

Anti-crisis paradigms of corporate governance in banks

Reported by
Prof. Alexander Kostyuk,
Ukrainian Academy of Banking
of the National Bank of Ukraine
(Ukraine)

Research purpose

- To find out the critical issues of corporate governance in banks which should be reinforced during financial crisis in the international context
- To suggest the methods to overcome the problem issues of corporate governance in banks

Research framework:

- Period of research - May 2008 – December 2009
- Number of countries covered – 18 (the USA, the UK, Germany, Japan, Italy, Belgium, Sweden, Australia, New Zealand, Ireland, Greece, China, Taiwan, Thailand, Argentina, Colombia, Poland, Ukraine)
- Number of researchers participated – 58
- Major outcome – the book “Anti-crisis paradigms of corporate governance in banks: a new institutional outlook”
- The research is headed, the book is edited by – Prof. Alexander Kostyuk, Prof. Fumiko Takeda, Prof. Kaoru Hosono (Japan)
- Introduced (as the book Introduction) by – Paul Chisnall, Executive Director, British Bankers’ Association

The structure of the research (for each country)

- Concept of CG in banks
- Models of CG applied
- The banking law and regulation
- Board composition and structure, executive remuneration
- Anti-crisis corporate governance in banks

The research results: Concept of CG in banks

- Most countries exploit monistic concept of corporate governance in banks
- Dualistic concept is used in Germany, Sweden
- Pluralistic – in Japan
- Monistic concept feels a lack of the rights for participation of stakeholders in CG in banks
- Pluralistic concept feels the lack of formal procedures to delegate the rights for participation of stakeholders in CG in banks

Intermediate conclusion – pluralistic concept should be developed in banks through strengthening the legislation and internal by-laws in banks

The research results: Models of CG applied

- Unitary board model is exploited by banks in the most of researched countries, for example the USA, UK, Australia, New Zealand, Ireland
- A two-tier board model in a fewer countries, for example, in Germany, Ukraine, Taiwan, China, Poland
- Italy and Japan apply an optional approach (voluntary choice by bank of a model of the board)

The research results: The banking law and regulation

- **Major regulatory focus** is on the executive remuneration, financial reporting and risk management
- **Executive remuneration** is a leading focus. More than 90 regulatory initiatives happened in the countries under research through 2007-2009. Through 2000-2007 it was issued less than 70 regulatory initiatives regarding executive remuneration
- **The leading countries** in bank executive regulation – UK (16 initiatives through 2007-2009), the USA – 11 initiatives, Australia – 9 initiatives.

The research results: Ownership structures

- Banking in the United States is dominated by bank holding companies ;
- Almost half of the financial institutions in Belgium are foreign controlled institutions;
- The shareholders of Italian banking groups are predominantly financial entities;
- The shares of foreign ownership of commercial banks in Poland is almost 70% of all sector assets;
- In Japan the shareholding ratio of foreign investor increased from 10.9 percent to 26.1percent;

Overall conclusion: bank ownership becomes international

The research results: Board composition and structure

- **The share of independent directors on the boards** increased over last ten years. The leading country is Australia where 86 per cent of board members are independent. Losers – Ukraine (14 per cent of board members are independent) and China (15 per cent)
- **Size of the board** reduced in the most countries. The largest boards are in the USA (18 members on the board), the smallest boards are in Ukraine (7 members)
- **Number of board committees** increased. Leading country - Australia (6 committees on the boards), losing country – Ukraine and Poland (1 committee)
- **CEO/Chair of the Board dual membership** reduces in the most countries. The leading country in this trend is India.

The research results: Executive remuneration

- Executive remuneration amounts increased through 2000-2007 in all countries as a result of bonuses
- Executive remuneration reduced in all countries through 2008-2009 as bonuses were reduced
- Major effect on bonuses was done by regulatory measures. Leading in regulatory initiatives – UK, the USA and Australia. Losers - China and Ukraine
- Bonuses become linked to long-term performance of the banks

The research results: Anti-crisis corporate governance in banks

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken in the country to develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank			
2	Process of advancing the compensation of bank executives	Irrational behavior of executives			
3	Process of empowering contractual relationships between the banks and executives				
4	Process of empowering the role of independent director	Irrational behavior of executives			
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information			
6	Process of empowering the financial reporting standards	Asymmetry of information			
7	Process of ownership structure changes	Transaction costs of the bank			
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders			
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders			
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank			
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants			
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants			

Anti-crisis corporate governance in banks: the USA

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken to develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank		x	
2	Process of advancing the compensation of bank executives	Irrational behavior of executives			x
3	Process of empowering contractual relationships between the banks and executives			x	
4	Process of empowering the role of independent director	Irrational behavior of executives		x	
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information	x		
6	Process of empowering the financial reporting standards	Asymmetry of information		x	
7	Process of ownership structure changes	Transaction costs of the bank	x		
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders		x	
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders		x	
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank	x		
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants		x	
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants	x		

Anti-crisis corporate governance in banks: the UK

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken to develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank		O	
2	Process of advancing the compensation of bank executives	Irrational behavior of executives		O	
3	Process of empowering contractual relationships between the banks and executives			O	
4	Process of empowering the role of independent director	Irrational behavior of executives			O
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information		O	
6	Process of empowering the financial reporting standards	Asymmetry of information			O
7	Process of ownership structure changes	Transaction costs of the bank		O	
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders		O	
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders	O		
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank			O
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants		O	
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants		O	

