Challenges to banks' good governance

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BANGLADESH Bank is committed to establishing good governance practices in banks and financial institutions besides fulfilling its core objectives like employment maximisation and price stability in the country.

Corporate governance is such a precondition that affects the financial soundness indicators of each institution. The quality of governance can affect the financial soundness indicators of banks such as asset quality and capital adequacy ratio. The ambiguity in either regulatory measures or the corporate management level can distort the smooth functioning of the financial intermediation process. Corporate governance failure can happen when one or more banks are devoid of transparency, accountability and oversight of their own managerial practices.

Moreover, when corporate governance structure is ambiguous and not very well developed, the ultimate accountability to the stakeholders can remain with the regulators. Sometimes, the amount of non-performing loan (NPL) can rise due to deterioration of industry-wide moral hazard and so, if regulators are unable to effectively curtail them, regulatory governance failure can be made responsible. The challenge of dealing with NPL includes a lack of proper legal procedures to recover bad loans and a tendency to reschedule or restructure those loans.

In recent times, the structure and style of corporate governance have changed overall. If we look at corporate governance structures across the globe, we may find that families constitute majority of the market capitalisation in most of the countries. With family ownership, rational succession plans are difficult to implement as family members may not be qualified to assume managerial responsibilities, or they may not be interested in carrying on family business.

In my understanding, it is the most significant problem of corporate governance in Bangladesh. Although our policies do not support this, it can happen sometimes indirectly due to opaqueness in the policies itself. This kind of structure may hinder the good governance practices since the exposures of connected persons can serve their personal benefits.

The second most problem of corporate governance is the lack of knowledge about monitoring new products, or insufficient attention to their risk characteristics. Moreover, the promotion policy in commercial banks (for example performance in line with deposit collection targets, etc) may not be coordinated with, or may even contradict with broader objectives of the bank. In regard to accountability and transparency, accounting standards and disclosures are very important.

A market for corporate control can play an important monitoring role, as poorly managed companies can become merger/acquisition targets. In Bangladesh, there seems to be no market for corporate control, as merger/acquisition of either publicly-traded or privately-held companies is rare. Moreover, independent directors do not act as an advocate for minority shareholders or as a source of innovative ideas as they are thought to be. It is assumed that due to a lack of shareholders' activities, corporate governance cannot be firmly established. There is also a lack of independence of auditors which is linked with "lemon problem" -- a problem of information asymmetry. In addition, due to managers' appetite to take excessive risks to earn more profits/incentives, banks' health can be deteriorated further. This can be solved by introducing "employee stock option plan", or by introducing multi-year remuneration programmes, where compensation over the years is tied to long-term outcomes, not the short-term ones only.

It has been observed that board members and senior management, who may be appointed by the government, may not have full discretion to carry out their responsibilities properly. It is my opinion that international guidance should pay more attention to the issue of domination of the board by a single individual or faction, and measures that banks or banking supervisors could put in place to address this problem. Domination of the board by the chief executive officer is a common problem, but there is also "reverse domination" -- individual board members interfering in specific decisions of senior management or even lower levels of management. There is also the problem of irreconcilable conflict between the board chairman (or individual board members) and the CEO that is not addressed adequately so far. It not only could deteriorate corporate governance of the bank but also could signpost unhealthy example to other banks.

STAR/FILE

Employees are seen at a branch of a bank. Ensuring good corporate governance in the banking system depends on the overall attitude of stakeholders.

Bangladesh Bank has been pursuing the best corporate governance framework for the banking system. The first principle suggested by the Basel Committee on Banking Supervision on corporate governance focuses on the board's overall responsibilities. However, the concept of "risk appetite" is still not very well developed in this regard, and board members may have difficulty being actively involved in its preparation, approval, and communication throughout the bank. Also, in some banks that have a more traditional, hierarchical structure, it may be difficult to implement a policy of escalating problems or ethical lapses to the attention of the board, without fear of reprisal. The second principle is about the board's qualifications and compositions. Initial and ongoing training of board members in their duties and responsibilities is very important, but in some banks it may be difficult to sustain that kind of training because of time constraints and reluctance of certain board members to attend.

