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Good Corporate Governance vital to financial system stability: Dr Akhtar

Dr Shamshad Akhtar, Governor State Bank of Pakistan has said good corporate governance for the banking industry, with assets to GDP ratio of almost 59%, is critical in ensuring solvency and stability of the country's financial system and to provide impetus to economic growth.

Delivering her keynote address on 'Corporate Governance for Banks' at a convocation of the Institute of Bankers, Pakistan today at a local hotel in Lahore, she said that the State Bank has been on the forefront in promoting good corporate governance in the country as a regulator and supervisor of banks and DFIs.

"SBP has implemented a comprehensive corporate governance regime for banks, which is driven by a robust legal and regulatory framework, risk-based supervision and over-arching banking sector reforms, notably, privatization, liberalization and consolidation of banks," she said and added the major thrust of legal and regulatory requirements is to strengthen the functioning of the Boards of Directors of banks.

Dr Akhtar said recently the State Bank has separated the positions of chairman and CEO of banks and made it mandatory on banks to appoint on the Board at least 25% independent directors and not more than two executive directors. SBP has also strengthened the fit and proper criteria and approves appointment of directors and CEO of banks in line with the criteria. Banks must also follow the fit and proper criteria in appointing key executives although such appointments do not require SBP approval, she added.

She said SBP has also issued guidelines on risk management, internal controls, IT security and business continuity planning besides detailed instructions on policy framework for banks, risk management framework including regulatory requirements that check banks' exposure to group companies and other related parties, restrict exposure to single borrower, borrowing group or sector, as well as limit banks' investments in equity market.

While giving details about current regulatory requirements for banks, SBP Governor said that the State Bank like other central banks is also steering the implementation of Basel-II in a phased manner. Initially banks are required to adopt the Standardized Approach for credit risk and the Basic Indicator/ Standardized Approach for operational risk from 1st January 2008, she said and added, subsequently, once banks improve their in house systems, they would have the option to switch over to more advanced approaches from 1st January 2010 subject to the adequacy of capacities and capabilities and its due diligence by SBP.

Dr Akhtar said as a further step to strengthen governance of banks, they are required to undergo credit rating annually. The rating must be announced publicly and disclosed in the financial statements of the bank, she said and added SBP also requires banks to appoint auditors from a panel of pre-approved auditors maintained by it. "The objective is to ensure credibility of audited financial statements of banks," she added.

Referring to monitoring and supervision mechanisms, she said that the State Bank has implemented a comprehensive framework, which is underpinned by regular on-site inspections of banks and DFIs under the regulatory ambit of SBP. Banks are inspected in accordance with a pre-approved annual inspection plan, following the CAMELS-S approach. SBP has also developed a comprehensive surveillance mechanism – the Institutional Risk Assessment Framework (IRAF) – to capture the host of risks facing individual banks based on the information gathered from on-site inspections, off-site supervision, market intelligence and self-assessment by banks, she added.

“The objective is to obtain a composite rating for each bank for effective and proactive supervision by SBP,” SBP Governor said and added the State Bank is endeavoring to further strengthen its own governance processes in consultation with its Board of Directors. “An adequate and appropriate governance framework is crucial for the optimal functioning of any enterprise, but more so for a central bank because of its objectives of maintaining price stability and ensuring financial stability along with its crucial contribution to the overall economic policy framework,” she said.

Dr Akhtar said SBP’s efforts to improve corporate governance have resulted in a visible improvement in the corporate governance practices of banks and the fundamental change is in the effectiveness of the board. The implementation of Fit and Proper criteria has ensured that board members are well equipped to carry out their responsibilities, she said. Furthermore, internal control system has been strengthened in banks through setting up of audit committees and internal audit functions. Compliance officers are now appointed to manage banks’ compliance to the policy framework and laws and regulations, including the AML requirements, she said.

SBP Governor said frequency of financial reporting has improved through circulation of quarterly accounts and financial reporting standards are at par with international best practices while credibility of financial information has received a boost through rotation of auditors after every five years. These improvements have been reflected in international assessments of corporate governance framework in Pakistan.

She said although considerable progress has been achieved in enhancing corporate governance practices of banks, SBP is geared towards filling in the remaining gaps. In this regard, foremost is the need to develop a suitable cadre of professional directors who are knowledgeable of banks’ affairs as well as independent of their management and majority shareholders, she said and added allied to this is the need to clarify and strengthen directors’ fiduciary duties to act in the interests of the bank and all of its stakeholders. It is also essential for banks to provide sufficient time and information to directors to prepare for Board meetings, structure Board meetings so as to allow ample time for discussion and establish appropriate criteria for assessing and improving performance of directors, including independent directors. To raise awareness on these and related aspects, SBP is working towards issuing comprehensive corporate governance guidelines for banks.

Dr Akhtar pointed out that Pakistan’s corporate and financial sectors present corporate governance issues peculiar to complex ownership and group structures and that to address such corporate governance issues, there is a need for group supervision by the regulators. As regard the banking supervision, SBP is working towards introduction of

consolidated supervision whereby it will not be monitoring banks as a stand-alone entity but rather as part of the entire banking group. “This will help to evaluate the strength of the entire group and to mitigate risks arising from group companies,” she said.

She said the State Bank has recently launched a survey of banks to assess their corporate governance practices. The survey will help to identify areas for reform in the regulatory framework as well as its implementation by banks and its results will be a key input in further improving the corporate governance framework for banks, she added.

While concluding her speech, Dr Akhtar asserted that no amount of regulatory intervention can fully institutionalize corporate governance unless Boards and senior management of banks appreciate the value addition of corporate governance to their productivity and competitiveness. In this context, banks should strive to build a reputation for honest and fair dealing while interacting with their internal as well as external stakeholders.

“Good corporate governance is essential in establishing an attractive investment climate characterized by competitive companies and efficient financial markets, she said and added it is imperative that Pakistan’s banking sector develops and implements good governance practices, in order to provide impetus to economic growth.
