



INTERNATIONAL ASSOCIATION OF  
DEPOSIT INSURERS (IADI).

"CORE PRINCIPLES FOR EFFECTIVE  
DEPOSIT INSURANCE SYSTEMS"

ANNUAL CONFERENCE

21-22 SEPTEMBER 09, BASEL

CORE PRINCIPLE ON "GOVERNANCE"

PRESENTATION BY: J M CHIKURA, CEO DEPOSIT  
PROTECTION BOARD

# Agenda

- Governance Principle & its supporting guidance points
- Key elements of the governance structure
- Relationships from a governance perspective
- Board appointments & Senior executives
- Training, Remuneration & performance assessments
- Roles & responsibilities of the board & management
- Audit & Legal protection
- Transparency & disclosure

# Introduction

---

“The proper governance of corporations will become as crucial as the governance of countries” Jim Wolfensen

- In the light of recent corporate scandals & collapses, these words have become more meaningful today not only for the corporate sector but also state owned entities (SOEs)

# Does good governance matter for deposit insurers?

- 
- The core principles produced by IADI & the BIS are a direct & positive response to that question

# Core Principle 5: Governance

- *"The sound governance of agencies comprising the financial system safety net strengthens the financial system's architecture and contributes directly to system stability"*
- *Operationally independent and accountable safety net organizations with clear mandates and which are insulated from undue political and industry influence provide greater integrity, credibility and legitimacy than entities lacking such independence*

# Core Principle 5: Governance

- *The deposit insurance system should have a governing body and the governing body should be held accountable to the authority from which the deposit insurance system receives its mandate*
- *The deposit insurance system should be structured such that the potential for undue political and industry influence and conflicts of interest respecting members of the governing body and management is minimized”*

# Supporting Guidance points

1. "The mandate and responsibilities of a deposit insurance system should be clearly defined, preferably in legislation.
2. Governing body members & officers should be subject to laws or codes regarding conflict of interest and ethical behaviour
3. A deposit insurer should consider maintaining a profile of desired skills for its senior executives and governing body members and for those persons to be appointed on the basis of competence and skill

# Supporting Guidance points

4. It is an effective practice for the governing body of a deposit insurance system to conduct meaningful self-assessments.
5. The governing body should set strategic direction of the deposit insurance system and for management to carry it out.
6. The governing body should have a charter or policy in place that lays out its responsibilities.
7. The governing body members & officers of the DI should be provided with legal protection for decisions made, omissions, and actions taken in good faith while discharging the mandate of the system.

# Supporting Guidance points

8. The DI should be subjected to regular external audits and these audits/  
examinations should be made public.
  - Daily operations should be subjected to internal audits & the internal audit function should report to the governing body
9. A deposit insurer should be as transparent as possible and should disclose appropriate information on its activities, governance practices, structure, and financial results".

# Definitions & Key Elements of Governance:

- ❑ Definition of Governance: Processes, structures and information used in directing and overseeing the management of an organisation
- ❑ Concerns relationships between the deposit insurance system & the authority from which it receives its mandate to which it is accountable

# Key elements of the framework:

---

1. Operational independence
2. Accountability
3. Integrity
4. Transparency

# Operational independence

---

- Ability of the organisation to use powers & means assigned to it without undue influence from external parties

# Accountability

---

- Individuals and organizations (DIs) should be responsible for their actions and for fulfilling their objectives

# Integrity

---

- ❑ The board & management should pursue organisational objectives, without compromising them through own or other's behaviour or self interests
- ❑ They should follow appropriate standards of behaviour, subject themselves to internal controls, audit & conflict of interest codes

# Transparency & Disclosure

---

- Transparency is fostered when the actions & decisions of the DI are revealed & clarified to its stakeholders
- The DI should release information to stakeholders in a manner that enables them to judge the effectiveness of the organisation's conduct

# Scope & purpose

---

- There is no one size fit all, just as the mandates vary from one country to another, so too can governance structures
- The governing board may be a board of directors or supervisory board or a department/divisional head and management
- Whatever structure is chosen, all share common characteristics, they must account to a higher authority & be responsible to all stakeholders

# Governance Structures

1. ~~Many are structured as separate government agencies e.g. Canada, Nigeria, USA, Malaysia, Zimbabwe etc~~
  - This could be more resource intensive but it enables DI to be more focused
  - It offers fewer opportunities for conflict of interest
2. Others are set up as not-for-profit or private sector e.g. France, Argentina, Brazil etc.
  - Although primarily managed by the private sector but the mandate issues from a public authority, save for Germany's DI which gets mandate from banks

# Governance Structures

---

3. The least common structure is the Ministry, Supervisory Authority or Central Bank departmental model ie Isle of Man, Slovenia, Kenya, Tanzania etc
- ❑ Simple & less expensive to run but has limited capabilities as it relies heavily on the organisation in which it operates
  - ❑ It creates challenges in ensuring the interests of the DI receive appropriate weighting in decision making for the entire organisation

# Governance Structures

1. Whatever the governance structure, DIs share a common framework:
  - (1) A higher authority were mandate comes from
  - (2) Governing body i.e. Board of Directors or Supervisory board &
  - (3) A Management team
2. Whatever the governance structure, the DI's mandate should be clearly defined, preferably through legislation

# Advantages of legislation:

- ❑ It clarifies the objectives of the system for all stakeholders
- ❑ Lays out the powers the system may or may not exercise
- ❑ Usually specifies the terms and conditions of coverage
- ❑ Specifies accountability of the DI to a higher authority