The principle no. 4, 5, 6 and 8 focus on senior management, governance of group structures, risk management function and risk communication respectively in which we do not find any visible challenge to implement. Considering the principle no. 7 which is named as risk identification, monitoring and controlling, we have observed that in some banks, there are challenges in accumulating a sufficient dataset to measure expected losses and unexpected losses in the credit portfolio, as well as in operational risk management and liquidity management. These practices are just getting started in many banks, and historical data are often not available with sufficient depth and quality. In regard to principle no. 9 that is referred to compliance, it is assumed that in some banks, there may not be an understanding of the difference in roles between compliance and internal audit.

The "second line of defence" functions of risk management and compliance are well-understood, but the "third line of defence" role of internal audit in reviewing the adequacy of risk management and compliance may not seem sufficiently distinct.

In regard to the principle related to compensation (principle no. 11), the legal basis for multi-year remuneration payout schedules, claw back (the recovery of money already expensed) provisions for unsatisfactory outcomes, and vesting of deferred compensation have not been sufficiently developed in Bangladesh to better align compensation with risk-taking.

Regarding principle no. 12 on disclosure and transparency, some of the matters such as compensation principles and amounts are kept highly confidential to depositors and market participants. Finally, principle no. 13 on the role of supervisors, we do not find any challenge to implement, except in the case of state-owned commercial banks where Bangladesh Bank cannot alter the composition of the board and senior management, or in requiring corrective action.

In summary, Bangladesh Bank has been trying to establish good corporate governance standards in the banking system but the efficacy of these mechanisms will depend on the overall attitude of the stakeholders.

The writer is a deputy governor of Bangladesh Bank.

Commodity price falls a $160b bonus for China

REUTERS/FILE

A worker rides his bicycle past piles of steel coils for export at a port in Yingkou, Liaoning province.

AFP, *Beijing*

SLUMPING prices saved China more than $160 billion on its imports of commodities such as oil, iron ore, coal and copper last year, official figures showed on Wednesday.

Slowing growth in the world's second-largest economy has hammered global raw materials prices, sending shockwaves through resource-rich producer countries from Australia to Zambia.

But the falls have proved a boon to China itself, which is reportedly taking advantage of the low costs to stockpile oil.

The average price of China's oil imports plummeted 45.3 percent in 2015 on the previous year, Customs spokesman Huang Songping said, with volumes rising 8.8 percent to 335.5 million tonnes according to the Customs website.

Overall, the country spent $134.5 billion on crude oil imports during the year.

The quantity it bought was a record, Bloomberg News reported, saying it has eased rules to let private refiners import crude, while boosting shipments to fill national stockpiles.

Iron ore imports were up 2.2 percent by volume and totalled $57.6 billion by value -- but on average cost 39 percent less than in 2014.

Copper imports were flat by quantity but 17.1 percent cheaper per tonne, with a total of $19.2 billion-worth brought in.

Coal prices also dropped 21.8 percent, with volumes of the fuel also slumping, by 29.9 percent.

Demand for some materials has weakened in the Asian giant due to manufacturing overcapacity and a cooling property market.

Calculations by AFP show that for the four commodities in total, the quantities imported would have cost $160.5 billion more at 2014's average prices.

For crude oil alone, the saving amounted to $113.9 billion.

Overall, China's import prices declined by 11.6 percent on average in 2015, while prices of exports edged down just one percent, Huang said.

"The price conditions for China's trade improved sharply and the efficiency of foreign trade increased," he told reporters.

For the full year, China's imports slumped 14.1 percent by value on 2014 to $1.68 trillion, Customs said, while exports were down 2.8 percent to $2.28 trillion.

"The sharp falls in global commodity prices and the slowdown in commodity import volume growth are the main causes for the decrease in China's 2015 import value," Huang said.

Beijing is seeking to transition the country's growth model away from reliance on exports and fixed-asset investment towards a consumer-driven economy, but the reform is proving bumpy.

China logged its worst economic performance since the global financial crisis in the third quarter of 2015, with gross domestic product (GDP) rising just 6.9 percent -- its lowest level in six years.

GDP figures for the full year are due to be released next week.

From chaos to calm: one year on from Swiss "Frankenschock"

REUTERS, *Zurich/London*

A year on from "Frankenschock", when Switzerland's central bank sent global foreign exchange markets into a frenzy by abruptly ending its cap on the Swiss franc, the currency is one of the most stable in the world.

