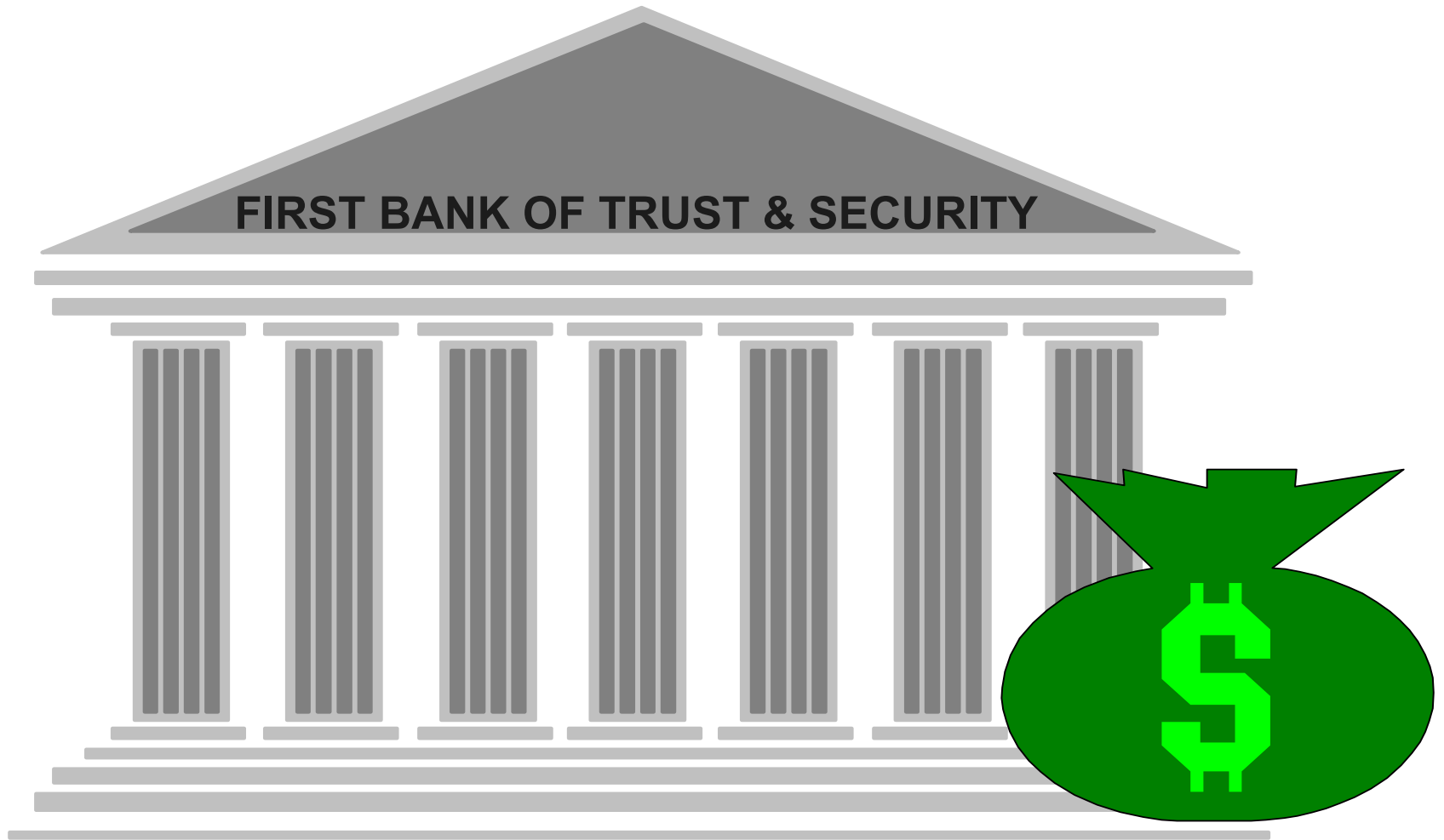




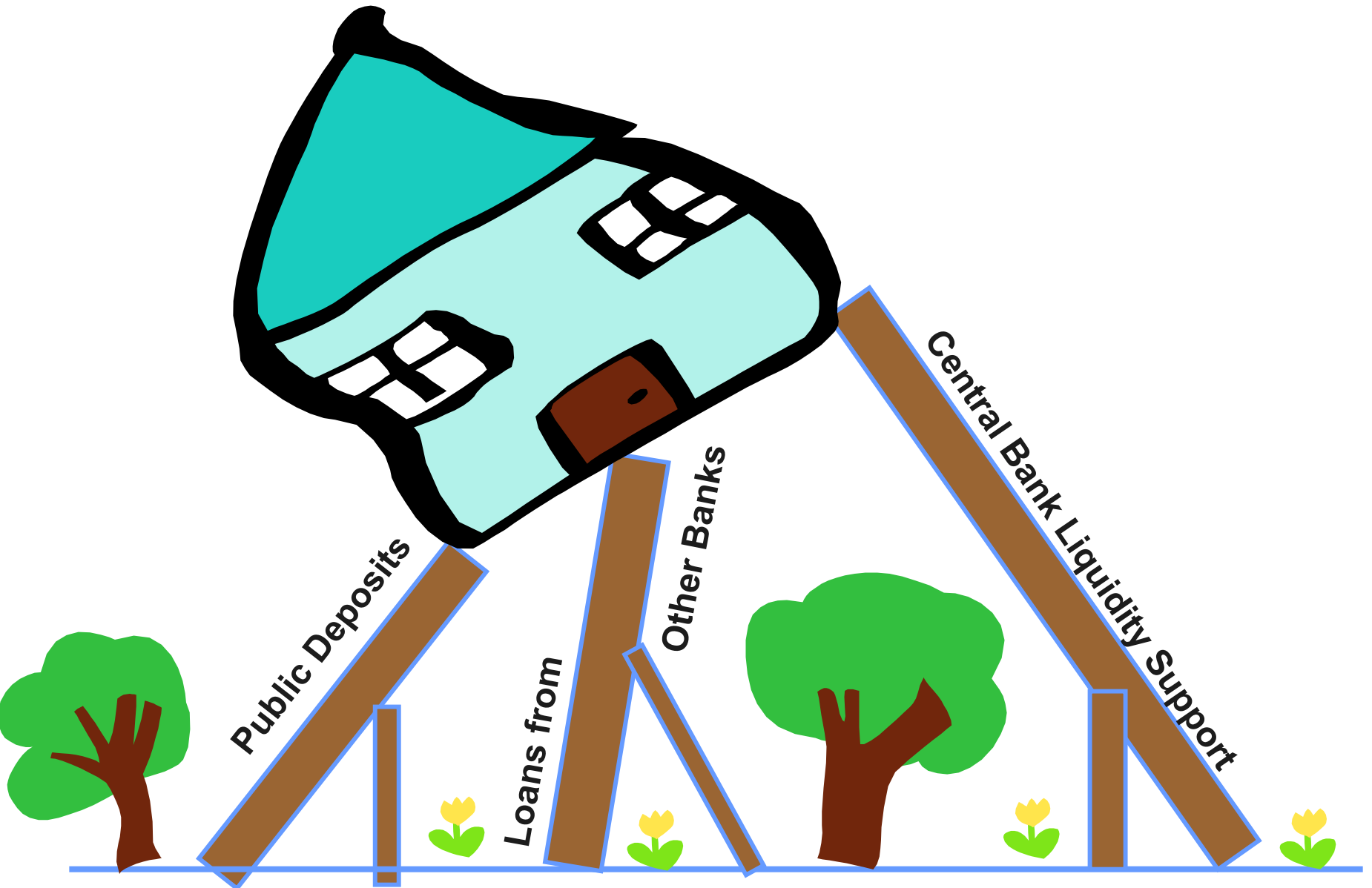
Building Strong Banks

The role and nature of
governance

Our common image of a bank



The reality of a bank





Reviewing Bank Governance and Policies (Rich Roulier)

- How do we build sound banks ?
- The nature and quality of governance
- Evaluating policies, plans and procedures

What is a “sound” bank ?

