

## Corporate Governance Department World Bank Group

### From Principles to Practice:

## The World Bank Approach to Bank Governance Reviews

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2nd OECD/EBRD Taskforce  
on Bank Governance  
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## ➤ Introduction

- Bank Governance Review (BGR) Methodology
- Main Findings and Policy Recommendations
- Next Steps in our Review Process



# Introduction: Who we are...

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## IFC/WB Corporate Governance Department

### Global Corporate Governance Forum

- Raising awareness and building consensus
- Disseminating Best Practices
- Sponsoring Research
- Supporting TA and capacity building

### Corporate Governance Policy Practice

- Diagnostics:
- ROSC assessments
  - Banking sector (BIS)
  - SOE governance
  - Islamic banks (2008)
  - Support WB operations
  - Publishes best practice papers

### Investor and Corporate Practice

- Evaluates client companies
- Uses IFC methodology
- Set of tools and practices
- Helps clients implement best practice
- Provides technical assistance



## Introduction: What we do...

In order to respond to growing country requests, a set of operational tools was developed.

The review tools include:

- a set of operational benchmarks
- a toolkit to collect relevant information; and
- a methodology to establish the review process

Country Reviews:

- 6 country reviews completed in 4 different regions of the World
- 4 more country review in the pipeline for FY 09



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- Bank Governance Review (BGR) Methodology
  - Main Findings and Policy Recommendations
  - Conclusions



# Benchmarks: Sources...

- **BASEL**
  - Basel BGR Guidelines, 1999
  - Basel Core Principles
  - Basel II Capital Accord, 2004
  - Basel BGR Principles, 2006
- **Office of the Comptroller of the Currency (OCC) (US)**
  - Various publications and examination procedures
- **WORLD BANK**
  - BGR Template, existing
  - Corporate Governance ROSC, 2005
- **EUROPEAN UNION**
  - EU CG Action Plan
  - EU Directives
  - C-EBS Publications
- **APEC**
  - Corporate Governance Guidelines, 2004
- **MOODY'S**
  - Risk Management Assessment, 2004



# Benchmarks: Informal Consultations...

- **BASEL**
  - Subcommittee for the revision of BGR 1999 Guidelines
- **OECD**
  - Corporate Affairs Division
- **EU COMMISSION**
  - DG Internal Market Unit - Banking and financial conglomerates; Regulatory Peer Review



# Benchmarks

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<b>A. Board Function</b>	<ul style="list-style-type: none"><li>A.1 Roles and Responsibilities</li><li>A.2 Fiduciary Duty</li><li>A.3 Composition, Qualifications, Compensation &amp; Performance</li><li>A.4 Related-Party Transactions.</li><li>A.5 Participation in Financial or Non-financial Groups</li></ul>
<b>B. Senior Management</b>	<ul style="list-style-type: none"><li>B.1 Roles and Responsibilities</li><li>B.2 Accountability</li><li>B.3 Conflict of interest—Related-Party Transactions</li><li>B.4 Management in Financial or Non-financial Groups</li></ul>
<b>C. Internal Review and Monitoring Functions</b>	<ul style="list-style-type: none"><li>C.1 Risk Management Function</li><li>C.2 Compliance Function</li><li>C.3 Internal Audit Function</li><li>C.4 Internal Alert Procedures</li></ul>
<b>D. External Audit Function</b>	<ul style="list-style-type: none"><li>D. External audit function</li></ul>
<b>E. Disclosure, Transparency &amp; Market Discipline</b>	<ul style="list-style-type: none"><li>E. Disclosure, Transparency &amp; Market Discipline</li></ul>
<b>F. Banking Supervision</b>	<ul style="list-style-type: none"><li>F.1 Legal authority</li><li>F.2 Corporate governance oversight</li><li>F.3 External audit and internal review function</li></ul>

# The BGR Methodology: Phase I ('05-'06)

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- Designed Tools to elicit legal and regulatory information on country's aspects of bank governance:
  - “Bank Supervisory Questionnaire” (to be completed by the Bank Supervisor) to elicit market practice information related to the sector
  - “Legal and regulatory Framework Information Request” (To be completed by the Legal/Research Department of the Central Bank) to collect information on:
    - Legal and regulatory framework
    - Judicial system
    - Accounting and auditing standards



# The BGR Methodology

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## But...can you guess the company?

