Abstract
The present financial crisis revealed serious deficiencies in the banking corporate governance and emphasized the need of major improvements in their corporate governance techniques. In this respect, we believe that it is crucial for the banks to stop focusing on what they considered important before the crisis, namely on shareholders interested in obtaining big profits, and to concentrate on improving the relationships with the stakeholders and on regaining of the trust in the reliability of the banking system.

By using adequate research methods, namely non-interactive observation, document analysis, comparison, interpretative methods and the empirical method of the survey, this article is intended to: present the concept of corporate governance in general and characteristics of this concept in the banking system; to present the new corporate governance regulatory frame in general and from the viewpoint of the supervisors of the financial stability; to discuss the characteristics of the corporate governance of banks in Romania, highlighting the structures of the corporate governance in the banking activity, remuneration policies, stakeholders’ position, transparency and ethics; and finally to present a series of conclusion regarding the lessons that the present financial crisis can teach us in order to consolidate the corporate governance of banks.

Key words: corporate governance, stakeholder, remuneration, transparency, ethics.

JEL classification: G21, G34, M14

1. Introduction
Since the middle 2007 the activity of credit markets has been seriously disturbed in what concerns financial institutions, as a result of the great global economic crisis.

Recovering the stability of the banking and financial system is one of the most important goals to reach in order to overcome this period of financial crisis and to re-establish international economic balance.

These times of crises turned the problem of corporate governance of banks into a very serious one, as they revealed a series of issues and deficiencies in the banking system, that impose certain measures and strategies to limit or avoid negative effects.

The events in this period determined credit institutions to improve their risk management techniques, internal control and audit, as well as to restore their ethical and moral business principles considered to be the backbone of governance, which can be done by tackling principles and concepts of corporate governance of organizations.

Yet this process needs time and imposes changes in the system, cultural changes and innovative thinking.

2. Corporate governance conceptual framework
The concept of corporate governance has a very broad meaning, including elements such as: management regarding the accuracy of the information that financial situations comprise; managing very tight deadlines for sending the financial reports;
communication and complete transparency with respect to financial results; transparency of the internal audit, of processes and of external audit.

There are various considerations regarding the concept of corporate governance.

The definition formulated by the OECD offers a more detailed approach: “Corporate governance implies a set of relationships between the managers of the entity, the board of directors, shareholders and other interested parties. Corporate governance also establishes the structure to follow for the purpose of reaching company goals, as well as the means by which the company can reach its goals and supervise the results it obtains. Good corporate governance should motivate shareholders to work together for the purpose of reaching company targets, and should help create an efficient supervision, encouraging companies to use their resources efficiently”.

From the point of view of the OECD principles, the concept of corporate governance has two aspects:

- a **behavioural aspect** – which concerns relationships and behaviour patterns between different agents of a company;
- a **normative aspect** – which concerns the set of regulations that frame the above-mentioned relationships and behaviours.

The definition provided by the International Federation of Accountants - IFAC is: “corporate governance is a set of activities of the board of directors, of the executive board, that are meant to shape operational strategies, to ensure target fulfillment, risk management and the responsible management of financial resources”.

The World Bank formulates another definition, describing corporate governance as a “combination of laws, regulations and codes of behaviour accepted voluntarily and offering the company a possibility to raise financial capital and draw human resources it needs to carry out its activity, as well as a possibility to perform its tasks efficiently as to make sure it stays solvent producing long-term profit for its shareholders and itself in general”. This definition is considered to be representative whereas it highlights both the means of enforcing corporate governance policies and the aspects it influences.

Another well-known definition is the one provided by A. Shleifer and R. Vishny: “corporate governance refers to the means by which the investors of a company make sure they receive their benefits as a result of the investment they make”.

However, another more comprehensive definition asserts that corporate governance includes “decision-making standards in a company, the responsibilities of the board of administration and of the senior management, the internal structure of the company and the relationship between the company and its shareholders, as well as with stakeholders.”

### 3. Features of corporate governance concept in the banking system

The concept of corporate governance as Stefan Grundmann and Peter O. Mülbert comprehensively define it corresponds to the way in which banking institutions understand corporate governance, the main topic of the guidance of Basel Committee on Banking Supervision named “Enhancing corporate governance for banking institutions”.

The guidance provides the following definition: “in what concerns the banking system, corporate governance represents the means by which business and transactions

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1. OCDE principles of corporate governance, Preamble 1999
3. Available on [www.ifac.org](http://www.ifac.org)
4. Corporate governance guide, [www.ifc.org/europe/pbas/corpgov/eng](http://www.ifc.org/europe/pbas/corpgov/eng)
are managed by the board of directors and the executive board, which also influences the way in which they: establish corporate objectives, manage the daily activity of the bank, fulfill their obligations towards the shareholders, consider the interests of other stakeholders (including, among other things, supervisors, governments and deponents), harmonize corporate activities and behaviour for banks to operate safely and adequately observing laws and regulations, and protect the interests of deponents.”

