



# The Assessment of Corporate Governance in Banks: from Principles to Practice

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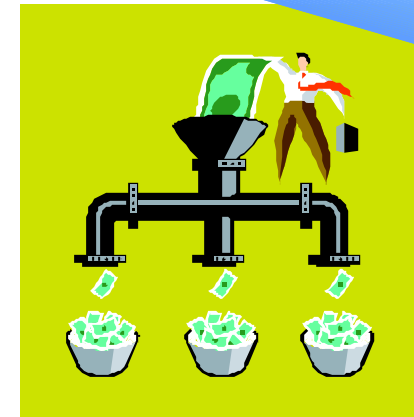
## Outline

- A. Critical Role of Effective Governance in Banks
- B. Key Findings Bank Governance Country Reviews
- C. Role of the Supervisor and Supervisory Framework
- D. Bank Governance Assessment Tools
- E. World Bank Assistance Program

# A. Critical Role of Effective Governance in Banks



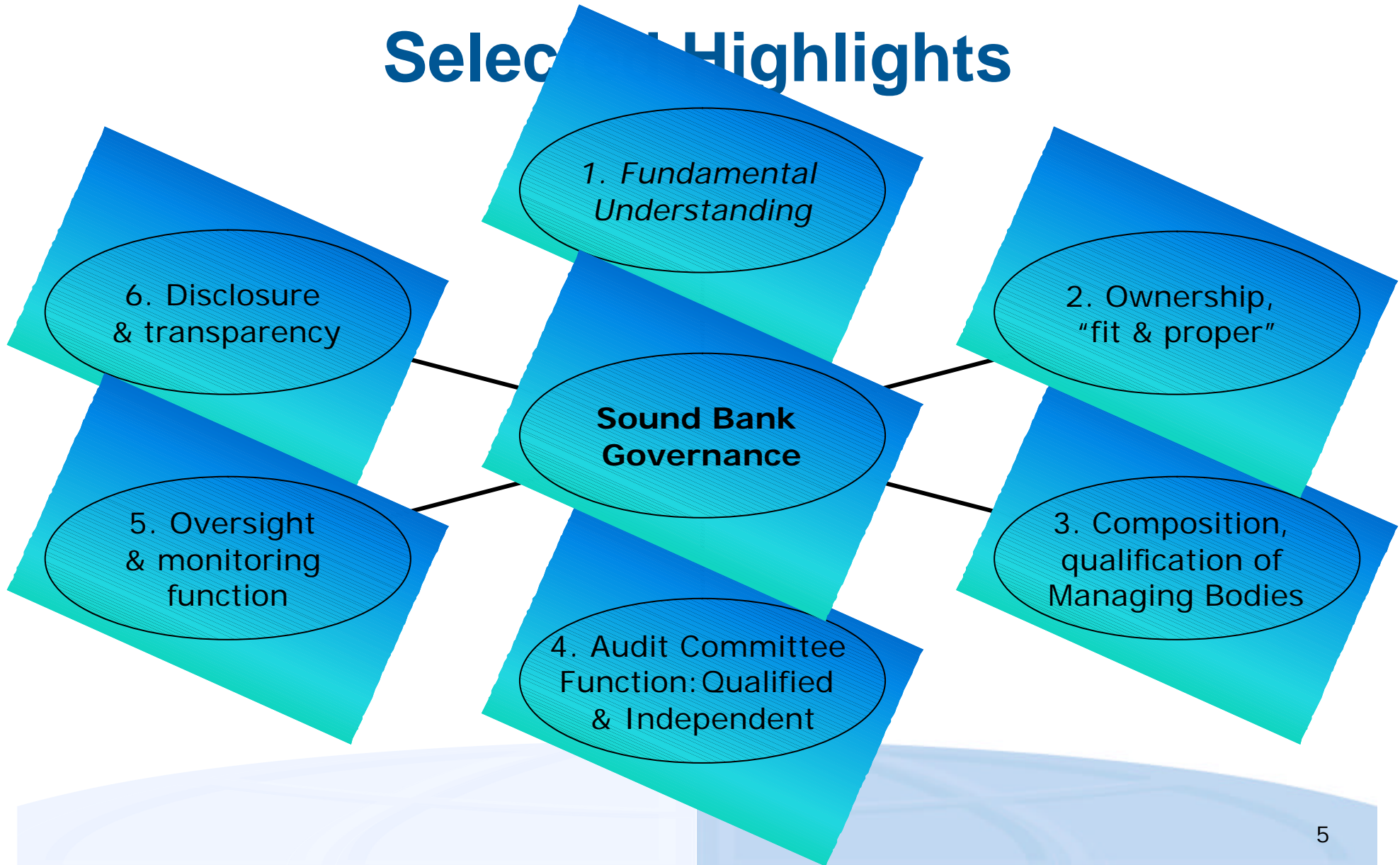
***Governance is about what people in responsible positions do (or don't do) with other people's money...***

