Financial Sector Corporate Governance

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1. Motivation

- The African society context of Institutions

- A vibrant, stable, efficient and customer-centric financial sector is very important in achieving this desire.

- Good corporate governance for the financial sector is thus important

2. What is Corporate Governance?

- **Corporate Governance** refers to institutional structures, processes, and information used to **direct**, to **oversee** and to **control** the management and operations of an organization.

- Effective and Sound Corporate Governance plays a vital role in the financial sector:
  - Enhances stability through effective risks management
  - Enhanced productivity, efficiency and effectiveness in the use of limited resources

- The **primary focus** and **purpose** of good governance is to;
  - Facilitate a competitive, performance and sustainable excellence of nations or institutions to deliver results,
  - Build the trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity.

…Principles of Corporate Governance.

- Sound Corporate governance practices are anchored on Principles of Corporate Governance…
  - ✓ Clarity in the mandate
  - ✓ Powers/Authority
  - ✓ Operational Independence, Transparency and Accountability
  - ✓ Strong Institutional Arrangement
  - ✓ Financial Independence
  - ✓ Predictability
  - ✓ Engagement
  - ✓ Performance Appraisal

3. Why Corporate Governance in the Financial Sector?

- Financial sector is key to sustainable economic growth - funding, liquidity and price discovery, while also providing effective risk management, payment and some monitoring services.
- Financial Sector services have unique characteristics: Customer-centric; efficiency and resilience; intangibility; dynamism and Perishability.
- Hence requires **Sound Corporate Governance** practices and cultures to deal with potential risks

Efficiency (in scarce resources use) and Resilient (able to adjust to normal business cycles and severe shocks) in service provision

Intangibility - FSPs must focus on the quality and innovativeness of their services and products for credibility and customer confidence

Dynamism: Financial services and products are dynamic i.e. constantly redefined and refined to reflect market dynamics driven by socio-economic and technological developments.

Perishability: financial services tend to perish and cannot be stored. Supply and demand must match customers' requirement.

Customer-Centric: FSPs must provide services and products meeting customer needs - cost, liquidity and maturity

…Why Corporate Governance in the Financial Sector?

- Sound corporate governance contributes to effective regulation and supervision of the financial sector, a foundation for safeguarding financial stability and enhanced integrity; and significant spill overs to the rest of the economy.

- Weak corporate governance practices in the public financial institutions manifests through:

  - ✓ Inadequate and less qualified directors, some with conflict of interest;
  - ✓ Less independent boards and weak institutional structures for effective oversight;
  - ✓ Limited understanding of risks facing the financial sector;
  - ✓ Limited transparency and accountability in reporting, management and oversight; and,
  - ✓ Weak risk management systems, internal controls and internal audit arrangements.

…Corporate Governance in the Financial Sector?

- Weak corporate governance practices in the financial sector, include:

  - ✓ Weak corporate governance law – limited disclosure requirements, overlapping roles & responsibilities;
  - ✓ Poor enforcement mechanism of corporate governance law – weak judiciary and regulatory authorities;
  - ✓ Limited competition in the financial sector and products – less market discipline and incentives;
  - ✓ Corrupt practices in public and private sectors;
  - ✓ Poorly developed financial disclosure requirements; and,
  - ✓ Underdeveloped capital markets – limited transparency in pricing.

- **Sound Corporate Governance practices** supported by **<u>a robust</u>** and **<u>dynamic</u>** laws is important in fostering development and integrity of a sound, safe and stable inclusive financial sector.

4. Board Composition, Selection Process and Structure

- **Board composition** – combination of executive directors and non-executive directors in the board

- Espouses of good corporate governance practices;
  - ✓ ***Size*** – matters in terms of efficient decision-making and problem solving;
  - ✓ ***Independence*** – boards with more non-external members are less prone to conflict of interest and have access to more external information;
  - ✓ ***Diversity*** – gender, race, ethnicity, religion, and age are critical in boards and overall organization functioning.
  - ✓ ***Expertise and professionalism*** - wide range of knowledge, experience and skills in relevant areas, and varied backgrounds to promote diversity of views in solving complex problems, formulating strategic decisions and playing their oversight role.
  - ✓ ***Integrity and fidelity*** - Board members should be people of high integrity, owe loyalty to the organization and have attitude for effective communication, collaboration and critical debate in the decision-making process.

