JOINT MEETING OF SOUTH EAST EUROPE AND EURASIA CORPORATE GOVERNANCE ROUNDTABLES

16 February 2006

Corporate Governance of State-Owned Enterprises
Corporate Governance of Banks

Meeting Co-Hosted by

The Federation of Euro-Asian Stock Exchanges

With the Support of

The Government of Japan

The Global Corporate Governance Forum

CENTRE FOR PRIVATE SECTOR DEVELOPMENT ISTANBUL

TICA

Session 4: The Role of Banks in Corporate Governance

Kenneth Bertsch, Moody's Investors Service, USA

Kenneth Bertsch, Managing Director of Corporate Governance Analysis, Moody's Investors Service, USA

1. Consultative document provides very useful guidance, from our perspective.

2. In detailed consideration of bank governance in North America, we have found somewhat less differentiation from other corporations than we had expected, despite bank regulatory oversight related to governance and compliance. Nevertheless, we believe regulatory pressure for strong governance and compliance policies is important (as, of course, are requirements for sound financial policies and adequate capital levels).

3. Some comments on specific guidelines:

    a. "*Board and senior management have an obligation to understand the risk profile, and to ensure effective oversight of risk models"*
        i. Ability of boards to do this effectively is questioned in some quarters, but we emphatically agree with OECD
        ii. Establishment of a risk committee of the board may be an appropriate step

    b. *Another area of short-fall at times, at least judging from public disclosure: "a well-articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured"*
        i. Lack of clarity in discussion of executive compensation
        ii. Our particular concern about compensation metrics that may be over-leveraged and strongly oriented to shareholders
        iii. We can have concerns, however, about outside director compensation linked to performance (other than restricted share awards linked to required share ownership)

    c. *"[W]here a bank is experiencing problems, or where significant corrective action is necessary, the board's role is intensified."*
        i. Again, we agree strongly, but this has implications for clarity of board leadership structures (particularly where there is a substantial independent majority), and for whether directors have sufficient time.

    d. *There are challenges where the bank ownership structure lacks transparency or where there are insufficient checks and balances.*
        i. A core concern for Moody's; we agree that controlling shareholders as such are not necessarily a negative factor, although risks are heightened to the extent the institution is treated as a private entity.
        ii. Management of conflicts of interest where a bank is owned by the state also is important.
        iii. Also, would emphasize importance of subsidiary bank board and its obligations.

e. *"Ensuring that board members are qualified for their positions, have a clear understanding of their role in corporate governance and are able to exercise sound independent judgment."*
    i. At least in the North American context, we tend to look both to board independence (and independent committee structures, especially the audit committee) and directors with sector-relevant experience, as well as financial reporting/accounting experience and understanding.
    ii. The role for director training and education
    iii. Independence requires some independent checks on information received from management.