Developed Solutions

Governance: Risk Management and Transparency in the Banking Sector

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Outline

- Context - Why are we in the Crisis?
- Benefits – Any Upside to Periods of Stress?
- Future Environment for MENA FI's
- Do We Know What Corporate Governance (CG) Is?
- Is There a Return on CG?
- What About Survival? Downside vs Upside
- What Do MENA Banks Need To Do To Benefit
- Is it Only Banks That Need to Shape Up?
- What Do Others Need To Do?
- Conclusions

Context- Why Are We in This Crisis?

- There appears to be general agreement on common causal factors
- Lax Governance amidst an Easy Credit and High Liquidity Environment are arguably the highest amongst these factors
- The Lax Governance cut across governments, regulators, banks, as well as corporations
- Therefore it would not be too far fetched to call this a Public and Corporate Governance caused crisis
- The regulators were too lax with enforcing good CG practice amidst a bubble friendly liquidity/interest rate environment
- Many banks had boards and managements that were complacent and/or sensitive to competitors rather than risk

Benefits- Any Upside to Crises?

- Many would agree that "learning from crises" can make institutions more resilient, so "it's time to learn!"
- Institutions that navigated well through the crisis were those that were "governed" for the long term and stuck to what they knew best, even if that meant short term "opportunity" costs
- This meant difficult expectations management of stakeholders (Risk Sensitive Chairmen/CEO's were not popular)
- Investment of time, money and effort in robust governance and risk management paid off post crisis
- The "culprits" were not new, e.g. leverage, illiquid, speculative, and/or complex investments, along with cheap money, low risk premiums, and generous short term pay-offs (bonuses)
- I like to call it "Bubble Bath Paradise"…addictive and fleeting

Future Environment for MENA FI's

- Demographics and employment outlook dictate infrastructure investment and expansionary policies to build capacity
- The financial and institutional capacities required go beyond local or even regional resources, which reinforces the trend to open up and attract external investment
- On the other hand, the global drive for enhanced regulation and upgrading governance is intensifying
- This will impose both domestic and international demands for enhanced governance, transparency and risk management
- Other global regions will vie and compete for the limited resource capacity that exists thru their own governance programs
- Regional developments have cross border impact (e.g. Dubai World, Gosaibi/Saad, Gulf Bank, etc.)

Do We Know What CG Is?

- In a recent IIF/Hawkamah survey, almost half the MENA Listed Companies and Banks surveyed responded improperly, basically responding that it was a "legal compliance", or "economic development" effort
- Corporate Governance (CG) is the system by which companies are directed and controlled
- In other words it is the process thru which stakeholder objectives are achieved
- Stakeholders include Shareholders, Customers/Depositors, Creditors, Regulators, Employees, and the Community/Public
- When Listed MENA FI's were surveyed as to the business case for CG, most responded that it was to comply with legal and regulatory requirements, while less than a third responded that it was to achieve lower costs of capital and access thereto

Do We Know What CG Is?

- Over 85% of the Chairmen of the top 1000 Listed UK companies cited protecting shareholders and lower cost or higher access to external capital as the benefits of improved CG, while only 1% cited compliance as a major benefit
- On average, MENA market Listed Companies scored less than 50% on a check list of 32 CG governance indicators (list available)

- Quality and quantity of resourcing at multiple levels; Regulator, FI Boards and Management levels is a pre-requisite to addressing governance and risk issues
- Empowerment of Risk Champions across the hierarchy, i.e. at Board and Management levels, whilst requiring escalation
- Strongly recommend appointing at least two independent expert directors on Gulf FI Boards, Risk, and Audit Committees
- Recommend that Board or Committee decisions declined by both independent directors be shared with regulator for info
- Upgrading ERM frameworks at FI firms, to incorporate risk strand correlation, including operational and liquidity risks

Conclusions and Recommendations

- Strongly recommend establishment of well regulated regional external ratings agencies of high (int'l) standard
- Strongly recommend establishment of regional risk management forum or association, as a knowledge, skill, research and data repository for all Gulf FI's to access
- Realignment of compensation structures at FI Boards, as well as Managements, to be based on medium term "risk adjusted" performance metrics, which are independently reviewed
- Require training, certification, & annual appraisal of FI Board members, that covers governance, risk appetite, regulatory compliance, liquidity management, and stress testing

Conclusions and Recommendations

- Employ system wide early warning systems, at regulators, that identify, inter alia, asset bubbles and system wide concentrations and/or vulnerabilities, along with major HR resource upgrade (this would entail remuneration enhancement at some GCC regulators)
- Establish regional cross border regulatory coordination, and financial sector review organization, such as a regional financial stability board

Conclusions and Recommendations

Thank You