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BANKS' CORPORATE GOVERNANCE

Specificities, crisis, and recent developments

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ABSTRACT

Banks are some of the most important actors in the economic system of the major advanced and emerging economies. This is because not only they provide capital to businesses, but also operate as an external monitors on the quality of the governance of the companies in which they have a share interest or to which they lend. The banking system is crucial in the economic and social development for every country in the world. Indeed banks play a key role in collecting and channelling savings to real-economy businesses. This is even more valid in Italy, a country still characterized by a bank-centred financial system and bank borrowing to finance economic activity much higher than funding from capital markets.

Banks' corporate governance and its regulation have not been studied in a systematic and extensive manner despite their high importance, as some authors¹

¹ R. Levine, *The Corporate Governance of Banks: A concise Discussion of Concepts and Evidence*, Discussion Paper n. 3, presented to the Global Corporate

complained. Indeed the importance of both has been underestimated for at least the first year of the recent global financial crisis, which also brought to light the overall inadequacy of the global system of corporate governance of banks. By now this aspect is recognised by analysts one cause, a major catalyst of the crisis.

The proper functioning of financial markets is chiefly based on investors' (increasingly more often financial intermediaries) confidence on proper behaviour and soundness of financial institutions which should be the result of the capacity and adequacy of the systems in charge of identifying and managing risks. Systems of corporate governance which are inadequate or do not guarantee transparency seriously harm the functioning of financial markets in which banks operate.

Banks' specificity requires a specific study on corporate governance of those companies. Banks' governance has also major structural differences. Consider the trust relationship between managers and shareholders and their conflicts of interest (the so-called Agency conflict). In banks there are other players involved, such as supervisors and depositors. In Italy the widening of the set of stakeholders takes a distinct connotation due to the still-very-large holdings of banking foundations in the capital of the banks. Recently new institutional investors slowly begun taking significant holdings in major Italian banks. This thesis explores the new frontiers of banks' corporate governance, in the light of developments following the recent financial crisis, in a time of strong and urgent legislative changes not only at national level (such as the regulatory interventions of the Bank of Italy from 2008 to date, not last the Supervisory Regulation on internal organization and corporate governance of banks). Should the legislator introduce measures to create additional mechanisms to constrain banks' governance or should it focus on creating incentives for a sound and prudent management of banks, so to stimulate a "appropriate market behaviour"?

The present work aims at addressing the specific aspects that affect the corporate governance of banks both at a national level and at a global one. These

levels that are increasingly intersecting each other, as we believe that now (perhaps since its origin) the banking system can only be considered in the multitude of complex international interconnections, which have become global. Those links have been made increasingly more stringent by the socio-economic reality of the new millennium.

In order to better put in context the recent regulatory changes, ample space is devoted to the reconstruction not only of the evolution in Italy of the recent global financial crisis (significantly called "interlude" and where there have been some important anomalies, luckily positive²), but also of the origin of the crisis with particular reference to the case of the United Kingdom (London remains the leading financial market in Europe, but before the crisis was by far the leading financial centre in the world), where through the reform proposal by Chancellor G. Osborne the supervisory architecture is ready for a revolution that will totally redraw the regulatory landscape.³

The first chapter is devoted to the reconstruction of the term corporate governance and to the long process of formation of its definition in the economic and legal environment. In the second chapter we review the main points of difference between banks and other companies of the real economy, with particular attention to the elements that impact on the systems of corporate governance adopted by the banks. The third chapter examines the main national legal reference which is the Supervisory regulation on internal organization and corporate governance of banks issued by the Bank of Italy in 2008. Moving from the development in Italy of the

² Interlude between the anarchic development of large international banks (with reference to both deregulation and financial innovation) and the return to business-as-usual. From R. Ruozzi, *Intermezzo, Tre anni di crisi bancarie*, Milano, l'alingua, Spirali, 2010.

³ The implementation of a thorough reform of the UK supervisory architecture was urged by economic actors and the new coalition Government has quickly release a consultation document entitled *A new approach to financial regulation: judgment, focus and stability*, published by the HM Treasury in July 2010. The so-called "Osborne Reform", named after the Chancellor of the Exchequer, provides for the abolition of the current tripartite architecture.

recent global crisis and the measures that the Government has put in place the fourth chapter identifies the main problems highlighted by the crisis collected in Principles for Enhancing corporate governance issued by the Basel Committee. The fifth chapter offers a comparison with the legal system in Britain, a country where much attention has been devoted to the evaluation of the regulatory and supervisory mistakes in particular on corporate governance.