CORPORATE GOVERNANCE IN THE BANKING ACT

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Among the main factors supporting the stability of any country's financial system according to the Guidance on Deposit Insurance (2001 Final Report) issued by the Financial Stability Forum may be included:

a) effective market discipline,

b) good corporate governance,

c) strong prudential regulation and supervision,

d) accurate and reliable accounting in financial reporting systems,

e) a sound disclosure regimes,

f) the enforcement of effective laws,

g) an appropriate savings deposit protection system.

Corporate governance as one of the abovementioned components may, according to the Financial Times, 1997, be more narrowly defined as the relationship of the enterprise to shareholders, or in the wider sense as the relationship of the enterprise to society as a whole. It may be defined as the sum of the processes, structures and information used for the directing and overseeing the management of an organisation (Guidance on Deposit Insurance, Financial Stability Forum, 2001). According to several theoreticians, for example, Mathiesena (1999) corporate governance is an economics discipline, which examines how to achieve an increase in the effectiveness of a certain corporation with the help of organisational arrangements, contracts, organisational regulations and business legislation.

The Basel Committee on Banking Supervision issued in September 1999 the document entitled "Enhancing Corporate Governance for Banking Organisations". This document was based on the principles of corporate governance issued by the OECD (OECD Principles of Corporate Governance). The principles should contribute to an improvement in legal, institutional and regulatory corporate governance in OECD countries and provide guidelines and provide food for thought for stock exchanges, investors and other subjects having a role in the process of developing good corporate governance. According to the cited document banking supervision cannot function if there does not exist correct corporate governance. Experience stresses the need for an appropriate level of responsibility, control and balance of competences in each bank. Correct corporate governance simplifies the work of banking supervision and contributes towards cooperation between the management of a bank and the banking supervision authority. Corporate governance is in the OECD document defined so: "It is a system, on the basis of which business companies are directed and managed. This system specifies the division of competences and responsibilities between individual included parties, such as the board of directors, the supervisory board, the management and majority and other owners and formulates rules and procedures for adopting decisions on corporate matters. Concurrently it defines also the manner in which the aims of a business are to be determined and the means for achieving them and the manner of measuring the level of their success."

Banks are a crucial element to the economy (for reason of their participation in effecting the system of payments, acting as money intermediary between lender and borrower and realising the transmission of monetary policy), and therefore it is important that they have strong and correct corporate governance. Among the basic hallmarks or components of correct corporate governance, according to the abovementioned document of the Basel Committee on Banking Supervision of September 1999 are:

a) the corporate values, codes of conduct and other standards of appropriate behaviour and the system used to ensure compliance with them,

b) a well articulated corporate strategy against which the success of the overall enterprise and the contribution of individuals can be measured,

c) the clear assignment of responsibilities and decision making authorities, incorporating hierarchy of required approvals from individuals to the board of directors,

d) establishment of mechanisms for the interaction and cooperation among the board of directors, senior management and auditors,

e) strong internal control systems, including internal and external audit functions, risk management functions independent of business lines and other checks and balances,

f) special monitoring of risk exposures where conflict of interests are likely to be particularly great, including business relationships with borrowers affiliated with the bank, large shareholders, senior management or key decisions-makers within the firm (e.g. traders),

g) the financial and managerial incentives to act in an appropriate manner, offered to senior management, business line management and employees in the form of compensation, promotion and other recognition,

h) appropriate information flows internally and to the public.

The administration itself and management of a company, thus also a bank has its own legislative basis. Along with the Commercial Code the Act no. 483/2001 Z.z. on banks and on the amendment to and supplementing of cer-

tain acts (hereinafter referred to as „the Banking Act") governed in their provisions these areas or elements falling under the term corporate governance:

1. Separation of competences and responsibilities and cooperation.

2. Internal and external control and risk management,

3. Transparency of proceedings and publishing of information.

A crucial provision for the application of the principle of corporate governance, or rather the requirements of the Basel Committee on Banking Supervision is Article 23 Para. 1 of the Banking Act. According to this provision a bank's articles, besides the requisite matters stated in the Commercial Code (Article 173 and 174), must contain also other requirements particular to the case of banks. A bank is obliged to regulate the organisational structure and system of the bank's management so as to ensure the proper and secure conduct of its licensed banking activities and to enable the healthy development and prosperity of the bank. Furthermore, a bank is obliged in its articles of incorporation to regulate the relations and cooperation between the statutory body, supervisory board, managing employees of the bank, internal control and internal unit. It is also obliged in the articles of incorporation to separate and regulate competence and responsibility in the bank for:

a) the creation, implementation, monitoring and control of the business objectives of the bank, in which there are directly or indirectly expressed also the basic values or attitudes of the bank in relation to the subject of business of the company as such;

b) the management system of the bank in complying with the "Four eyes" rule, which does not simply contain the requirement of two signatures, but also the separated division of functions, cross checking, and a double-entry checking of assets, meaning that the two-signature requirement is not the only possible form of implementing the "Four eyes" principle;