Banks are different from companies in several important aspects, namely:

- Banks produce liquidity on the basis of the difference between maturity dates of its assets and liabilities; voluntarily accepting and adequately managing this difference represents the core of banking business;
- The high degree of indebtedness of credit institutions, which are compensated for accepting maturity differences by premiums paid by loan beneficiaries;
- Financial situations of banks are more opaque than the ones of regular companies;
- There is a strong connection between banks, which creates a major default risk and may cause problems to spread from one bank to another;
- The risks of a bank can change even without the bank changing its position, as a consequence of managing a derivative and put option securities portfolio exposed to risk factors that are extremely sensitive to market conditions;
- Banks run the risk of suffering from massive cash withdrawal because of the structural differences between assets and liabilities. The only solution of reducing the massive withdrawal risk is deposit insurance;
- Banks are entities that follow strict regulations under strict supervision; governments impose a whole series of regulations for banks and the international standards issued by BIS (Bank for International Settlements), FMI (International Monetary Fund) and the World Bank basically make sure that governments get seriously involved in the banking industry.

Supervisors show a big interest on ensuring strong corporate governances since this concept is the basic condition for creating a well-operating bank and can have a negative influence on the bank’s risk profile if it is not appropriately enforced.

4. The current regulation framework of corporate governance

The first set of analyses regarding the common causes of private corporations’ failures was carried out in Great Britain by Sir Adrian Cadbury, following the great crisis of the 1980s. Sir Adrian Cadbury is the one who integrated and created the background for the first European code of corporate governance; the Cadbury code comprising 19 main recommendations formed the basis for the creation and development of the Corporate Governance Code of the London Stock Exchange, which asserted for the first time the basic rules that need to be observed when governing a company so that the entity becomes efficient and able to remove any shade of discrimination regarding shareholders. Subsequently, various similar codes emerged; for instance multinational companies such as Microsoft, General Electric created their own corporate governance codes as they became increasingly more transparent to their investors.

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7 Basel Committee on Banking Supervising, Enhancing corporate governance for banking organisations, Bank for International Settlements, 2006, p. 4
The principles and codes of corporate governance were further amended and completed by the OECD\textsuperscript{10} and by the World Bank which became active and permanent elements of this process. Therefore, in 1999 the OECD Principles of corporate governance were approved. Nowadays this set of principles represents the only set of governance regulations accepted worldwide, and which applies to the entire corporate governance framework – legal, institutional and regulatory structures; the Financial Stability Forum accepts it as one of the 12 basic standards of international financial stability. These principles were adopted by the International Organization of Securities Commissions, as well as by private bodies – the International Corporate Governance Network, for instance.

The OECD principles refer to:

- Creating the grounds for an efficient corporate governance framework;
- Shareholders’ rights – protecting and enforcing these rights;
- Fair treatment of all shareholders, including the ones representing minorities or other nationalities;
- The importance and rights of stakeholders (employees, creditors, suppliers and clients) in corporate governance;
- Information transparency, accurate and effective information transmission;
- The responsibilities of the Board of directors and of the executive board.

The OECD set of Principles served as a reference point in creating many corporate governance national codes. These principles mainly apply to companies that are listed on the stock exchange, but they also tackle issues regarding companies with many shareholders, which are not listed on the stock exchange.

The OECD Principles provide the fact that there cannot be a universal corporate governance pattern; the corporate governance framework available in each country comprises laws, regulations, standards, including jurisprudential elements, business codes, principles and policies. All these form the result of the specific environment, history and traditions that characterize a certain country, so that this combination will vary from one country to another\textsuperscript{11}.

4.1. Corporate governance from the point of view of financial stability supervisors

In the European Community, credit institutions’ governance is brought under regulation by Article 22 of the Directive no 2006/48/EC which states that every credit institution should have a solid governance framework including a clear organizational structure, well-defined, transparent and consistent responsibilities, efficient processes of identification, management, supervision and analysis of the risks it takes or may take, adequate systems of internal control, policies and remuneration practices that help promote an efficient and solid risk management.

In 1974 the Basel Committee on Banking Supervision (BCBS) was founded for the purpose of promoting international banking stability. Its objective is to contribute to the understanding of the essential aspects of banking supervision and to improve the quality of banking supervision at the international level. This target can be reached through information exchange concerning national supervision issues, for the purpose of creating a homogeneous issue comprehension forming the grounds for new guides and supervision standards issued by the Committee for the aspects where these are considered to be necessary. In this respect the Committee is well-known for international standards regarding capital adequacy, for the Core Principles for Effective Banking Supervision and for the Concordat and cross-border issues.