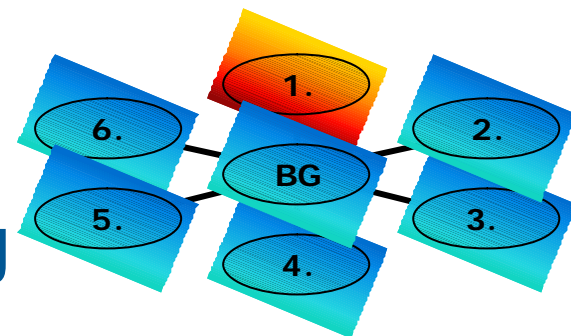


## **B. Key Findings from Country Reviews**



# Select Highlights



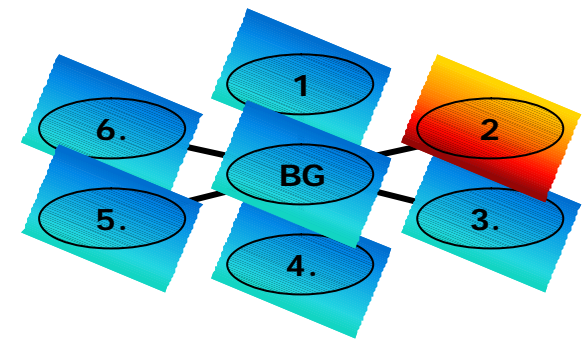


# 1. Fundamental Understanding (lack of) Sound Bank Governance

Banks are considered ***“public interest entities”***.

Through the taking of deposits, dealing with customers,  
and facilitating funds flow through the economy,  
owners, directors, senior mgmt. assume responsibility for  
the ***“public trust ” - first.***

**Boards & management must embed this  
fundamental understanding in the banks' culture  
and decision-making processes.**



## 2. Bank Ownership, Organizational Structures and “Fit & Proper”

- Beneficial or ultimate owners and organizational structures should be known, at a minimum to supervisor, to facilitate evaluation by all stakeholders



- Clear lines of authority and responsibility should be established between the boards and senior management and role of controlling the shareholders

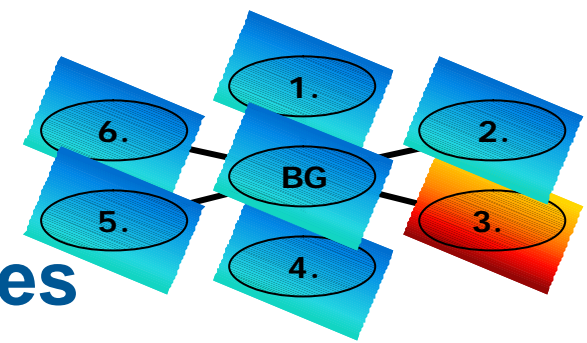


- “Fit & Proper” Members of Banks’ managing bodies (BOD, SM) should be ensured



- Identification of direct and indirect related party transactions

**Historically close links among ownership, boards, and management have led to blurred lines of roles and responsibilities.**



