly necessary simply to provide for the new Member States to become shareholders of the Bank), the opportunity could be taken to increase the membership of the Audit Committee, possibly by giving the Governors the power to vary it in the future, by analogy with their existing power in relation to the Management Committee. Otherwise, the only possibility would be to co-opt further "Observers". The overriding priority, however, will be to continue to appoint to the Audit Committee members with the necessary professional experience and standing.

8. Conclusions

This paper does not at this stage make detailed recommendations, or propose any fundamental changes in the relationships between the Bank's present governing bodies. The latter would in any case depend in part on any changes to the bodies themselves, and vice versa. Rather, it seeks to set out the main issues that will need to be considered by the Board as a basis for a first progress report to the Board of Governors in June.

Nevertheless, the following preliminary conclusions are implicit in this analysis:-

- (i) there is scope for a certain amount of change and flexibility within the present Statute and further consideration should be given to developing new rules and procedures within this framework;
- (ii) there should be no further increase in the numbers of the Board of Directors or the Management Committee as a result of enlargement. The former will require a statutory change and, subject to any concurrent developments in respect of the governance of other Community Institutions, it would be advisable to reach a clear decision in principle to this effect before the prospective new Member States engage in negotiations on the terms of their future membership of the Bank;
- (iii) the intervening period should be used to consider in detail what statutory changes should be made when the accession time arrives.

Annexes: 2

**The Governance of the EIB :
Principal provisions of the Statute**

Article 11

2. The Board of Directors shall consist of 25 directors and 13 alternates.

The directors shall be appointed by the Board of Governors for five years as shown below :

- three directors nominated by the Federal Republic of Germany,
- three directors nominated by the French Republic,
- three directors nominated by the Italian Republic,
- three directors nominated by the United Kingdom of Great Britain and Northern Ireland,
- two directors nominated by the Kingdom of Spain,
- one director nominated by the Kingdom of Belgium,
- one director nominated by the Kingdom of Denmark,
- one director nominated by the Hellenic Republic,
- one director nominated by Ireland,
- one director nominated by the Grand Duchy of Luxembourg,
- one director nominated by the Kingdom of the Netherlands,
- one director nominated by the Republic of Austria,
- one director nominated by the Portuguese Republic,
- one director nominated by the Republic of Finland,
- one director nominated by the Kingdom of Sweden,
- one director nominated by the Commission.

The alternates shall be appointed by the Board of Governors for five years as shown below:

- two alternates nominated by the Federal Republic of Germany,
- two alternates nominated by the French Republic,
- two alternates nominated by the Italian Republic,
- two alternates nominated by the United Kingdom of Great Britain and Northern Ireland,
- one alternate nominated by common accord of the Kingdom of Spain and the Portuguese Republic,
- one alternate nominated by common accord of the Benelux countries,
- one alternate nominated by common accord of the Kingdom of Denmark, the Hellenic Republic and Ireland,
- one alternate nominated by common accord of the Republic of Austria, the Republic of Finland and the Kingdom of Sweden,
- one alternate nominated by the Commission.

The appointments of the directors and the alternates shall be renewable.

Alternates may take part in the meetings of the Board of Directors. Alternates nominated by a State, or by common accord of several States, or by the Commission, may replace directors nominated by that State, by one of those States or by the Commission respectively. Alternates shall have no right of vote except where they replace one director or more than one director or where they have been delegated for this purpose in accordance with Article 12(1).

The President of the Management Committee or, in his absence, one of the Vice-Presidents, shall preside over meetings of the Board of Directors but shall not vote.

Members of the Board of Directors shall be chosen from persons whose independence and competence are beyond doubt; they shall be responsible only to the Bank.

Article 12

1. Each director shall have one vote on the Board of Directors. He may delegate his vote in all cases, according to procedures to be laid down in the rules of procedure of the Bank.

2. Save as otherwise provided in this Statute, decisions of the Board of Directors shall be taken by a simple majority of the members entitled to vote. A qualified majority shall require 17 votes in favour. The rules of procedure of the Bank shall lay down how many members of the Board of Directors constitute the quorum needed for the adoption of decisions.

Article 13

1. The Management Committee shall consist of a President and seven Vice-Presidents(*) appointed for a period of six years by the Board of Governors on a proposal from the Board of Directors. Their appointments shall be renewable.

The Board of Governors, acting unanimously, may vary the number of members on the Management Committee.

2. On a proposal from the Board of Directors adopted by a qualified majority, the Board of Governors may, acting in its turn by a qualified majority, compulsorily retire a member of the Management Committee.

3. The Management Committee shall be responsible for the current business of the Bank, under the authority of the President and the supervision of the Board of Directors.

It shall prepare the decisions of the Board of Directors, in particular decisions on the raising of loans and the granting of loans and guarantees; it shall ensure that these decisions are implemented.

4. The Management Committee shall act by a majority when delivering opinions on proposals for raising loans or granting loans and guarantees.

5. The Board of Governors shall determine the remuneration of members of the Management Committee and shall lay down what activities are incompatible with their duties.

6. The President or, if he is prevented, a Vice-President shall represent the Bank in judicial and other matters.

7. The officials and other employees of the Bank shall be under the authority of the President. They shall be engaged and discharged by him. In the selection of staff, account shall be taken not only of personal ability and qualifications but also of an equitable representation of nationals of Member States.

8. The Management Committee and the staff of the Bank shall be responsible only to the Bank and shall be completely independent in the performance of their duties.

(*) The number of Vice-Presidents was increased from six to seven under Decision taken by the Board of Governors on 3 March 1995.

Article 14

1. A Committee consisting of three members, appointed on the grounds of their competence by the Board of Governors, shall annually verify that the operations of the Bank have been conducted and its books kept in a proper manner.

2. The Committee shall confirm that the balance sheet and profit and loss account are in agreement with the accounts and faithfully reflect the position of the Bank in respect of its assets and liabilities.

Bases for working assumptions in the progress report

Now : Management Committee : $1 + 7 = 8$ (President, Vice-Presidents)
Board of Directors : $25 + 13 = 38$ (Directors ; Alternates)

If enlargement, in two phases as expected, 6 then 5, follows the previous pattern of additions to decision-making bodies, and if a very arbitrary assumption is made regarding the establishment of constituencies, the numerical scenario could be something like this :

6 new members = say, 2 constituencies :

Hungary + Poland = say, 2 Directors + 1 Alternate

Czech Republic + Estonia || Slovenia + Cyprus = say, 4 Directors
+ 2 Alternates

Hence : Management Committee : $1 + 9 = 10$
Board of Directors : $31 + 15 = 46$

11 new members : say 3 constituencies (reforming after second enlargement?) :

Baltics : Estonia + Latvia + Lithuania = 3 Directors + 1 Alternate

Central : Hungary + Poland + Czech Republic = 3 Directors + 1
Alternate

Southern : Albania + Bulgaria + Romania + Slovenia + Cyprus = 5 + 2

Hence : Management Committee: $1 + 10 = 11$
Board of Directors : $36 + 19 = 55$