# Relationships

- ❑ Relations between DI & its key stakeholders can create the potential for conflict of interest & for excessive stakeholder influence & interference
- ❑ It is considered best practice for the DI to have operational independence in the fulfilment of its mandate
- ❑ Minimise potential conflicts arising from undue political, industry, or other external influence eg the Deposit Insurance Agency of Russia's legislation forbids undue political & bureaucratic influence
- ❑ In Canada the Chairman of CDIC can only be removed for cause

# Relationships

- In some cases the reporting line creates potential for conflicts of interests
- This could be minimised by the DI reporting to non- or multi-partisan authority like a legislative body instead of an individual like the Minister
- Caution is required to avoid manipulation of the system by a member bank
- As a result some jurisdictions do not appoint to the board, any member with an active relationship with a bank

# Relationships

- ❑ The supervisor or central bank may be able to shed some light on the approach it takes to an intervention
- ❑ However the Financial Stability Forum (FSF) cautions against DI governing boards being “dominated” by representatives from other safety net participants
- ❑ This could be achieved by ensuring that persons from these other safety net participants, do not form a majority on the board as is done in Mexico, Canada, USA, Malaysia etc
- ❑ It is important to note that directors fiduciary duties are to the organisation and not the constituency that appoints you on the board

Appointments to the board & management

- These should be based primarily on skill & competency, not political or industry considerations
- The FSF recommends that members of the governing board be subjected to a “fit & proper” test, be free from serious conflicts of interest & be independent i.e. be without undue influence
- E.g. Malaysia legislation requires that all directors must have relevant experience in the private sector & at least one should have banking & financial sector experience.
- Canada; The Chair must be a person of “proven financial ability”.

## Appointments to the board & management

---

- ❑ Mexico requires people who would have held top management positions & experience from private sector of at least 5 years or have at least 10 years of teaching & research experience in economics & finance from an institution of higher learning
- ❑ In USA, FDIC Chair is approved by bipartisan committees in the Senate & House of Representatives & no more than 3 members of the 5 board of directors can come from the same political party
- ❑ To preserve institutional memory appointments/retirements should be staggered

## Training, Remuneration & Performance Assessments

- ❑ Appointees should possess knowledge of the ~~deposit insurance & the financial services industry~~
- ❑ The DI needs to provide training & development programmes to appointees without such skills & knowledge
- ❑ Adequate remuneration is necessary to attract the right calibre of governing board members
- ❑ The board should assess its own performance. This should not just be a tick box exercise
- ❑ It could be done in-house or outside consultants could be used

# Roles of the governing body & Management

- ❑ Role of the board broadly covers 4 areas namely strategy, performance, risk and people. Board should direct & oversee Management in its administration of the affairs of the DI
- ❑ Management's role is to translate the board's policies into action ie implementing these & running the entity on a day to day basis
- ❑ The DI should have a Board Charter, which outlines its responsibilities & how it will fulfil them & those responsibilities delegated to Management
- ❑ In many systems the position of Chair of the governing body & that of head of management functions are separate
- ❑ Merging the two creates a more efficient command-and-control & decisions are made & carried out quickly
- ❑ It can also lead to fewer relationship problems between the board & management & it can more efficiently align operations with strategy

# Roles of the governing body & Management

- ❑ On the other hand separating the position creates a much more clearer delineation between the governing body & management
- ❑ Combining the jobs, puts one in a conflicted position of conducting oversight of his or her own actions
- ❑ It stifles criticism of management & eliminates the fundamental oversight function of the board
- ❑ Appointment of the CEO ideally should be by the board
- ❑ To provide proper oversight, Board may appoint committees such as Audit, Risk, Remuneration, Nomination etc
- ❑ Relevant stakeholders of the DI need to be identified a policy developed on how to relate to them
- ❑ There should be a policy on communication with stakeholders & the role of Chair & CEO need to be clarified in terms of speaking on behalf of the DI

# Audit & Legal Protection

- Independent validation of the state of the DI by external Auditors is important. This provides assurance to the board & stakeholders
- An Internal control system is a critical element of risk management & The Board needs to ensure that it is robust, effective & regularly reviewed
- It is considered best practice for the Head of Internal Audit to report to the Audit Committee on operational matters & to the CEO on administrative issues
- The DI should have legal protection for actions done in good faith by Directors & staff members to enable them to discharge their responsibilities without fear of reprisals

# Transparency & Disclosure

- Transparency & disclosure are necessary to re-enforce accountability of the DI to a higher authority & assess their responsibility to other stake holders
- A culture of transparency must be cultivated e.g. the FDIC conducts board meetings in public, with some exceptional sessions held in camera
- In publishing financial & non-financial information to the public, balance needs to be struck between providing adequate information & maintaining confidentiality
- The release of sensitive information could seriously affect the stability and possibly competitiveness of some players on the market
- Appropriate disclosure of non-commercially sensitive information goes a long way in fostering confidence in the DI & reinforcing stability of the financial system

# Conclusion

---

- In conclusion governance is about leadership. Leadership that is independent both in thinking & action, leadership that is accountable, honest, transparent with nothing to hide, leadership with responsibility & integrity
- The future of our financial systems & indeed our national economies is tied to the success of our corporations, DIs & other safety net players. The leadership provided by governance bodies is crucial

□ I Thank You