MFW4A WEBINAR SERIES

Efficient Corporate Governance for Financial Sector Development

July 28, 2020
Today’s session is scheduled to last 1 hour including Q&A

To ensure the highest quality of experience, all participants will be muted

QUESTIONS can be submitted via the “Chat” or “Q&A”

For Live questions / Comments. Click on “Raise Hand” icon to speak
(Lower Hand and mute after)

Slides and a recording of this presentation will be circulated after we conclude. They will also be available on MFW4A.ORG.

Message the organizers for any issues

Don’t forget to fill out the survey that appears automatically after the session
• G8 initiative launched in October 2007

• Common platform for the harmonization and facilitation of financial sector development and knowledge sharing in Africa.

• Donor partners, African governments the private sector, and other financial sector with the aim of unleashing the full potential of Africa's financial sector in order to drive economic development and reduce poverty across the continent.
MFW4A WEBINAR SERIES

VISION, MISSION & PILLARS

MFW4A’s activities are broadly focused on three thematic pillars:

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<th>Financial Inclusion</th>
<th>Long-term Finance</th>
<th>Financial Stability and Governance</th>
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<td>• Digital Finance</td>
<td>• Institutional Investors</td>
<td>• Community of African Banking Supervisors</td>
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<td>• Agricultural Finance</td>
<td>• Housing Finance</td>
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<td>• SME Finance</td>
<td>• The Africa Long Term Finance Initiative</td>
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<td>• Trade Finance</td>
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<td>• Insurance</td>
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Knowledge Management and Advocacy

EFFICIENT CORPORATE GOVERNANCE FOR FINANCIAL SECTOR DEVELOPMENT

HOUSEKEEPING
- MFW4A PRESENTATION

PANELISTS
- KPMG PRESENTATION

Q&A

CONCLUSION
MFW4A WEBINAR SERIES

EFFICIENT CORPORATE GOVERNANCE FOR FINANCIAL SECTOR DEVELOPMENT

HOUSEKEEPING

- MFW4A PRESENTATION

PANELISTS

KPMG PRESENTATION

Q&A

CONCLUSION
MFW4A WEBINAR SERIES

PANELISTS

▪ Speaker

Thierry Mbimi
Partner and COO – Central Africa
Head, Financial Services – Francophone Sub-Saharan Africa
KPMG

▪ Moderator

Hugues Kamewe-Tsafack
Financial Sector Advisor
Making Finance Work for Africa (MFW4A)

BANK CRISIS MANAGEMENT PROGRAMME IN RESPONSE TO COVID-19

HOUSEKEEPING
MFW4A PRESENTATION
• PANELISTS
LIBF PRESENTATION
Q&A
CONCLUSION
Outline

01 Corporate Governance
02 Key Players & Governance Structure
03 Financial Sector development & Corporate Governance
04 Risk Governance
05 Board Governance
1. Corporate Governance
Corporate Governance
Definition and role

“The board is responsible for the successful perpetuation of the corporation. That responsibility cannot be relegated to management.”
John G. Smale

“Corporate governance is a set of relationships between a company’s management, its board, its shareholders and other stakeholders”.
Organisation for Economic Co-operation and Development (OECD)

“Corporate governance is defined as the structures and processes by which companies are directed and controlled”.
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In essence, corporate governance is the “system by which companies are directed and controlled.”
Sir Adrian Cadbury, Cadbury Report

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Sir Adrian Cadbury, Cadbury Report
Corporate Governance
Evolution of Corporate Governance

Corporate governance follows either corporate scandals or financial crises.

Each episode of financial instability has been followed by a revision of corporate governance.

→ The great depression: 1929 – Fall of share prices – Asset bubble – Response: Keynesian and monetarist policy;


Benefits of Corporate Governance

Objectives of Corporate Governance Codes

- Optimize operational and financial performance;
- Improve access to capital and investor support;
- Mitigate risk and safeguard against mismanagement;
- Efficiently allocate and manage resources
- Build and improve the reputation of a company
- Create confidence, establish goodwill and restore/build investor trust.

