**Basel Recommendations on Corporate Governance Principles for Banks**

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**Definition:**

The Basel Recommendations on Corporate Governance Principles for Banks are a set of high-level, broadly stated guidelines that provide standards on how banks should approach discharging their fundamental responsibilities and obligations to put in place sound and transparent decision making and risk management structures and processes. These standards aim to enhance bank stability and the confidence that shareholders and stakeholders have in banks. The Recommendations are published by the Basel Committee for Banking Supervision (BCBS)that is headquartered at the Bank for International Settlements in Basel, Switzerland. As banks play a key role in channelling funds to productive investments and in facilitating payments, they are instrumental in the financing of the SDGs and in preserving natural systems and social stability.

Following the global financial crisis there was a strong recognition of the need for robust standards in the governance of banks. The 2015 Basel Recommendations build on previous corporate governance guidelines issued by the BCBS as well as draw from standards issued by the OECD and the Financial Stability Board. Specifically the recommendations, which have practical implications for banks regulators alike, have an increased focus on risk and aim to improve corporate governance in banking institutions by restating and reinforcing the oversight and risk governance role of bank boards and board committees; identifying the roles that different parts of banks have for identifying and managing risk and strengthening checks and balances. The Recommendations join other efforts to provide a more robust global financial architecture that will maintain the financial sustainability which is needed for economic growth, social stability and inclusive societies.

**Introduction:**

Engagement with the SDGs has focused the attention of businesses on stakeholders and relational concerns, putting both relationships and transactions to the heart of business decisions that seek to achieve long term success. The work of the Organisation for Economic Cooperation and Development (OECD) in which corporate governance is described as involving a set of relationships between a company’s management, its board, its shareholders and other stakeholders has been particularly influential in the development of the Basel Recommendations on Corporate Governance Principles for Banks. Following the global financial crisis, governance weaknesses in banks were widely cited as fundamental flaws in financial systems that threatened sustainability and the financing of the SDGs, especially in the case of largest banks (Walker, 2009; Kirkpatrick 2009). Using principles to provide guidelines that will influence the behaviour of banks is generally seen as superior to adopting a rules-based approach. This is because of the flexibility that principles afford to banks to make decisions that are in line with their range of characteristic. Banks vary in terms of size, risk profile and complexity and these differences give rise to different governance requirements.

The Banking Committee on Banking Supervision (BCBS) has been setting guidelines and standards on Corporate Governance for banks since 1999. Since then, the BCBS has continued to review and revise its advice on corporate governance to keep abreast of developments and emerging trends in the banking sector. The BCBS was set up in 1974 and comprises representatives of central banks and supervisors from several countries. This international regulatory body has published several international banking standards and is best known for the prudential standards embodied in the Basel Capital Adequacy Accord.

In September 1999, the BCBS set out the first set of principles on corporate governance in the banking sector. This publication titled ‘Enhancing Corporate Governance in Banking Organisations’ was issued shortly after the OECD published a set of corporate governance standards and guidelines in June 1999 for governments to support stock exchanges, investors, businesses and other entities that were involved in establishing good corporate governance systems and practices.

The motivation for the BCBS to issue this publication was the recognition not only does corporate governance in banks have unique elements but also that good corporate governance plays a critical role in the proper functioning of banking supervision. Banks are deemed to have a fiduciary duty that goes beyond their obligation to shareholders and extends to multiple stakeholders such as depositors, creditors, bondholders, the society and the environment (Macey and O’Hara 2003, De Haan and Vlahu 2016). Detecting and satisfying the expectations of these stakeholders in a way that creates shared value is a clear challenge for banks from strategic to operational levels (Formisano et al. 2018). Public confidence in banks is essential to maintain financial stability and sustainability. Good corporate governance would contribute significantly to ensuring that suitable checks and balances and the necessary accountability checks are established in each bank.

**History**

The first set of corporate governance guidelines issued by the BCBS targeted banking supervisors globally, with the aim of providing a tool for supervisors to promote good corporate governance practices amongst banks. Bank supervisors are responsible for checking that a bank is properly governed and for highlighting any shortcomings in bank’s corporate governance practices to senior management. Prior to publishing these guidelines, the BCBS had issued some publications on the management of interest rate risk, the management of credit risk, bank transparency and internal control systems which highlighted and reinforced the importance of corporate governance to banks’ strategies and techniques. The 1999 guidelines identified and set out seven areas of good corporate governance practice but did not refer to these explicitly as principles. These are related to setting and communicating strategic objectives and corporate values; setting and enforcing lines of responsibility and accountability; board member qualifications and independence from senior management; senior management oversight; internal and external auditors; compensation and transparency of corporate governance. While noting the primary responsibility for corporate governances rests with the board and senior management, the important role of other players, such as governments, stock exchanges and securities regulators, auditors and trade associations in implementing good corporate governance is also acknowledged in the guidelines. The paper was divided into three clear sections titled practices, supervisors and environment respectively.

