



Bank governance & risk management

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Bank branches in Australia 2006

	<i>no.</i>	<i>%</i>
ANZ	757	14.7
CBA	1,005	19.5
NAB	787	15.3
WBC	817	15.9
Others	<u>1,781</u>	<u>34.6</u>
	5,147	100%

Source: APRA, *Points of Representation*, June 2006, p.7.

Bank asset market share 2006

■ Nationwide Australian banks (5)	67.9 %
■ Other Australian banks (9)	14.4 %
■ Foreign bank subsidiaries (12)	7.8 %
■ Foreign bank branches (27)	<u>10.0 %</u>
Total	<u>100.0 %</u>

Source: APRA, *Insight*, Issue 2, 2006

Shifts in market share



* Excludes intra-group assets

** Adjusted for bank entries and exits

*** Adelaide Bank, Bank of Queensland, Bendigo Bank and Suncoast-Maleny

Sources: APRA; RBA

Corporate governance (ADIs)

APRA supervised financial institutions should have a board of directors where:

- The chair must be an independent, non-executive director.
- There should be at least five directors with a majority of independent, non-executive directors. At least one of these must have financial expertise.
- The board must have an audit committee, board risk committee and a dedicated internal audit function.
- All directors should be “fit” and “proper.”

Bank governance & risk

- By this time in the conference program, delegates will be very familiar with why corporate governance matters are important in bank risk management.
- The expected argument is that good governance should enhance bank performance and curtail bank risk taking by their better control of bank management.
- Delegates will also know the standard recommendations or beliefs in this regard.

Bank governance beliefs

- Smaller board of directors are better than larger boards.
- The more independent directors on the board the better.
- The CEO should not chair bank boards.
- More qualified directors result in better boards.
- Boards with a more diversified range of expertise are better boards.

Are these beliefs true?

- There is substantial logic behind these beliefs, but whether these actually work to enhance bank performance and reduce bank risk in the real world is less apparent.
- The empirical work supporting these views relate more to corporate than bank related research.

Small boards are better

- As boards become larger, they have increasing problems of coordination. Some directors may also be able to minimise their contributions and become “free riders.” As their effectiveness is reduced, so is their ability to manage the managers.
- The empirical evidence on bank board size, however, is not so clear.

Board size evidence

- The empirical work on board size is mixed. A few studies suggest that board size has a non-linear relationship with performance and risk. So some bank boards are too small or too large, others are just right – so an inverse U shape.
- Some research on US banks, however, found a positive relationship for board size with performance and risk when bank's size and complexity of operations is considered.

More independent directors

- Independent directors should be concerned about the impact of bank failure on their reputation (future income) and so be more objective in monitoring bank risk and performance. So more independent directors should enhance this monitoring.
- The empirical evidence is not quite as expected.

Independent director evidence

- A few studies have found no significant relationship between the proportion of independent directors and bank performance. The same maybe true for risk taking but there are mixed findings in this regard.
- Some research on US banks found a negative relationship with both performance and risk taking.

No CEO/chair duality

- The concept of splitting the roles of the board of director chair and the CEO is well established as the chair is expected to supervise the CEO's performance. It is difficult to supervise one's self.
- The evidence is again mixed, but research on US banks found the banks with CEO/Chair duality tended to perform poorer but with less risk than did other banks.

More qualified directors

- One would expect the greater the training and experience of the bank directors, the better a bank should perform and manage risk.
- The evidence is again mixed but is at least positive for Australian bank performance.
- It is also positive in respect to Australian bank risk taking. So the more qualified the board, the more risk that bank is likely to undertake.

More expertise diversity

- While a board with well qualified directors is good, an appropriate mix of qualifications is similarly desirable. Australia has specific requirements for insurance company boards.
- Like expertise, the evidence suggest a positive relationship here both with performance and risk taking.

Conclusion

- While good governance is no doubt a useful objective, there are dangers in applying the beliefs of one country to another without researching their impact.
- Chinese banking research may discover quite different results and are likely to vary based on the type of banking institution, their ownership and size.