Lecture 2: Generalities about banking governance

Technological development, globalization, privatization, liberalization of financial markets...and the rapid changes that followed in the international banking environment have exposed banks to more fluctuations and various risks. To keep pace with these global financial and banking developments and reduce crises, interest in the concept of corporate governance in the banking sector has expanded.

The concept of governance in banks

The Basel Committee on Banking Supervision defined bank governance as “involving the manner in which a bank’s affairs are managed through the board of directors and senior management, which defines:

The bank's strategic objectives

Managing the daily operations of the bank

Protecting the interests of depositors or shareholders

Commitment to work in accordance with applicable laws and regulations

Bank governance is a system, or rather a set of laws and regulations, that govern and monitor the bank’s management, taking into account the interests of the transacting parties, which represent the main source of the bank’s capital (investor shareholders).

The importance of banks 'governance

Banks play an important role in the economy by granting loans and providing various financial services. The failure of banks’ performance leads to a financial crisis for the economy as a whole, as governance in this area reduces the risks related to financial and administrative corruption through monitoring the performance of administrative boards and executive management.

The application of governance principles in banks has become important in light of technological development, globalization, and the diversification of financial markets. The international banking environment has become unstable, dominated by the problem of information asymmetry and high risks...

Protecting investors regardless of size (whether they are small or large investors).

- Attracting investments, whether foreign or local, because investors are more attracted to banking institutions that apply governance principles because of their transparency in their transactions.

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Banks exercise a supervisory role over customers to protect their loans from credit risks, as this role cannot be performed appropriately by banks if there is not good governance that enables their management to control risk and avoid the problem of information asymmetry.

- Reducing the risks related to financial and administrative corruption faced by both financial and non-financial institutions, through oversight imposed by governance principles.

- Good application of governance principles in banks, especially adherence to global control standards (Basel Committee standards), which particularly emphasize commitment to capital adequacy (greater or equal to 8%) may lead to raising the value of the bank’s shares and thus increasing its competition in global financial markets.

Recently, banks have been interested in financial innovations (documentary credits, financial derivatives...) as they are considered a tool for various risks, whether credit, operational liquidity... but in return they are considered a source of income, so adherence to the precautionary standards of the Basel Committee has become very important to avoid crises.

5 basic factors supporting bank governance:

To support the proper application of governance within the banking institution, a set of necessary elements must be in place, including:

* Taking into account transparency when applying governance.

* Establish a clear organizational structure that defines points of authority and responsibility.

* Ensuring the competence of board members, their awareness of the role assigned to them in the governance process, and that they are not subject to any influences, whether external or internal.

* The existence of an effective internal control system.

* Providing incentives that are consistent with the bank’s systems, objectives, strategy and surrounding environment.