Size	<ul style="list-style-type: none"><li>• Appropriate size – 15 directors</li></ul>
Independence	<ul style="list-style-type: none"><li>• Over 70% outside directors</li><li>• Separated role of chairman and CEO</li><li>• 5 sub-committees (executive, finance, audit, compliance, compensation, and nominating)</li></ul>
Diversity	<ul style="list-style-type: none"><li>• 4 professors / directors of academic institutions and 6 current or former chairmen / CEOs of companies.</li><li>• Backgrounds in accounting, medicine, trading, technology, petroleum and gas, and banking.</li></ul>
Experience	<ul style="list-style-type: none"><li>• Several directors had more than 20 years of experience; in total board members had more than 140 years of experience</li><li>• Many directors served on boards of other blue chip companies as well.</li></ul>



Source: McKinsey

# The BGR Methodology

private sector development

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December  
2001:  
Enron files for  
bankruptcy

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# The BGR Methodology: Phase II ('07-'08)

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Toolkit was refined to better capture corporate governance practices:

- **A Survey of selected banks, capturing measures of:**
  - Composition of the Board
  - Professional background of board members
  - Remuneration schemes
  - Board commitment to duties
  - Board attendance
  - Board MIS (package etc.)
  - Strategy approval criteria
  - Board self-evaluation policies
- **Questions to further elicit board risk management practices:**
  - What are the risks your bank is facing?
  - Why are you facing these kinds of risks?
  - How do you intend to mitigate them?
  - Why have you chosen this course of action?
- **Bank Specific Financial Indicators Request**

***The added value of the review methodology is to capture what is actually happening in the banking sector***



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# Main Findings

## 1. Blurred lines of responsibilities and authorities

- Legal framework's definitions on role of board and management tend to be incomplete (codes often try to fill that gap)
- Board & management do not always understand their role (or the business / risk profile of the bank)
- Independence of board members not clearly defined or misunderstood by market participants.



# Policy Recommendations

## 1. Blurred lines of responsibilities and authorities

- Clarify in the legal framework (especially in civil law countries) roles and responsibilities of board and management.
- Draft/enhance regulations, guidance to include:
  - Clear responsibilities of board and management to understand the business / risk profile of the bank
  - Clear definition of independence
  - Board performance evaluation
  - Limit number of outside directorate commitments



## 2. Ownership opaqueness

- The supervisors and the market often claim to know who the beneficial or ultimate owners of banks are...  
...BUT it's hard to get a clear ownership structure from the public information readily available.
- Adequate fit & proper tests for owners are not often in place



## 2. Ownership opaqueness

- Disclosure requirements should include identification of cross shareholding
- Introduce ownership approval thresholds and specify fit and proper vetting.



## 3. Limited scope of Related Party Regimes

- If owners are not identified or identifiable , related party transactions are difficult to monitor.
- RT Regimes are often related to connected parties / borrower groups under the large exposures provisions and often do not capture all material transactions.
- In case of conglomerates, the related party provisions should also include disclosures of transactions with other companies in the group.



## 3. Limited scope of Related Party Regimes

- Ensure set up (via internal policy) of monitoring systems for RPTs and clear definition of RPTs.
- Capture (via internal policy) all Related party transactions in the definition, including controlling and controlled companies.



## 4. Lack of independence of internal monitoring functions

- Not often adequately staffed and funded
- Internal audit function needs to be elevated within many banks, with more serious emphasis on role of the audit committee.
- Risk management, compliance, internal audit are not often part of the strategic planning process, especially for business expansion & new products
- Compliance function not fully developed (often misunderstood with AML monitoring); a cooling off period for bank supervisors entering the private banking sector is often missing.
- Risk management - often lagging behind, and not structured based on market growth and core business lines of the institutions



## 4. Lack of independence of internal monitoring functions

- The resources allocated for internal review functions should be made an integral part of the planning process.
- Clearly define in internal policies reporting lines of internal monitoring functions
- Develop risk management systems tailored to core business lines of the institutions



## 5. Supervisory Challenges

- Supervisory tools to address opaque ownership structures need to be expanded
- Well-established channels of communications with board members are often missing
- In sectors populated by financial conglomerates, sharing of sensitive information among supervisors is often missing



## 5. Supervisory Challenges

- Hold the board accountable for critical governance issues and require timely corrective measures
- Consider issuing guidance to banks on sound corporate governance
- Ensure signing of formal MoU with other domestic and foreign supervisors for sharing of information



## In Summary...

- Effective bank governance cannot be legislated.
- Achieving regulatory requirements should be seen as a starting point, not an end goal
- Sound bank governance is an attitude, a way of doing things, and the manner in which owners, directors, & management fulfill their public trust.



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# Next Steps in our review process

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## Review Process

### Next Steps:

- **Convert the questionnaires into a professional survey instrument.**
- **Develop a higher level, more brief alternative to a full-scale review.**
- **Build a bank governance legal and regulatory database**