■ Legal framework

■ Regulatory framework

■ Supervision / enforcement

■ Real sector

■ Governance

Macro-stability



The key pillar: governance

- What is it ?
- What is it most dependent upon?
- The role and structure of the “governance body”



Governance –

very broadly defined is the set

of internal and external forces exerted by a wide range of interested parties which separately provide discipline and incentives to produce responsible corporate behavior:

- Monetary Authorities
 - Debt suppliers
 - Legal system
 - Competition
 - Public opinion
- Prudential regulators
 - Depositors
 - Business practices
 - Unions



Governance

The Cornerstone = Ownership

Discipline and incentives:

- The equity markets
- Owners/shareholders
- The governance body: tool/bridge/buffer
- Management structure
- The staff (and the culture in which they function)



Ownership Governance

The shareholders

- **Their legitimate rights**
 - What stock to own
 - Select members of governance body
 - Decide strategic issues (merger, etc.)
 - Confirm external auditor
 - Receive residual in liquidation
- **Their hopes and dreams**
 - Dividends + stock appreciation
- **What they shouldn't have**
 - Preferential access to bank products (loans)
 - Preferential terms (loans or deposits)



Ownership Governance

The Governance Body

- Responsibilities
- Structure
- Composition
- Incentives



The Governance Body Responsibilities

- Clarify responsibilities for governance
- Assure adequacy of Board skills
- Preclude conflicts of interest
- **SET THE AGENDA**
- Establish performance criteria
- Select, retain, compensate, & dismiss senior management based on criteria established and monitored by the Board
- **APPROVE policies, plans, and procedures (PPP)**
- Monitor compliance with laws, regulations, PPP
- Protect the depositors and assure basic financial soundness



The Governance Body Structure

- Executive Committee
- Loan Review (or Risk Management) Committee
- Audit Committee
- Asset/Liability Committee (ALCO)
- Compensation Committee



The Governance Body Composition

- Business, financial, legal skills
- Financial sector experience
- Management, leadership, strategic thinkers (vision)
- Inquisitive and analytical
- Internal and external



The Governance Body

Incentives (carrots and sticks)

- Status and prestige ??
- Compensation -- commercial incentive
 - short term fees? Long-term gains?
- Accountability
- Liability
 - Common Law
 - Statutory and regulatory
 - Negligence, self-enrichment, malfeasance
 - Insider transactions, lending limits, affiliates, unsafe & unsound practices, reporting requirements



Evaluating a Bank's Policies, Plans and Procedures

Are the Policies, Plans and Procedures:

- In writing, comprehensive and consistent
- Adequately approved
- Distributed in the bank
- Monitored for compliance

Do they adequately cover:

- The Basic Building Blocks (17-21)
- Protecting Assets and Liabilities (22-28)
- “The Back-Office” (29-33)
- Human Resources Development (34-36)



Evaluating a bank's Plans, Policies and Procedures

Basic Building Blocks

- ✓ Recognize prerequisites
- ✓ Strategy
- ✓ Structure / Distribution
- ✓ Budget / Plan
- ✓ Decision Process

The Back-Office

Operations

IT

MIS

Protecting Assets & Liabilities

- Credit
- Treasury
- Audit

Human Resources

Staffing

Performance Management

Training



Basic Building Blocks:

Pre-Requisites for Sound Banking

- Regulatory / supervisory regime
- Articles of incorporation
- Ownership structure
- Ownership governance (board authority, structure, committees, liability, etc.)
- Creditors' rights and other legal tools
- Accounting, auditing and disclosure



Basic Building Blocks:

THE STRATEGIC PLAN

- Competitive analysis
- Markets
- Products
- Basis of competition
- Product differentiation
- Strategic goals
- Where are we? Where do we want to be? And how do we get there?