Anti-crisis corporate governance in banks: Germany

Note: Lack of a mark means that no effort has been taken at all

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank			x
2	Process of advancing the compensation of bank executives	Irrational behavior of executives			x
3	Process of empowering contractual relationships between the banks and executives				x
4	Process of empowering the role of independent director	Irrational behavior of executives	x		
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information			x
6	Process of empowering the financial reporting standards	Asymmetry of information			x
7	Process of ownership structure changes	Transaction costs of the bank			
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders	x		
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders			x
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank			
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants	x		
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants			x

Anti-crisis corporate governance in banks: Japan

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken in the country to develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank		x	
2	Process of advancing the compensation of bank executives	Irrational behavior of executives			x
3	Process of empowering contractual relationships between the banks and executives			x	
4	Process of empowering the role of independent director	Irrational behavior of executives		x	
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information		x	
6	Process of empowering the financial reporting standards	Asymmetry of information	x		
7	Process of ownership structure changes	Transaction costs of the bank			x
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders		x	
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders	x		
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank	x		
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants		x	
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants			x

Anti-crisis corporate governance in banks: China

	New institutional corporate governance features	Problems featured by new institutional corporate governance	Efforts undertaken in the country to develop corporate governance in banks during financial crisis 2008-2009		
			Weak	Moderate	Strong
1	Process of corporate governance standards change (corporate governance codes, laws, etc.)	Irrational behavior of stakeholders of bank			x
2	Process of advancing the compensation of bank executives	Irrational behavior of executives			x
3	Process of empowering contractual relationships between the banks and executives				x
4	Process of empowering the role of independent director	Irrational behavior of executives	x		
5	Process of development of the board committee system	Irrational behavior of executives and asymmetry of information	x		
6	Process of empowering the financial reporting standards	Asymmetry of information			x
7	Process of ownership structure changes	Transaction costs of the bank			x
8	Process of stakeholder rights' protection	Irrational behavior of stakeholders			x
9	Process of minority shareholders' rights protection	Irrational behavior of minority shareholders	x		
10	Process of interacting between the state and banks	Irrational behavior of stakeholders of bank	x		
11	Process of empowering the long-term oriented corporate governance	Uncertainty of the market participants	x		
12	Process of empowering the international corporate governance standards and practices	Irrational behavior of the market participants			x

Corporate Governance Ratings in banks

Rating	Country	Sum of points (maximum – 12 points)
1	UK	7,0
2	India	7,0
3	Sweden	6,5
4	Japan	6,0
5	Australia	6,0
6	Belgium	6,0
7	Italy	6,0
8	Colombia	6,0
9	USA	4,5
10	Germany	3,5
11	Greece	3,0
12	China	3,0
13	Taiwan	2,0
14	Poland	1,5
15	Ukraine	1,5

Rating – the sum of points achieved by each feature of corporate governance
Weak – 0; Moderate – 0,5; Strong – 1

Major issues of concern: executive compensation

- Size of executive compensation is weakly linked to the bank performance;
- Bonuses take an abnormal large share in the structure of executive compensation;
- Executive compensation is weakly linked with the long-term performance of the bank.

Corporate governance paradigm 1:
“Executive compensation is a reward for.....bank failure”

Proposed solutions:

- to introduce “malus” provision to allow for a withdrawal bonuses;
- to link the bonuses to the long-term bank performance (a 5-years perspective with an option “delayed bonus payments”);
- to improve the remuneration disclosure (disclosing remuneration policies for each board member)

Major issues of concern: board committees

- Weak remuneration system for board committee members (“pay for presence, not for performance”);
- Weak functional borders between control and operational committees (“a functional disorder” effect).

Corporate governance paradigm 2:

“Board committees arestatic because disordered and weakly motivated”

Proposed solutions:

- To develop a committee member remuneration system based on principle “pay for performance”.
- To put in order the committee functions and empower their rights.

Major issues of concern: corporate governance national standards

- A lack of obligatory status of the national standards;
- Mostly conclusive than propositional content of corporate governance codes;
- A lack of international consent with regard to the structure and content of the corporate governance codes;
- A weak activism of some countries in this issue.

Corporate governance paradigm 3:

“Corporate governance national standards put a lot of.....disorder in corporate governance development worldwide”

Proposed solution:

- It is time for Basel committee.....to put these in order.
- To give an authorized right to Basel Committee to develop a new code for “Corporate governance in banks under crisis”.
- A new Summit of Big 20 should delegate this right.

December, 2009

“Strengthening the resilience of the banking sector”

A new consultative document issued by
Basel committee for public comment by 16 April 2010

You are welcome to comment by email:

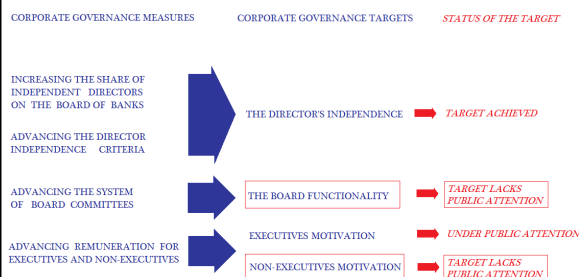
baselcommittee@bis.org

Timely initiative, but.....

The consultative document does not contain corporate governance issues with regard to the role of the board and its committees in bank performance, risk management and control.

It is a document we all need to improve.

The research suggestions



So, researchers should pay urgent attention to

- **Board functionality**
- **Non-executive directors motivation**

Paul Chisnall, Executive Director, British Bankers' Association underlines in the book:

- there are differences in the approach to corporate governance adopted in individual countries and in the statutory provisions that underpin governance arrangements;
- however, statute tends to be fixed – or relatively fixed – whereas governance practices reflected in codes tend to be more responsive to changes in approach and application;
- The lesson from the financial crisis is that the fundamentals behind the – comply or explain|| approach remain as strong as ever .