c) an internal control system including a unit of internal control and internal audit, corresponding to the complexity and risks of the banking activities. The Banking Act does not require the creation of two independent units; this is a matter for each specific bank. An explanatory criterion for determining the organisational form of the control unit is the complexity and risk of the activities performed by the bank. The Banking Act does however stipulate the orientation of the activity of the unit of internal control and internal audit. While the act mentions new types of deals, this concerns only those new types of deals that have some relevance from the viewpoint of risk management;

d) separated risk management from banking activities including a system of identification, monitoring, measuring and managing of significant risks to which the bank is exposed. The Banking Act highlights the importance of risks in the activity of a bank and, for the first time in examples, defines the term risk, as well as several specific types of risks – credit, market, liquidity and operating risk. Besides these risks, others may also be stated, such as country risk, legal risk and goodwill risk, all of which a bank must take account of in its activity. The act also highlights the need for monitoring, evaluating and controlling risks to which a bank is exposed;

e) separated performance of classic credit deals (which include besides loans also guarantees) and investment deals, which are defined in Article 34 Para. 4 of the Banking Act. Article 34 of the Banking Act, which conveys in more detail this requirement is based on Council Directive No. 89/592/EEC of 13 November 1989 and the Council Directive No. 93/22/EEC of 13 May 1993. The application of the cited directives should assist towards integrity of the financial market and maintaining confidence in this market. With this there is also connected a ban on the misuse of information gained in connection with the performance of a function or employment for the unauthorised gaining of advantages for oneself or for another;

f) the separated monitoring of risks to which the bank is exposed in conducting banking activities with entities having a special relationship to the bank, these being defined in provisions in Article 35 of the Banking Act. This concerns the implementation of the 10 fundamental principles of the effective discharge of banking supervision, which should prevent the misuse of connected or family relations in providing loans and to create in such cases especial requirements for objective decision-making and monitoring repayment of the loan provided;

g) an adequate information system both internal and external that among other matters ensures the transparency of the bank's proceedings, thereby supporting market discipline. This requirement is elaborated in more detail in particular in Article 37 of the Banking Act.

h) the prevention of legalisation of incomes from criminal activity, which is based on Council Directive No. 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering, which was amended and supplemented by directive of the European Parliament and the Council no. 2001/97/EC of 4 December 2001. This is governed in particular in Act no. 367/2000 Z.z. on the prevention of legalisation of incomes from criminal activity and on the amendment to and supplementing of certain acts. In this the Banking Act itself touches on the issue of money laundering, for example in provision § 89 Para. 1 on the need to ascertain the identity of the bank's client.

For the need of ensuring implementation of the principle of corporate governance the Banking Act imposes new duties on members of the statutory body, the supervisory board and managing employees of a bank. These duties are imposed in the interest of the security and health of the bank and should in their final result help in achieving an increase in the value of the bank's shares or of its long-term profit. In this is highlighted the requirement for proceeding in accordance with the legal framework of the Slovak Republic.

Specifically there is for the first time imposed on members of the statutory body of a bank the duty to acquaint oneself with, direct, and control the conduct of the bank's licensed banking activities and to ensure the secu-

rity and health of the bank. In assessing the fulfilment of this requirement it is necessary to judge the statutory body as a whole. This means that for example not every member of the statutory body must be acquainted with all activities performed by the bank and with the risks connected with it. Nevertheless the composition of the statutory body must fulfil this requirement. In this the Banking Act defines the term "security and health of a bank" as that performance of banking activities that does not threaten capital adequacy, liquidity and the transparent business conduct of the bank as well as the authorised interests of depositors and other creditors nor the banking system. From the definition it may be concluded that this concerns a broad safeguarding of interests, i.e. from the interests of the individual, e.g. the shareholder, through to group or society-wide interests.

In connection with the application of corporate governance the Banking Act solves the so-called conflict of interests, i.e. it limits members of the statutory body of a bank, members of the supervisory board of a bank and employees of a bank in the performance of certain activities, for example a member of a statutory body of a bank may not be the statutory body or a member of a statutory body or confidential clerk, or a member of a supervisory board of another artificial legal entity that is a business entity.

In view of the significance of the system of internal control the Banking Act in Article 25 deals specifically with the organisation of the internal audit and internal control, their relations to the bank's supervisory board and to the National Bank of Slovakia and deals also with certain other conditions of the application of internal control.

The provisions of the Banking Act that govern the principle of corporate governance relate accordingly also to a branch of a foreign bank, to the manager of a foreign bank and to employees of a branch of a foreign bank.

The Banking Act deals specifically with the provision of information to the external environment in Article 37, and this in relation to individual clients of the bank and of a branch of a foreign bank, to the National Bank of Slovakia and also to the public as a whole. In this it concerns the provision of individual items of information, e.g. on a specific deal or remedial measures imposed, or on information in aggregate form, e.g. financial indicators.

Under certain conditions, if certain published information are incomplete or substantially deviate from actuality, the bank or branch of a foreign bank are obliged without delay to publish a correction.

In conclusion it may be stated that the aim of applying the principle of corporate governance in the Banking Act is first and foremost to create the legal foundations for the early entry of a healthy banking subject into the banking sector and from which may be expected long-term success in the marketplace.