Basic Building Blocks:

ORGANIZATIONAL STRUCTURE

- Ownership, Governance, Management, Production, Sales
- Organizational units and reporting channels
- Role of the branches
- Adequacy of the structure and staffing levels to support the strategic plan



Basic Building Blocks: **BUDGETING & PLANNING PROCESS**

- Cycle, process and approval
- Planning levels
- Profitability as a basis for business decisions
- Items to be planned



Basic Building Blocks: **DECISION PROCESS**

- Situation analysis
- Goal identification
- Methods of analysis and bases for comparisons
- Request and authorization process and documentation
- Approval limits at varying levels



Protecting Assets and Liabilities

CREDIT

- Approval
- Documentation
- Disbursement procedures and controls
- Monitoring
- Provisioning



Protecting Assets and Liabilities

CREDIT APPROVAL

- Delegation of authority
- Credit products
- Tenors & structure
- Pricing guidelines
- Underwriting criteria (sector specific)
- Acceptable collateral
- Concentration Limits



Protecting Assets and Liabilities

CREDIT DOCUMENTATION

- Standard Documents
- Drafting and approving modifications
- Recommended affirmative and negative covenants
- Control of signed documents



Protecting Assets and Liabilities

CREDIT MONITORING

- **Initial risk rating**--approximation of statistical probability that a loan will be repaid in full and on time
- **Periodic review**--borrower status, confirmation of risk assessment, compliance with covenants, delinquency experience, accrual status, techniques for problem identification and responsibilities for work-out
- **Periodic reclassification**
- **Migration analysis**
- **Separation of Loan Approval and Loan Review**



Protecting Assets and Liabilities

CREDIT PROVISIONING

- Mechanistic rules versus judgment
- Delinquency-driven versus risk-driven
- Tax regulations versus prudential regulations
- Regulatory versus management information
- Compliance versus “adequacy”



Protecting Assets and Liabilities

TREASURY

- **Liquidity management**
 - Asset/Liability maturity schedules
 - Interest rate risk identification and management
 - FOREX exposure
 - Derivatives
 - Off balance sheet exposures
 - ALCO Committee
- **Centralized versus decentralized funding**



Protecting Assets and Liabilities

INTERNAL AUDIT

- Purpose, responsibility, checklists, frequency & reporting channels
- Minimum objectives
 - Determine compliance
 - Assure adequacy of policies and procedures
 - Advise senior management and the Governing Body or risk/failure
 - Identify source of failure
- Link to External Audit



The Back Office

OPERATIONAL PLAN

- **Supports: strategic goals & business plan**
 - Products and projected volumes
 - Staffing
 - Basis of competition
 - Financial dynamics
- **Organization & distribution:**
 - Manual vs. automated environment
 - Centralized vs. decentralized transaction processing
 - Centralized vs. decentralized decision processes
- **Often ignored: In-house vs. Out-sourced**



The Back Office

INFORMATION TECHNOLOGY

- **Often ignored: In-house vs. Out-sourced**
- **Supports: strategic goals & business plan**
- **Integrates and improves:**
 - Back office operations & business strategy
 - Treasury operations, financial planning, product design and delivery
- **Technical specifications and systems architecture**
- **Payment systems interface**



The Back Office

MIS

- Manual versus automated
- Major report types
- Organization units on which reports are prepared
- Content, frequency, recipients of reports



The Back Office: **MIS -- Report Types**

Financial Reports:

- Unit, Business Line, Product Profitability
- Balance Sheets
- Income Statements
- Average balances & average rates
- Direct costs vs. fully allocated costs
- Sensitivity analyses -- actual vs. projected volumes
- Variance analyses -- volumes vs. rates



The Back Office: **MIS -- Report Types**

- Financial
- Transaction
- Asset quality
- Funding and liquidity
- Service Quality



Human Resources Development

- Regulatory compliance
- Recruitment
- Retention
- Rotation
- Performance Management
- Training



Human Resources Development Performance Management

- Job descriptions & job grades
- Salary guidelines (min/max/avg)
- Performance appraisals
- Management by objectives: quantitative and qualitative considerations
- Incentive compensation
- Tracking mechanisms
 - Achievement of performance objectives
 - Compliance with/deviations from guidelines



Human Resources Development Training Plan

- Supports strategic goals & business plan
- Responds to existing and anticipated needs
- Based on input from line management
- Courses, # of participants, # of hours, cost, purpose and description, desired benefits
- External vs. internal
- Mechanisms to track:
 - Total cost associated with training efforts
 - Response to & perceived benefits from training provided