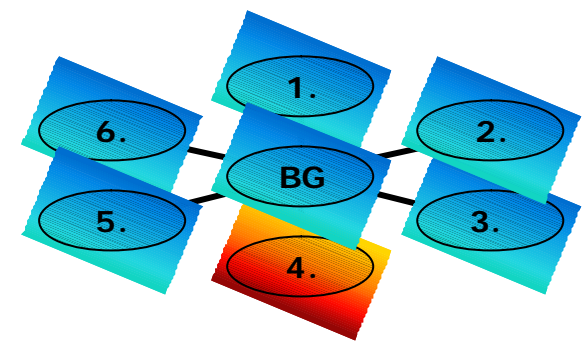
### 3. Composition and Qualifications of Managing Bodies

- Members of Managing Bodies should be able to:
  - ✓ Understand the dynamic **risk profile** of bank
  - ✓ Be **qualified**, updated as complexity of the bank grows, and not be over-committed
  - ✓ Be **independent** in judgment from the controlling owners and other external influences

**Governance structures need to keep pace with bank & market changes, particularly as new unidentified risks may accumulate and be masked by corresponding (initial) revenue growth**

- Board remuneration should be **linked** to L-T banks' performance and not, for example, to remuneration of senior management
- Senior management **succession planning** is a concept that needs to be fully embraced
- Subsidiary boards of largely foreign owned banks should be required to **act in the best interests of the bank** and have qualified, independent local representation



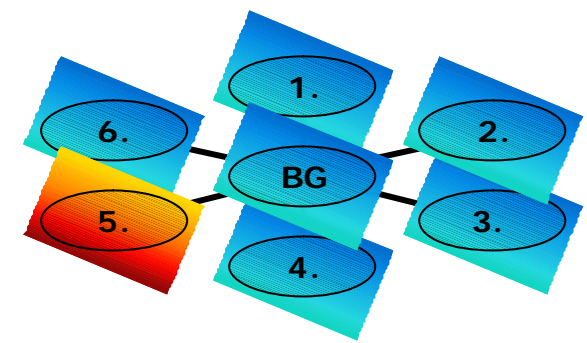


## 4. Audit Committee Function: Qualified & Independent

- Good practice: comprised of **non-executive directors**, independent directors and have **updated, pertinent skills**
- **Former senior officials from supervisory agencies**, subsequently employed by banks, should be disallowed from making representations on supervisory matters prior to the bank
- **Independently receive** audit results & take actions
- Responsible for **accuracy of financial statements** (with full board)
- Ensure proper review of **“special structures”**
- Promote independence / **elevate internal audit**
- **Adequately fund** external internal audit

**Long-standing directors on board and audit committees may not have updated skills for the review of audits, risks, and related issues;**

**The responsibility for & the importance of financial statement accuracy may not be fully realized by bank parties.**

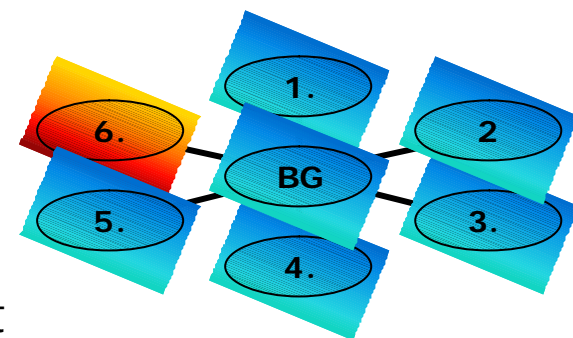


## 5. Oversight and Monitoring Functions

(risk management, compliance, internal audit)

- **Planning for internal review functions** >>> inherent part of strategic planning, especially for business expansion & new products
- **Adequately** staffed and funded
- **Independent** from the business line they
- Internal audit function: **elevation** with  
more serious **emphasis** by  
management and Audit Committees
- **Related party transactions:**  
define, identify, approve (board)  
and monitor

