Corporate Governance and Financial Markets

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Disclaimer

Financial Stability Forum

- **Comprised of:**
  - National and international regulatory authorities
  - International financial institutions
  - Key central bank expert groups
- **Seeks to mitigate risks to financial stability**
- **Support for sound *international standards*, including those for:**
  - Corporate governance,
  - Accounting and auditing

Corporate Governance & Financial Markets: *The Theory*

- **The integrity of businesses & markets is central to economic vitality & stability**
- ***Corporate governance*** **(CG) -- the rules & practices determining the relationships between management, shareholders & stakeholders of corporations**
- **Sound CG contributes to financial stability by providing a foundation for market confidence, financial market integrity & economic efficiency**
- **Corporate scandals have focused the public, investors, businesses, auditors, governments & regulators on the need for better CG**

An Example of CG Principles: *OECD CG Principles (revised 2004)*

I. **Ensuring the basis for an effective CG framework**

- *The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.*

II. **The rights of shareholders & key ownership functions**

- *The corporate governance framework should protect and facilitate the exercise of shareholders' rights.*

III. **The equitable treatment of shareholders**

- *The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.*

An Example of CG Principles: *OECD CG Principles (revised 2004)* (Cont.)

IV. The role of stakeholders in corporate governance

- *The corporate governance framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.*

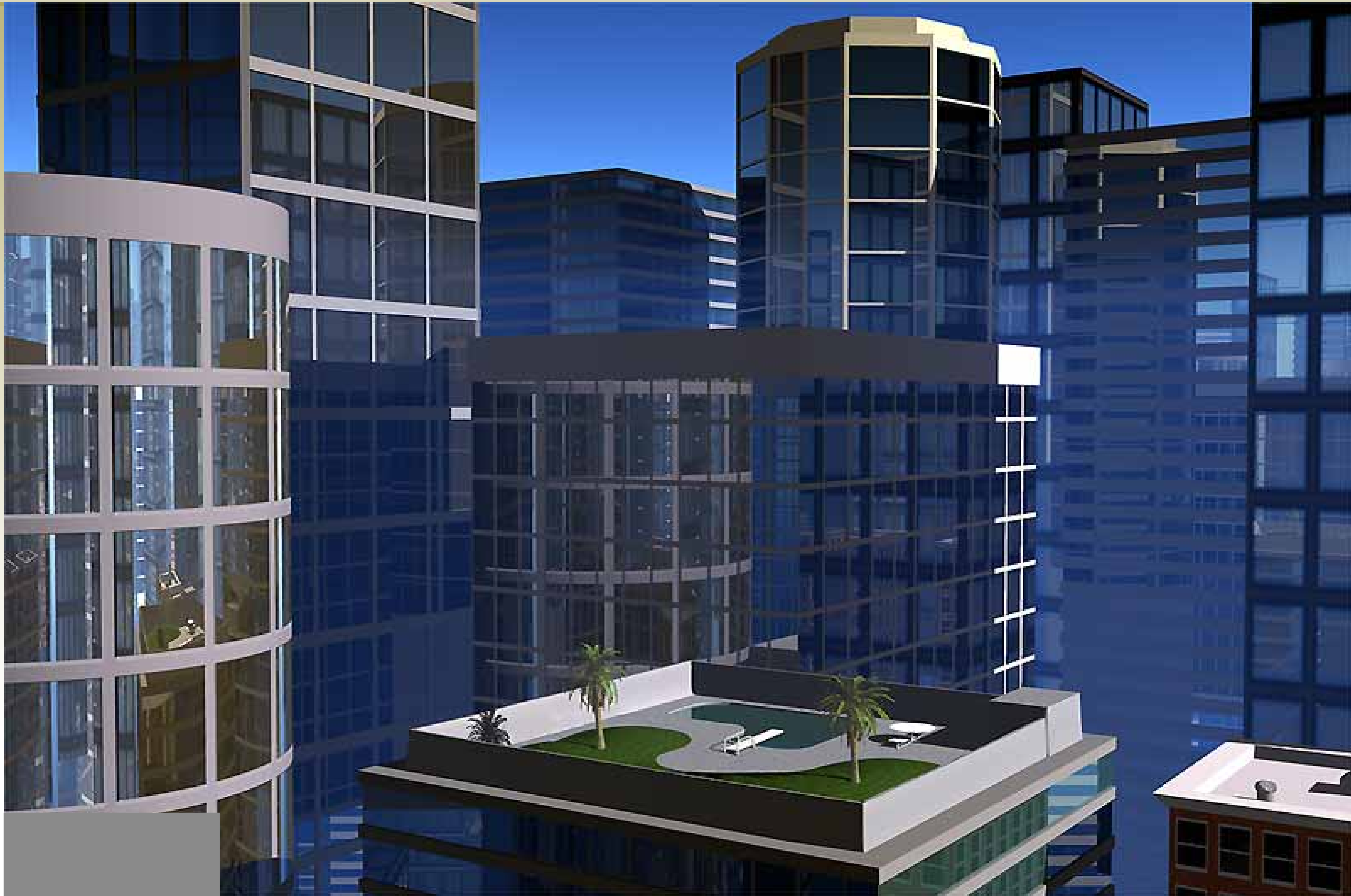
V. Disclosure and transparency**

- *The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.*

VI. The responsibilities of the board

- *The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.*

Corporate Governance Principles in the Financial Sector



An Example of CG for the Financial Sector: *Basel Committee CG Policy – revised 2006*

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.
2. The board of directors should *approve and oversee the bank's strategic objectives and corporate values* that are communicated throughout the banking organisation.
3. The board of directors should *set and enforce clear lines of responsibility and accountability* throughout the organisation.
4. The board should ensure that there is *appropriate oversight by senior management* consistent with board policy.