…Board Selection Process

- **Selection Process and qualifications of board members** are key to good corporate governance:
  - ✓ A clear and rigorous process for identifying, assessing and selecting board candidates is needed including appropriate succession planning of board members.
  - ✓ Robust selection review processes

- **Appropriate Board Structures** are key to good corporate governance – clear leadership structure, optimal size and use of committees to effectively play their oversight role;

- **Appropriate board records** (charter, minutes or reports on matters reviewed, recommendations made, decisions taken and dissenting opinions) of its deliberations and decisions are mandatory.

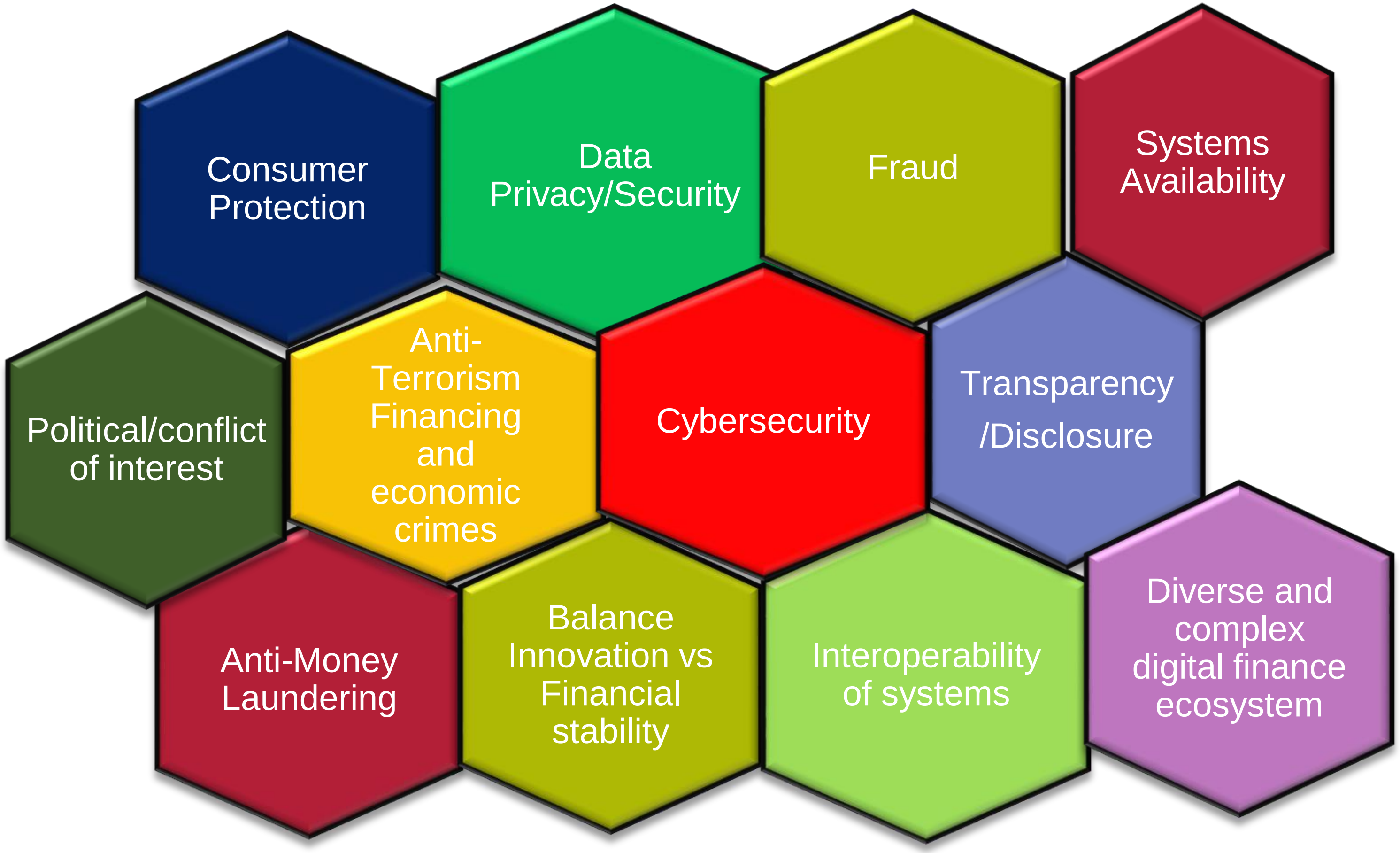
- **Supporting Committees** for efficiency and focus, chaired mostly by independent, non-executive board member- *Audit, Risk, Technical etc*

5. Key challenges in Corporate Governance in Public Financial Institutions in Africa

- Challenges emanate from both internal and external environment.

