Session III. Policy Brief on CG of Banks in Asia

Outline of the Policy Brief on Corporate Governance of Banks in Asia (ARCG Task Force)

Motoyuki YUFU
Principal Administrator, OECD

Hong Kong
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Before we start; The Asian Roundtable on Corporate Governance (ARCG)

- The OECD and the World Bank Group promote five regional Roundtables on CG in the world. The Asian Roundtable (ARCG) was established in 1999.

- ARCG comprises policy-makers, regulators, academics, stock exchanges, non-governmental institutions and private-sector bodies from 13 Asian jurisdictions.
  - Bangladesh, China, Hong Kong, India, Indonesia, Malaysia, Pakistan, Singapore, Korea, Chinese Taipei, Thailand, Vietnam

- ARCG participants agreed on the *White Paper on Corporate Governance in Asia* (2003)
  
The ARCG Task Force on CG of Banks in Asia

- One of the six priorities of the *White Paper* (2003)
  “Governments should intensify their efforts to improve the regulation and corporate governance of banks.”

- ARCG established a Task Force (2004)
  - Both banking supervisors and capital market authorities
  - Experts from both Asian and OECD countries
  - Members participate in their private capacities

- The Task Force developed the *Policy Brief on CG of Banks in Asia* (2006)
Brief Overview of the Policy Brief

INTRODUCTION

PART I: Importance of CG of banks and characteristics of Asian banks

PART II: Main issues and priorities
- The board and board members (II-1, II-2)
- Board’s composition and committees (II-3, II-4)
- Related party transactions and banking groups (II-5, II-6)
- Bank’s autonomy in relation to the state (II-8)
- Bank’s monitoring of CG of its corporate borrowers (II-9)
- Others (Disclosure and Next Steps) (II-7, II-10)
“Introduction” of the Policy Brief

- Non-binding. Not a detailed prescription for legislation/regulation.  
  Suggests various means and options (a source of reference)

- Not an another international standard  
  Harmonisation with the Basel Committee’s guidance

- Does not cover every important issue (OECD Principles, etc.)

- Assists bank supervisors, securities regulators, stock exchanges, banking industry associations, and banks

- Applicable to listed and non-listed banks, including FOBs, SOCBs

- Applicable to both one-tier and two-tier board structures
Part I. The importance of CG of banks & characteristics of Asian banks

The importance of CG of banks differs from that of other companies;
1. Amongst others, *depositors* as a stakeholder
2. Huge impact on the whole economy
3. Potential risk of bank run
4. Safety nets (weaker monitoring, manager’s moral hazard, public funds at stake)
5. Prudential regulation

Characteristics of Asian banks;
1. CG practices vary within Asian region
2. CG Challenges lie in the implementation
3. Banks play a dominant role in Asian economy
PART II - 1  The responsibilities of individual board members

- **Fiduciary duties** of banks’ board members
  - Arguably more important than those of other companies; They also include fiduciary duties to depositors. Board members should have high ethical standards

- These duties cannot be discharged without skills, personal abilities (including maintaining “healthy scepticism”)
  - Ongoing training programs on integrity and professionalism
PART II - 2 The roles/functions of the board
- Not exhaustive but several key functions -

Rather than being immersed in day-to-day operations…

- Guiding, approving and overseeing strategies/policies. For instance, the board should ensure high ethical standard throughout the bank
  - Code of conduct
  - Setting the “tone at the top” by example

- Creating clear accountability lines and internal control systems
  1. Evaluation and appointment/removal of executives
  2. Well-defined decision-making authority and internal control
  3. Executives directly accountable to the board regarding specific key functions
PART II - 2 The roles/functions of the board
(Cont.)