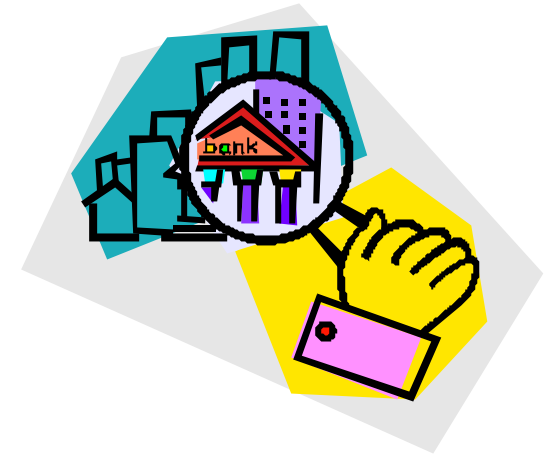
**The degree of development of internal review functions is quite wide ranging, usually a function of international activity and/or desire for increased efficiency and profitability.**



## 6. Disclosure & Transparency

- **Accuracy and integrity** of financial statement (incl. supporting notes & disclosures) and management information > key indicator of governance status of a bank
- Disclosure of **full financial statements**, including supporting notes; websites should be informative, including full financial statements
- **Qualitative disclosures** provide market participants with additional information with which to judge governance quality. Key areas include:
  - significant shareholders / ownership structure
  - related party & affiliate transactions
  - Codes of ethics / governance
- Activities in **jurisdictions that impede transparency** and activities through complex structures need particular attention

**Under an inadequate framework, governance issues may remain unreported unless uncovered by the supervisor during the examination**



## Role of the Supervisor and Regulatory Framework

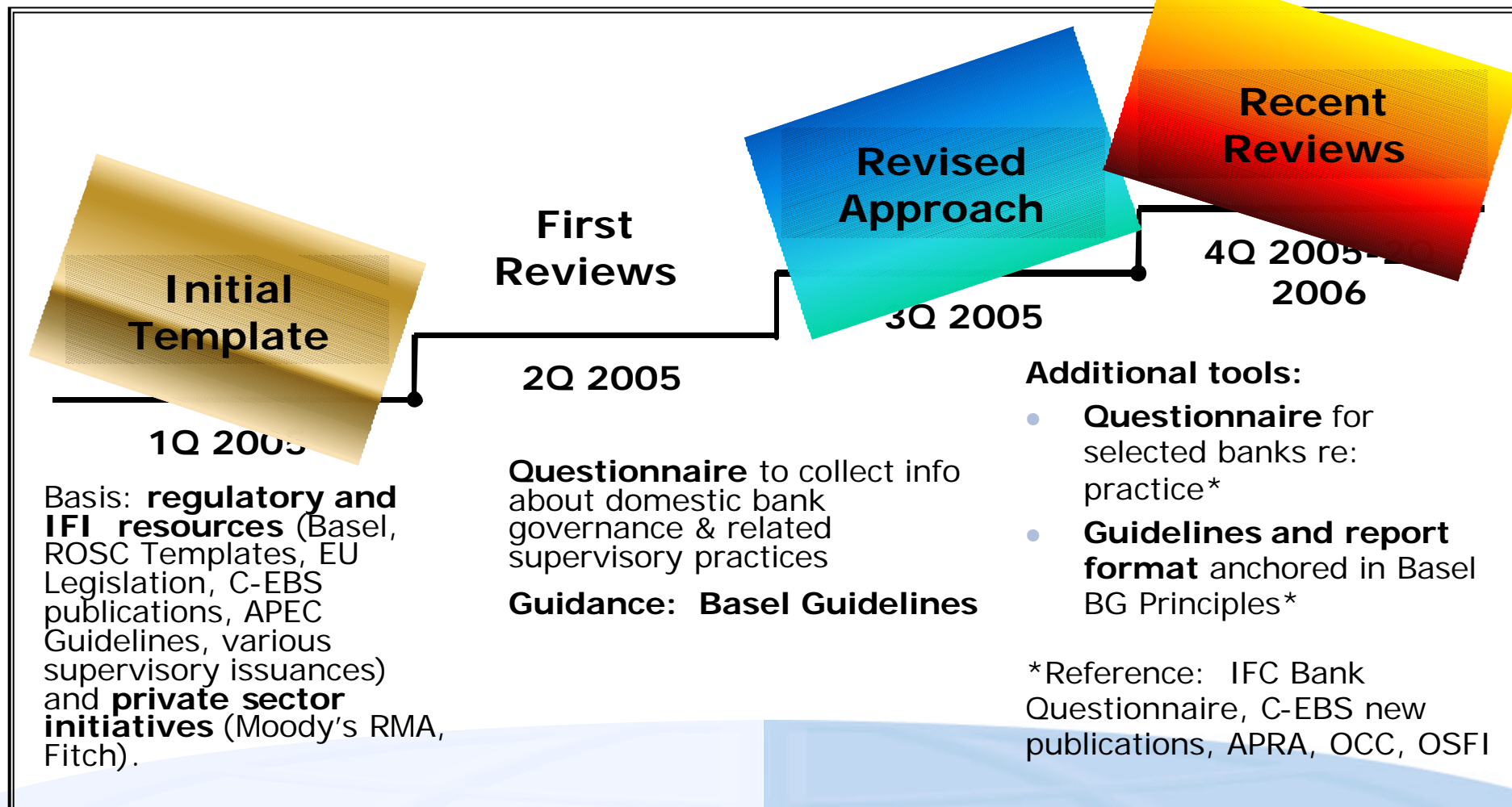
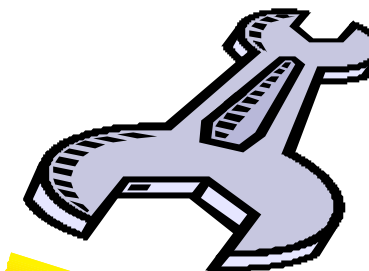
**The supervisory function is key to the promotion and diligence of sound bank governance**