\textsuperscript{10} OECD – Organization for Economic Co-operation and Development

\textsuperscript{11}***, Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance, OECD 2007, p. 13
The principles listed by the Committee are meant to reduce corporate governance issues of banks and are considered to be important elements in the process of efficient corporate governance.

These principles refer to the following aspects:

**Principle 1** – Board members should be qualified for their positions, have a clear understanding of their role in corporate governance and be able to exercise sound judgment about the affairs of the bank;

**Principle 2** - The board of directors should approve and oversee the bank’s strategic objectives and corporate values that are communicated throughout the banking organisation.

**Principle 3** - The board of directors should set and enforce clear lines of responsibility and accountability throughout the organisation;

**Principle 4** - The board should ensure that there is appropriate oversight by senior management consistent with board policy;

**Principle 5** - The board and senior management should effectively utilise the work conducted by the internal audit function, external auditors, and internal control functions;

**Principles 6** - The board should ensure that compensation policies and practices are consistent with the bank’s corporate culture, long-term objectives and strategy, and control environment;

**Principle 7** - The bank should be governed in a transparent manner;

**Principle 8** - The board and senior management should understand the bank’s operational structure, including where the bank operates in jurisdictions, or through structures, that impede transparency (i.e. “know-your-structure”).

Considering the many corporate governance failures and deficiencies unveiled by the financial crisis, in 2010 the Basel Committee reviewed the Principles for enhancing corporate governance. According to the Committee, the main aspects that need special attention are the following:

1) **The activities of the board of directors** who need to fulfill their general obligations, including the ones regarding the approval and supervision of the enforcement of banking strategic objectives, of risk strategies, corporate governance and values;

2) **The executive board** who needs to make sure that banking activities comply with business strategies, risk tolerance and policies approved by the board of directors.

3) **Risk management and internal controls**, namely the existence of risk management functions, conformity and internal audit aspects.

4) **Compensations**, referring to banks that need to enforce all the Principles for Sound Compensation Practices of the Financial Stability Board or the adequate national provisions that comply with the FSB Principles and Standards.

5) **Complex or opaque corporate structures**: the board of directors and the executive board need to know, understand and control the corporate evolution and structure of a bank, without turning its structure into an extremely complex and inadequate one, being able to justify it at any time.

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14 *** Financial Stability Board’s (FSB - formerly the Financial Stability Forum) *Principles for Sound Compensation Practices* (FSB Principles) and accompanying *Implementation Standards*8 (FSB Standards), 2009
6) **Transparency**, the instrument that helps emphasize and implement essential principles for an adequate corporate governance.

The proportion in which the Principles for enhancing corporate governance are enforced should depend on the size, complexity, structure, economic importance and risk profile of the bank, and, if the case may be, on the group it belongs to.

Some countries chose to create or accept legal frameworks and standards, as well as audit and accounting standards that may be even more complex and prescriptive than the principles of the Committee. Such frameworks or standards tend to be relevant especially for big or listed banks or for financial institutions.

Considering the defaults revealed during the financial crisis and the events occurred since the former guidance was published (Basel Committee on Banking Supervising, Enhancing corporate governance for banking organizations), the European Banking Authority (EBA) updated previous recommendations of the CEBS regarding corporate governance and created the „Guidelines on Internal Governance” published in September 2011, which need to be enforced by competent authorities by 31st of March 2012.

Effective corporate governance needs adequate legal, institutional and regulatory grounds. Market discipline and general economic performance are influenced by a series of factors that more often than not are beyond the power of banking supervision authorities. Yet supervisors are encouraged to consider the factors that can have a negative influence on adequate corporate governance and to promote efficient corporate governance principles every time their legal authority allows them to do so.

5. **The characteristics of corporate governance in Romanian banking system**

The Romanian banking market had gone through an important development stage for 6 to 7 years right before the economic crisis begun. Few of the 40 banks that operate in Romania have a significant number of Romanian shareholders; the rest of the banks are affiliates of foreign banks or branches without legal personality. This means that most of the banks are internally governed from abroad, especially from EU members such as Austria, Greece, the Netherlands, Italy, countries of origin of most of the foreign banks with agencies in Romania.

At the national level, the legal framework of corporate governance is covered by the Corporate Governance Code adopted in 2008 by the Bucharest Stock Exchange (BVB), and enforced in the tax year 2009; the code is based on OECD principles of corporate governance.

The Corporate Governance Code of the BVB provides that companies listed on the BVB will adopt and voluntarily observe the Code as they are obliged to submit an annual Declaration of Observance or Nonobservance of the Corporate Governance Code (the “observe or explain” declaration) which specifies the recommendations that were effectively enforced and the means by which they were enforced.

With respect to the Romanian banks, the institutions listed on BVB, observe the provisions of the Corporate Governance Code of the BVB. The other credit institutions may also voluntarily observe the provisions of the Corporate Governance Code of the BVB.