An Example of CG for the Financial Sector: *Basel Committee CG Policy – rev. 2006 (Cont.)*

5. The board and senior management should *effectively utilise the work conducted by internal audit, external audit, and internal control functions*. **
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.
7. *The bank should be governed in a transparent manner.***
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.

** *Guidance is also provided on the role of supervisors***

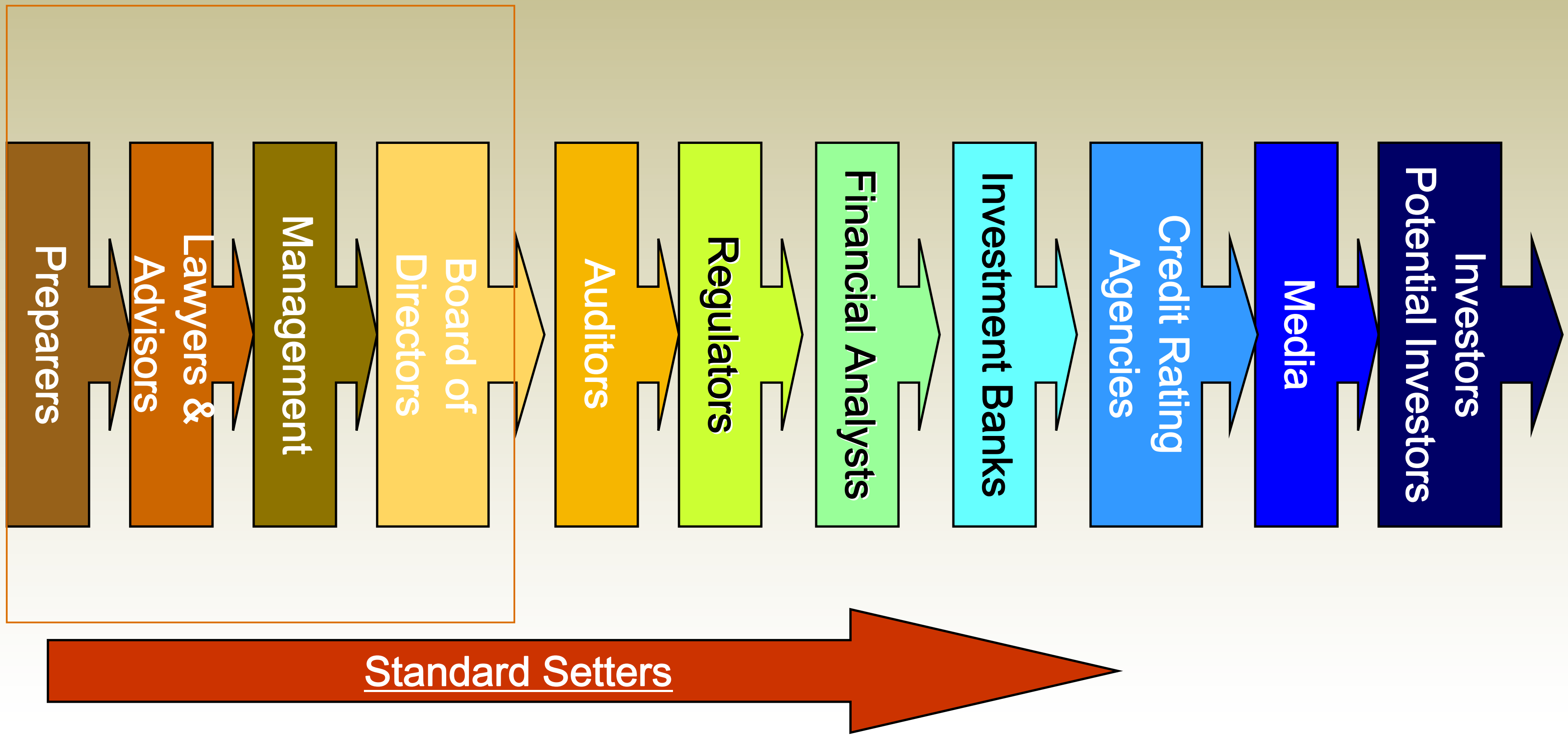
Some Corporate Governance Considerations

- **No "one perfect" CG framework exists**
- **Ethical environment, "tone at the top" by Board and senior management are critical**
- **Bad governance can ruin a company; but good governance may *not* ensure its success**
- **More attention in CG frameworks to "enterprise governance"& "enterprise risk management" concepts**
  - **<u>EG</u>** concepts – *conformance* (CG =accountability and assurance); *performance* (enterprise governance=value creation, resource utilisation)
  - **<u>ERM</u>** – must be applied within the context of strategy setting; internal control is an integral part of risk management

Additional CG Considerations

- **Sound CG facilitates**
  - Transparency in financial reporting
  - The maintenance of strong internal control
  - Appropriate relationships with internal and external auditors, including follow-up on auditors' findings (eg, control weaknesses)
- **Strengthens role of Bd. audit committee, other committees**
- **External reporting on CG and internal control varies around the world, as does the related role of auditors**

*One View of the Financial Reporting Chain for Public Companies**



* Adapted from an IFAC presentation at the FSF-IASB-IFAC Roundtable on Financial Reporting and Auditing, Paris, France, February 2006.

The Future of Corporate Governance?

- More principles-based instead of rules-based standards?
- Clarifying the role of management vs. the auditor
- Reducing complexity of requirements and guidance
- Balancing costs & benefits – *reducing undue burdens*
- Voluntary initiatives and best practices?
- International convergence?

Corporate Governance and Markets: *Lessons from the Past*

The Future of Corporate Governance and Financial Markets?

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