Following the OECD’s reissue of a set of corporate governance principles in 2004, the BCBS also revised the guidelines in 2006. The 2006 version was issued to both banking organisations and supervisors. This paper also paid specific attention to complex banking organisations and financial conglomerates that operate across jurisdictions and cross several lines of business which results in them having structures that are not transparent. This paper followed a similar structure to the 1999 paper. Section 1 presented 8 distinct principles; section 2 considered the role of supervisors and section 3 commented on prompting an environment that is conducive to sound corporate governance

The 2010 release was the first post crisis version. The global financial crisis revealed several corporate governance failures and weaknesses in banks that had contributed to the global financial crisis. Kirkpatrick (2009) highlighted several areas of weakness. These include weaknesses in r*isk* Management systems; compensation and Incentive systems that encouraged risk taking; Ineffective board oversight; gaps in Disclosure and Accounting standards and a flawed Credit Rating process. In response to the weaknesses identified, a key focus of the BCBS was curbing short-termism and excessive risk taking in banking. The principles were revised and expanded to 14 principles. These principles were set out in six different section as follows:

Section A – Board Practices – Principles 1 to 4 (overall responsibilities, qualifications, structure, group structures)

Section B- Senior Management- Principle 5 (consistency of activities with risk appetite and strategy)

Section C- Risk Management and Controls – Principles 6 to 9 ( effective internal controls and risk, management function including a Chief Risk Officer of equivalent, risk identification and monitoring, robust risk communication and reporting, use of work conducted by internal auditors, external auditors and internal controls)

Section D – Compensation- Principles 10 and 11 (design, operation and review of compensation systems, alignment between compensation and risk)

Section E- Complex or Opaque Structures – Principles 12 and 13 (board and senior management knowing and understanding structures and associated risks, understanding the risks of special purpose structures and jurisdictions that may impede transparency and steps taken to mitigate these risks

Section F – Disclosure and Transparency - Principle 14 (transparency of governance to shareholders and stakeholders)

This breakdown shows that eight out of the fourteen principles are in the areas of board practices and Risk governance. The guidelines were strengthened on the role, qualifications and composition of boards and board oversight of compensation systems. The significance of the risk management function and the role of the Chief Risk Officer were also emphasised. Furthermore, the importance of an understanding of banks’ operational structure and risks by both the board and senior management was incorporated in the guidelines.

**The 2015 principles**

Following consideration of the comments received after Consultative Version of the principles in 2014, an updated version was published in July 2015. This version also considered recommendations made by the Financial Stability Board in its 2013 Thematic Review on Risk Governance about the board’s role in risk governance and in establishing a risk culture in a bank. The thirteen principles include changes that provide more clarity, detail and guidance on the obligations of board members, board collective competence, the oversight and risk governance responsibilities of the board, the allocation of responsibilities between committees, senior management and control functions, the key elements of a robust risk governance framework and the internal control mechanism of banks.

The principles acknowledge that the primary role of the board is oversight and with regards to board structure the requirement that the board chair should not chair any board committee is removed. Specifically, the principles would also guide bank supervisors in how they assess the processes that banks have used to select their board members and senior management. There are important changes with regards to risk management and to compensation provisions for those who are deemed to be risk takers in banks. Compared to the preceding version of the guidelines, some aspects of the 2015 recommendations are worth noting because of their implications for responsible conduct and its regulation. In recognition of growing concerns about mis selling and other scandals in banking, specific provisions on conduct risks are include explicitly in the responsibilities of board members and senior management. As trust and integrity are important for sustainability, a new feature of the guidelines is the recommendation in Principle 9 that banks establish a compliance function as a second line of defence that will support corporate values and ensure that banks act responsibly. The guidelines also specify roles for supervisors that will strengthening the global financial architecture that identifies and manages the risks that are inherent in a global financial system. The global financial architecture is the framework for identifying and managing systemic risk and crises at the global level. It comprises a network of international financial institutions (IFIs), policy initiatives and rules to facilitate financial stability and the smooth flow of capital across countries.

The thirteen principles of the Basel Recommendations on Corporate Governance for Banks cover the following topics:

1.Board’s overall responsibilities

2.Board qualifications and composition

3.Board’s own structure and practices

4.Senior Management

5.Governance of group structures

6.Risk management function

7.Risk identification, monitoring and controlling

8.Risk communication

9.Compliance

10.Internal audit

11. Compensation

12.Disclosure and Transparency

13. The role of supervisors

**Summary**

The 2015 Basel Recommendations on Corporate Governance Principles for Banksare part of the developments that have evolved to create a more sustainable financial system so that banks could play an effective role in financing the SDGs and in maintaining the financial stability that is needed for growth and development. Institutions such as the Basel Committee for Banking Supervision, the OECD and the Financial Stability Board are collaborating and cooperating to help promote financial stability through better bank governance and to end the problem of institutions are deemed too big to fail. Strengthening bank governance by means of a principles based approach to regulation is an ongoing process that will progress over time as bank boards adopt the appropriate oversight and develop the appropriate corporate culture, controls, risk management and compliance systems that underpin good corporate governance.

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