IFC Brief Issue Corporate Governance (2014)
Corporate Governance

Other failures and responses

Enforced Corporate Governance Models:

Examples of Key Global Codes include:
- OECD Corporate Governance Principles
- Sarbanes Oxley (USA)
- King IV Report (South Africa)
- UK Code of Corporate Governance
- ASX Corporate Governance Guideline (Australia)

Nigeria Codes issued after Governance failures:
- PENCOM Code – 2008
- NAICOM Code - 2009

Examples of Governance Failures

1. Overbearing Chairmen/CEO
2. Poor risk management practices
3. Poor transparency and scrutiny of related party transactions
4. Misalignment of shareholders’ interest with that of management
5. Ineffective boards and board practices
## Failures – Banks in Africa

<table>
<thead>
<tr>
<th>Name</th>
<th>Cause</th>
</tr>
</thead>
<tbody>
<tr>
<td>9 bank failures in Ghana. (UT Bank, Capital Bank, Unibank, Beige Bank, Construction Bank, Sovereign Bank, Royal Bank, Premium Bank, Heritage Bank)</td>
<td>The Bank of Ghana revoked the licenses of 9 banks in Ghana in 2017 and 2018. Reasons for the revocation of the licenses included poor corporate governance and risk management practices, related party transactions that were not above board, regulatory non-compliance, and poor supervision, (questionable licensing processes and weak enforcement).</td>
</tr>
<tr>
<td>6 bank failures during the 2009 Nigerian Banking crises (Afribank, Bank PHB, Spring Bank Fin Bank, Intercontinental Bank and Oceanic Bank)</td>
<td>2009 saw another round of bank failures in Nigeria. This failure came on the heels of joint CBN/NDIC special investigation into the books of the 25 banks operating in the country as at that date. The findings of the investigation revealed that the banks were technically insolvent on account of capital, poor credit risk management, liquidity and lack of corporate governance.</td>
</tr>
<tr>
<td>Nossa Banco (Mozambique)</td>
<td>Nossa Banco was closed by order of the Bank of Mozambique in November 2016 due to lack of capitalisation and a sustainable economic and financial structure, and serious liquidity and management problems.).</td>
</tr>
<tr>
<td>Crane Bank (Uganda)</td>
<td>In September 2016, Crane Bank, with its estimated 500,000 customers, was taken over by the central bank, having become “seriously undercapitalised”.</td>
</tr>
<tr>
<td>Imperial Bank and Chase Bank(Kenya)</td>
<td>Imperial Bank was placed under receivership on October 13, 2015 after the Central Bank of Kenya learnt of a fraud, which milked the lender of Sh34 billion.</td>
</tr>
<tr>
<td></td>
<td>On April 7, 2016 Chase Bank was placed under receivership—taken over by the Central Bank— with all accounts frozen, and the CEO and managing director suspended pending investigations. Panic withdrawals on Wednesday, caused by &quot;inaccurate&quot; rumours on social media, led to a run on Chase Bank, said the Central Bank of Kenya (CBK).</td>
</tr>
<tr>
<td>Bank M (Tanzania)</td>
<td>The Bank of Tanzania (BoT) placed Bank M under receivership for failure to meet its debts in 2018. The central bank said that the lender failed to keep minimum reserves of Tsh50 billion ($21.9 million). The decision to take over the bank followed a determination by the Bank of Tanzania that Bank M had critical liquidity problems and was unable to meet its maturing obligations.</td>
</tr>
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Corporate Governance
Regulatory Reforms : Example of the Ghanaian Banking Sector

<table>
<thead>
<tr>
<th>Increase in minimum capital requirements for banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks have complied with the increased minimum capital requirement of existing of GHS400 million by the end of December 2018</td>
</tr>
<tr>
<td>Ghana has only 23 banks, down from the 34 that were operating in the country as of January 2017. With 14 foreign-controlled and 9 domestically-controlled banks</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>IFRS 9 : Impairment</th>
</tr>
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<tbody>
<tr>
<td>Banks are computing IFRS 9 : Expected Credit Loss effective Jan 2018.</td>
</tr>
<tr>
<td>The impact of Stage 2 and Stage 3 provisions has significant impact on the profitability of the banks</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Implementation of the Capital Requirement Directive (CRD)</th>
</tr>
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<tbody>
<tr>
<td>As part of measures to further strengthen risk management across the industry, BoG issued the Capital Requirement Directive, the rule book for Basel II&amp;III compliance, effective January 2018.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Corporate governance directive</th>
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<tbody>
<tr>
<td>In order to strengthen corporate governance structures across the industry, BoG published the Corporate Governance Directive in March 2018 to provide a framework to regulate corporate governance practices in banks.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>The Ghana Reference Rate (GRR)</th>
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<tbody>
<tr>
<td>BoG introduced the GRR in April 2018 as a benchmark rate on which banks will add or subtract the risk premium based on customers’ risk profile.</td>
</tr>
<tr>
<td>The GRR replaced the Base Rate Model as the new formula for interest rate calculation.</td>
</tr>
</tbody>
</table>
Corporate Governance
Key governance challenges facing the banking industry

