CORPORATE GOVERNANCE EVOLUTION IN BANKS

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INTRODUCTION:
An Academic Outlook

We have observed a number of financial crises in the past. The financial crisis can to some degree be attributed to weaknesses in corporate governance system. Various studies suggest that the causes of the global financial crisis stem not only from weak regulatory framework at the national and international levels, but also from poor corporate governance practices as witnessed in the risk management standards in many banks. G20 has recognized that one of the causes of the financial crisis was the poorly designed executive compensation packages that lead to excessive risk taking. At their summit in Pittsburgh in 2009, leaders of the G20 called for stricter rules for risk-taking, improved corporate governance mechanisms that align compensation with long-term performance, and greater transparency in corporate governance. Needless to say, the causes of the crisis are complex and the cures for them are multifaceted: Bank's corporate governance system differs from other industrial firms and its activity has a tint of public nature. Their stakeholders vary more widely than those of other firms, including not only shareholders, but also depositors and the general public. Various measures have been proposals so far to strengthen the corporate governance of banks with a view to prevent the recurrence of the financial crisis. The remedies are ready, but important thing is whether they have taken necessary steps and they are functioning or not.

It is crucial to strengthen board oversight of management, position risk management as a key board responsibility, and encourage remuneration practices as indicated by G20. Sound internal governance for banks is extremely important, demanding members of the boards to focus even more on assessing, managing, and mitigating risk. Good internal governance can reduce the responsibility of financial supervisors and is an integral part of effective risk-based oversight. Regulators play a special role in improving the corporate governance of financial institutions. They now impose more strict regulation on the activity of financial institutions. The United States has enacted financial-market regulations which curtail certain risky activities since the Great Depression, marking the conclusion of an effort to craft a legislative response to the 2008 financial crisis.

Although the recent governance failures of banks originated in the sophisticated banks operating in the most developed countries, the financial reform efforts currently underway can also be applicable to financial institutions in emerging markets. Banks and regulators in emerging markets have to bear in mind certain factors, such as proper risk assessment and management, board independence and qualification of board members, incentive structure, and rights of minority shareholders, etc.

Lastly, I would like to stress an importance of linking good corporate governance and sustainability. As a lesson of the financial crisis, we have to pay special attention to the fact that there is a relationship between governance, sustainability of business, and the long-term strategy.

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Academics and overseers first focused their attention on the peculiarities of banks' corporate governance during the Asian crisis in 1997. Indeed, it was soon evident that the weakness of corporate governance mechanisms characterizing banks had contributed to the East Asian financial crisis. In particular, ineffective boards of directors, weak internal control, unreliable financial reporting, lack of adequate disclosure, lax enforcement to ensure compliance, and poor audits had caused the failure of internal oversight and external monitoring, thereby allowing financial institutions to shield themselves from market discipline (WORLD BANK, 1998: 67-68).

Ten years later, the story repeated itself and the issue of banks' corporate governance surfaced again. In actual fact, according to the prevailing view, the recent financial crisis has been closely linked to the inability of the banks' corporate governance to make managers accountable to stakeholders, inducing bankers to take excessive risks with the intent to maximize their own utility at the expense of their shareholders and society at large. Because of poor corporate governance systems, banks have failed to handle risk effectively and the costs of this failure have been massive (the IMF reckons that average government debt for the richer G20 countries will exceed 100% of GDP in 2014 - up from 70% in 2000 and just 40% in 1980 – as a consequences of governments' efforts to save their financial systems and support their economies) (The Economists, 2009: 3-4).

The empirical evidence offered by the two financial turmoils that have affected the world economy over the past fifteen years provide a concrete answer to Fama's (1985) question "What's different about banks?", and encourage a in-depth analysis on corporate governance in financial institutions. Hence, the eleven contributions collected in this book explore these issues and analyze the evolution of banks' corporate governance rules worldwide. The first chapter is dedicated to the US banking and financial system and describes the substantial changes in the corporate governance framework applied to those companies operating where the recent financial crisis had begun. Subsequently, attention shifts to the European institutional context through an analysis of the evolution in the banks' corporate governance rules adopted in several countries such as Denmark, Germany, France, Italy and Spain. Reactions to the financial crisis by market participants and policy-makers in the far eastern hemisphere of the world are described by two contributions on Japanese and Malaysian banks. Finally, the examination is completed by assessing the effectiveness and efficiency of the internal and external governance mechanisms implemented by Egyptian banks and United Arab Emirates' financial institutions.

Such a broad examination of the corporate governance systems adopted by banks worldwide should help the reader to better understand, on the one hand, how specific social, economic and political factors influence the effectiveness and efficiency of the internal and external monitoring mechanisms and, on the other hand, the way in which the institutional context has shaped the financial crisis and affected the evolution in corporate governance of financial institutions in each country.

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