In order for the board to fulfil its functions…

1. Sufficient flows of information and managerial support
   ✓ Access to the staff, its technical expertise and information
   ✓ Financial resources to obtain advice from external experts
   ✓ Views of internal and external auditors

2. Fit and proper tests

3. Performance evaluation for the board and its members
   ➡ utilise a committee

4. Banking supervisor’s checks/assessment on board’s function
PART II - 3  The composition of the board

- Banks are more encouraged to have independent directors than other firms
  
  “A sufficient number of non-executive board members capable of exercising independent judgement… (on) the review of relate party transactions” (OECD Principles)

- “Independent” of;
  1. Management
  2. Controlling shareholders
     
     “Asian countries should continue to refine norms and practices of ‘independent’ directors” (White Paper)

- Separation between Chairman and CEO;
  
  Independent or, at least, non-executive chairman
PART II - 4 The committees of the board

Banks boards have found it beneficial to establish certain committees. Several examples are:

- The Audit Committee
- The Risk Management Committee
- The “Governance Committee” with combined responsibilities;
  - Nomination, remuneration, succession planning, training, access to managerial support & info., performance evaluation, etc.
PART II - 5 Preventing abusive related party transactions

Not all related party transactions are harmful but…

- Is the current “firewall” in your jurisdiction sufficient?
  - Single borrowers limit
  - (Limiting ownership and voting rights for certain types of vote)

- One of the options:
  A specialised committee which mainly monitors and approves related-party transactions
PART II - 5 Preventing abusive related party transactions (Cont.)

- (Basel Core Principles) “Transactions with related parties that pose special risks to the bank” should be reported

→ Approaches can be twofold
  1. Clearly define such transactions as a minimum list
  2. Also require bank boards to monitor and report those transactions which are not on the minimum list but are nevertheless materially important

- Require banks (including non-listed ones where appropriate) to publicly disclose such transactions

- It might be advisable that certain specific types of related party transactions should be categorically prohibited
PART II – 6 Bank holding companies and groups of companies including banks

- **Banks** within banking groups
  - Bank boards should not be lessened their responsibility
e. g. independent directors independent of a parent company

- **Banks’ parent** companies
  - Refrain from intervening in banks’ day-to-day operations
  - Appoint independent directors to the bank board (as a controlling owner)
  - Have a sufficient number of independent directors for their own boards.
  - Fitness and propriety

- **Legal framework**
  - Banking supervisors need sufficient legal authority to supervise banking groups
PART II – 7  Disclosure

- Efforts on convergence into international standards on accounting, etc. should be encouraged.

- Where appropriate, public disclosure by non-listed banks should be required.

- State owned commercial banks (SOCBs) should be subject to annual independent external audit besides state audit.

- Problems found regarding listed bank’s disclosure should be shared in due course by both;
  1. Banking supervisors, and
  2. Securities regulators and stock exchanges.
PART II – 8 Bank’s autonomy in relation to the state

- The state as an owner should utilise and respect the legal corporate structure of SOCBs
  - Once the state as a shareholder sets the objectives for SOCBs
  - It should refrain from intervening in SOCBs’ day-to-day operations
  - Instead, the state should make the boards accountable/responsible

  → OECD Guidelines on CG of SOEs

- SOCBs that are going to be privatised; e.g. Banks under temporary state-ownership
  should adopt most advanced CG framework available on their privatisation
To what extent banks should assess/monitor CG of their corporate borrowers, or exercise influence to improve it?

Regarding CG of their corporate borrowers, banks’
(i) assessment (ex-ante of lending) and
(ii) monitoring (ex-post)
should be encouraged as a critical part of credit risk management, and even as a policy tool to improve CG practice in a jurisdiction.

Banks’ exercising influence on the CG of corporate borrowers;
may need careful consideration;
1. Sending bank employees to the boards should be discouraged
2. Maintaining good CG of banks themselves is a prerequisite for exercising influence
PART II – 10  Next steps

- Banking supervisors or others should develop a national code of CG specialised for banks (template)

  Based on the template, banks should be required to develop their CG codes respectively.

- Banking supervisors should provide more incentives for banks to improve CG. For instance:
  - Ratings in terms of the quality of CG of banks
  - Differentiated deposit insurance premium reflecting (at least partially) such ratings
Discussion Session

- Discussions in **four** parts
- Approximately **15 minutes** each
- **Any views:** Your views based on the experiences in your jurisdiction are especially appreciated
Discussion on the *Policy Brief* 1/4

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