- Complex institutions and business environment – firms are expanding into different business lines:

- Oversight boards must be well-equipped to deal with these challenges to safeguard stability



…Key challenges for Financial Institutions in Africa

- How can countries ensure that principles of good corporate governance including Board selection process, composition and structures are adhered to?

- How can we mitigate politically leaning selection of board members?

- How do boards navigate political/parliamentary decisions that might threaten the stability of the financial system?

- How do financial sector regulators deal with problem SOE's under their jurisdictions?

6. What has Kenya Done – Central Bank Perspective

- *Kenya, and the Central Bank*, in particular has embraced good corporate governance practices. Specifically, the Oversight board of the central bank is anchored on;.
  - ✓ ***Constitution***: Chapters 6 and 12 provide for – *mandates, ethics, integrity and independence*
  - ✓ ***Central Bank of Kenya Act (Cap.491)*** – *clarity of mandates; board recruitment, composition, powers, functions and qualifications; separation of powers between the Chairman and the Governor; non-voting rights of The National Treasury.*
  - ✓ ***Mwongozo*, Chapter 1** - *provides effective Boards comprising of competent, diverse and qualified members capable of exercising objective and independent judgment.*
  - ✓ ***Others*** – *Tax compliance, Certificate of Good Conduct, Credit worthiness, and Ethics & Anti-Corruption Clearance*
  - ✓ *Strengthening controls and systems*

…Central Bank Perspective

- Separation of Powers and Roles between Governor and Chairman/the Board to ensure checks and balances:

Executive/ Governor	Board/ Chairman
• Executive leadership • Management of Bank resources • Monetary Policy formulation and implementation • Delivery of mandates and responsibilities • Implements Strategic Plan set by the Board	• Oversight role of the Bank including budget and human capital • Sets strategic and policy direction of the Bank • Reporting except on monetary policy • Performance Appraisal of the Executive

Central Bank Perspective on

- Autonomy
- Transparency and Accountability
- Conflict Management

… Impact of embracing corporate governance practices in Kenya

- Clarity in Boards Appointments, size, structures including board charters and terms limits
- Boards now held accountable in decision making
- Improved communications and reporting including audit reports
- No holding of multiple directorships in different boards
- Board induction and continuous skills development

…Challenges

- Slow political process in appointment of Boards.
- Getting the right mix of Skills Sets, Experience and Competencies
- Fragmented legal and institutional frameworks for effective Cooperation and collaborative initiatives –Limited capacity building opportunities at policy level on emerging issuesConflict of interest and integrity concerns
- Weak disciplinary and/or enforcement mechanism for Board members who flout integrity rules and ethics that define this office -

- Limited performance appraisal system to the Boards.

- Dependence on other constitutional offices can impact Board’s performance

For the MEFMI Region

- Development and regulation of financial sector predominantly under the ministries of Finance and or by independent regulatory bodies established by Acts of Parliament.

- These are better-suited to drive sound corporate governance practices adhering to the principles of good corporate governance, in particular;
  - ✓ Clarity in the mandate – *for purpose, effective strategic direction and use of resources etc.*
  - ✓ Powers/Authority – *independent decision-making and service delivery*
  - ✓ Operational Independence, Transparency and Accountability – *avoidance of conflict of interest, enhanced disclosures and reporting, and compliance with standards and rule of law*
  - ✓ Strong Institutional Arrangement – *effective governance structures and culture, risk management, and enhanced internal controls and systems*

8. Opportunities to Address the Challenges

- ***Effective Policy Direction and Oversight* –** to enable the institution deliver on its mandate and responsibilities
- ***Leverage on technology and innovations to address emerging risks financial sector*** – fraud, AML/CFT, Cybersecurity
- ***Effective Utilization of Resources* –** adequate human capital, technology to access large volume of information/data and financial.
- ***Setting the Institution's Governance Culture and Ethics* –** value system, integrity, conflict of interest, political interference.
- ***Cooperation and collaborative Arrangements* –** to strengthen institutional engagements at national, regional and international levels to address emerging issues and risks.
- ***Ensure Adequate capacity building*** – to take advantage of changing environment and skills sets

9. Conclusion

- MEFMI to work with policymakers and regulators in the region to institute harmonized and appropriate capacity building programs that entrench better corporate governance practices in the Financial Sector with particular focus on:
  - ✓ Exercise of ethical and strategic leadership to manage and lead the future finance sector
  - ✓ Governance and management leadership in disruptive and transformative technological digital era
  - ✓ Guiding and leading the competitive, performance and sustainable excellence of the financial sector
  - ✓ Enhancing the social accountability, responsible citizenship and environmental responsibility of the finance sector.

THANK YOU