- Tools of Supervisor to address opaque ownership structure need to be expanded
- Market oversight, particularly in the securities market, financial accuracy, and board liability areas need strengthening
- Legal framework need to be balanced to avoid significant regulatory burden (rules-based) of new BG requirements
- Effective related party transaction regimes need to be enforced
- The effectiveness of enforcement actions, if and when taken, should be clear, particularly in transactions such as mergers
- Governance of supervisory agencies

# **D. Bank Governance Assessment Tools**



# Development of an Assessment Tool, 2005-2006





# Approach and BG Assessment Tools

- **BG Assessment “Toolkit”:**
  - Guidelines and Methodology
  - Bank Specific Questionnaire
  - Questionnaire to Domestic Bank Supervisor
- **Process Reviews:**
  - World Bank internal review
  - (Informal) Basel Working Group for BG (through WB participation in group)
- **Refinement of Tools ongoing**
- **Output of Review** – “Technical Note” focused on bank governance specific issues; focus on selected bank ( ) practice

**Review Components, anchored in Basel BG Principles, include: board oversight, SM, internal review functions (RM, IA, C), external audit, disclosure-transparency, bank supervision**

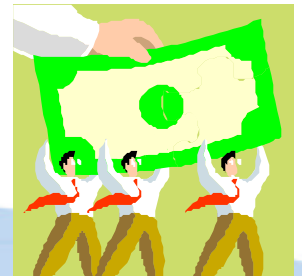
# Bank Governance in Practice – Key Message



- Are the tools a **“magic answer”** to identify weaknesses in bank governance?
- NO. The bank governance review intends to provide a powerful apparatus to initiate **fundamental cultural changes** required to upgrade governance environment by addressing
  - **Quantitative framework, or, “hardware”**: legal and institutional structure. Governance indicators may convey a different setting than that which exists (“measuring against tick-boxes”) ...but also
  - **Qualitative aspects, or, the “software”**: actual practice, implementation.

Effective bank governance cannot be entirely legislated...

***... it is about what people in responsible positions do or don't do with other people's money.***





**Thank you.**

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