The credit institutions from Romania also comply with the Basel Committee Core Principles of Effective Supervision in Banking, which have a strong impact on the banking market.

The Romanian National Bank (BNR) plays the main part in controlling and maintaining financial stability, given the responsibilities arising from its double function of financial authority and prudential supervisory authority, respectively. BNR works for the determination of risks and vulnerable aspects of the entire banking system,
considered as a whole, as well as a combination of elements, because financial stability supervision has a preventive character.

Conclusions regarding the extent to which corporate governance principles are practical for Romanian credit institutions are based on the analysis and interpretation of the information provided by credit institutions’ relevant public documents, of information resulting from surveys, and of the opinions of specialists and managers in the audit departments or risk management department of some Romanian banks.

Information obtained following a survey carried out in nine banks that cover approximately 70% of the Romanian banking market, was analyzed. Three of these institutions are listed on the stock exchange.

We mention below some of the results of the survey.

As far as corporate governance structure is concerned, the survey revealed that most of the banks prefer the unitary system (5 out of 9); the banks that prefer the dual governance system are the ones with Austrian, German, French or Italian capital.

With respect to the board of directors, they have an average number of 9 members; the number of members of the board for the banks participating in the survey varies between 6 and 13.

The board of directors has one president chosen generally from among the executive members.

Most of the members of the board are non-executive directors, observing the law on that matter (Law 31/1990).

Regarding the number of independent members, they represent 7 -72% of the total number of directors. This result reflects significant differences between banks in this respect.

As for the stakeholders’ situation, all analyzed credit institutions stated that their policy is client-oriented. Yet the events occurred during the financial crisis proved that the policy of banks regarding profit maximization for the benefit of shareholders, did not benefit clients; banks took some risks that could affect depositors’ interests. Financing or recovering them may be possible with the help of taxpayers.

In what concerns remuneration policies, 6 out of 9 banks confirmed that their remuneration policy is approved by the AGA.

With respect to information transparency and accurate and efficient dissemination, the survey revealed that these aspects characterize listed banks that observe the provisions of the BVB Corporate Governance Code. As for the rest of the banks we noticed many instances of nondissemination on banks’ websites of the Corporate Governance Code, of the Articles and memorandum of incorporation, of information regarding the structure of the board of directors, a.s.o.

As far as ethics is concerned, most of the banks adopted Ethics Codes, available for all employees.

6. Conclusions regarding the lessons the present economic crisis can teach us in order to enhance the corporate governance of banks.

The current crisis revealed serious defaults in the corporate governance of banks and proved that major changes need to be operated in the theoretical background, as well as in the practices of credit institutions’ corporate governance, as it taught us important lessons in this respect. The inefficiency of the corporate governance system is one of the factors that caused the current trust deficiencies with respect to credit institutions.

Though there is a general belief that the existing principles of corporate governance for banking institutions cover a considerable part of the issues emphasized by the financial crisis, the enforcement of such principles was quite inefficient.

We believe that the reasons for this inefficiency might be the following:
- The voluntary nature of corporate governance principles enforcement, without any legal obligation to do so;
- Official enforcement of principles, without any intention coming from the factors in question to understand and observe them, nor is there any trace of taking the responsibility of observing them.
- Insufficient attention paid by the authorities supervising corporate governance issues.

One of the problems that caused bank losses during the crisis was inappropriate risk management, that is: risk managers did not entirely understand the risks taken by the bank; insufficient training of the employees in charge of selling risk products; the pressure generated by a continuous attempt to reach sales targets as to obtain maximum profits in short intervals of time, corroborated with insufficient authority coming from the function managing the risks regarding the suppression of the activities that imply too much risk-taking; insufficient information regarding risks.

To avoid repeating these defaults, we believe that it is necessary for the managers of financial institutions to become responsible and to develop a strong risk management culture at all levels in banking institutions.

One of the aspects that needs special attention is creating an adequate balance between independence and ability inside the board of directors, which could help increase the competence of the board of directors to efficiently control the activities of the governance.

Yet, to ensure the objectivity and independence of the decisions made by the members of the board, an adequate policy for managing conflicts of interest is mandatory.

Another aspect emphasized by the financial crisis is the inefficiency of supervisory authorities regarding their part in influencing internal governance of financial institutions, in introducing positive corporate governance practices and in ensuring an adequate system of electing the members of the board of directors following pre-established criteria.

We also believe that it is extremely important for the banks to focus upon acknowledging the importance of the other interested parties, for a change and to stop focusing on obtaining profits for shareholders as they did before the crisis. In this respect, the board of directors should consider protecting depositors and creditors’ interests when making a decision.

Under these circumstances, the conclusion that can be drawn from this work paper is that corporate governance is currently experiencing changes capable to stress its normative character and to allow a more effective supervision of financial institutions.

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