Sharply negative Swiss interest rates - three month rates are around minus 0.75 percent - and subtle market interventions by the Swiss National Bank have stabilised the franc at around 1.08 per euro.

Whether it lasts is an open question - there have been political and economic costs - but the situation is nonetheless a far cry from Jan. 15, 2015 when the cap's removal prompted the biggest currency market swing since the 1970s.

"Nobody who was involved in the franc on Jan. 15 will ever forget that one, what the move was like," said Tim Mueller, a senior foreign exchange trader at Zuercher Kantonalbank. "I've been doing this for nearly 28 years and that was a unique move."

Global markets had complete confidence the SNB would stick to its three-year-old pledge to keep the euro above 1.20 Swiss francs, a tool it had described as the cornerstone of monetary policy as recently as Jan. 12.

So when it published a brief statement in early European trading hours bluntly saying it had lifted the cap, investors were caught cold.

As the franc soared past parity against the euro, economists fretted Switzerland's export-reliant economy would plunge into recession while some foreign exchange brokers were pushed out of business.

A year later, the picture has brightened.

The SNB still describes the franc as "significantly overvalued" but the currency is at a tolerable price for Swiss exporters to the euro zone, Switzerland's biggest trading partner,

REUTERS

Swiss 100 franc bank notes are withdrawn from an ATM in the Swiss town of Kreuzlingen.

and has not thrown the country into an anticipated recession.

"The SNB looks to have regained control over the franc and a lot of investors believe that," said Joachim Corbach, head of currencies and commodities at asset manager GAM in Zurich.

Wariness about what the SNB could do next, along with the negative rates, has deterred speculators and kept franc in a narrow range since August.

Reflecting this, the share of the franc in daily spot deals in London, the biggest trading centre for currencies, has slipped, according to the Bank of England.

Investors have instead plumped for more liquid currencies like the Japanese yen, another safe-haven currency, and the dollar in the latest bout of turmoil hitting global markets.

The latest trends in the derivative markets indicate investors are certain about the franc's stability in the coming weeks given concerns about China and the pull of the franc as a safe haven.

"If things get nastier, then we could see them (investors) coming into the franc, but at the current moment they seem to prefer the U.S. dollar and the yen," Corbach said.

Meanwhile, the political and economic fallout from the cap's removal still grips Switzerland and the SNB.

Unemployment hit 3.7 percent last month, the highest in nearly six years, as Swiss companies that rely on selling goods abroad cut jobs to save costs. Consumer prices have fallen every month in year-on-year terms since November 2014.

The SNB posted a record 23 billion franc ($23 billion) loss last year largely due to enormous losses on its foreign currency positions.

Foreign investment plummets in junta ruled Thailand

AFP, *Bangkok*

FOREIGN investment in Thailand plummeted last year, official data showed, the latest sign that the kingdom's once-vibrant economy continues to falter under prolonged military rule.

Total investment applied for by foreign companies between January and November 2015 plunged 78 percent from a year earlier to 93.8 billion baht ($2.62 billion), according to figures from Thailand's state-run Board of Investment (BoI) sent to AFP late Tuesday.

The figures will do little to cheer junta leader Prayut Chan-O-Cha, who seized power in a May 2014 coup vowing to restore stability but who has struggled to kickstart the country's lacklustre economy.

After years of impressive growth, Thailand's economy is struggling, mired in high household debt, stuttering exports and low consumer confidence.

It also faces stiff competition from increasingly attractive neighbours like Vietnam, Cambodia and Myanmar.

Particularly worrying for Prime Minister Prayut is a significant drop off in investment from Japan -- historically the largest investor in Thailand by far -- which slumped 81 percent.

EU investment also plunged from 86.7 billion baht in 2014 to just 2 billion baht last year. Investment from the United States was also heavily down, while Chinese investment was only down slightly.

Krystal Tan, an Asia economist with Capital Economics, said the trend was indicative of deeper fissures within the Thai economy, which was among the slowest growing in the region last year.

"The 2015 [FDI] figures are very weak, indicating foreign investor confidence in the economy remains fragile," she told AFP.

"More broadly, Thailand's economic competitiveness is on the decline," she added. "The country continues to face significant challenges on the political front that have negative repercussions for business and investor confidence."