<table>
<thead>
<tr>
<th>The Agency Problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Governance is facing with two agency problems:</td>
</tr>
</tbody>
</table>

- **✘ Upper management vs Shareholders:** Corporate governance is necessary to align and coordinate the interest of upper management (corporate rules) with those of shareholders (dividends)

- **✘ Central banks and regulatory bodies vs shareholders:** The former is to maintain solvency, ensure supervision and stability of banks and of the banking system, protecting the bank customers
Corporate Governance
Questions from the Board

➢ What is the Corporate Governance definition best suited to our environment?
➢ What are the 5 most recent failures of Corporate governance of banks in the country?
➢ What are the 3 latest regulatory reforms on corporate governance in the region?
➢ What are the key governance challenge facing the banking industry?
2. Key Players & Governance Structure
Key Players & Governance Structure
Ecosystem and stakeholders of the Company

- Professional bodies
- Service providers: Lawyers, Accountants, Auditors, Consultants, Notaries, Insurers, ...
- Media: Press, TV, radio, Internet, Social networks, ...
- Supervisory authorities
- Clients
- Suppliers and subcontractors
- Economic agents: donors, rating agencies, ...
- Authorities: Control bodies, Tax administration Customs, ...
- Employees
- Social organizations
- Unions
- Civil society: Consumer associations, Communities, NGOs
Key Players & Governance Structure

Key Players

As defined as the “system by which organizations are directed and controlled”, Corporate governance generally refers to the relationship among the various participants who are involved in determining the direction and performance of an organization. The main parties who are involved in the governance of a corporation are:

- The **Regulators** in their role of setting up the corporate Governance Directives, Regulations and Code, monitoring and supervision;
- The **shareholders** who contribute capital to the organization;
- The **Management** that runs the everyday operations of the company;
- The **Board** which oversees the managers and protects the interests of shareholders;
- The **Employees**
- **Other Stakeholders**
Key Players & Governance Structure

Corporate Governance Structure

The suggested Corporate Governance Structure, comprising the following parties, provides a comprehensive framework to:

(i) enhance accountability to shareholders and other stakeholders,
(ii) ensure timely and accurate disclosures of all material matters,
(iii) deal fairly with shareholders and other stakeholder interests, and
(iv) maintain high standards of business ethics and integrity.

Its goal is to discharge the bank of its statutory duty of ensuring an orderly, informed and fair market, and of ensuring risks are managed prudently, while pursuing its business objectives.
Key Players & Governance Structure

Corporate Governance Structure

**Board of Directors** – is responsible for providing leadership, either directly or through its committees, to the bank and its subsidiaries (Group) in order to deliver long-term value to shareholders and other stakeholders. It also leads and supervises the Group’s management to act in the interest of the public as well as its shareholders. It establishes corporate policies, sets strategic direction, ensures that an effective internal control environment is in place, and oversees the management which is responsible for day-to-day operations.

**Board Committees** – assist the Board in focusing on specific matters, fulfil their roles and responsibilities delegated by the Board, report to the Board on decisions and actions taken, monitor the management’s performance, and make any necessary recommendations.

- Audit Committee
- Corporate Social Responsibility Committee
- Executive Committee
- Investment Advisory Committee
- Nomination and Governance Committee
- Panel Member Selection Committee
- Remuneration Committee
- Risk Committee
- Risk Management Committee
- Etc...

**Company Secretary** – is responsible for facilitating the Board process, as well as communications among Board members, with our shareholders and the management, and advising the Board and its committees on all governance and CSR matters.
Key Players & Governance Structure
Corporate Governance Structure

**International Advisory Council** – comprises experts in economics, business and finance from around the world, acting as advisors to provide the Board with expert insight and perspective.

**3 Consultative Panels** – act as the advisory bodies to the Board and the management to provide market expertise and advice relating to the Cash Market, Derivatives Market and clearing business.

**Management Committee** – has delegated authority from the Board for performing the day-to-day management functions of the business and implementing all projects and initiatives as approved by the Board.

External auditor and Internal Audit Department – provide assurance on financial reporting and/or internal controls to ensure accountability and audit quality.

**Shareholders** – elect their representatives as directors (Directors) at general meetings to oversee the Group’s business.

**Other stakeholders** – interact with the Group on daily operations. They include institutional investors, market regulators, government bodies, listed/potential issuers and market intermediaries, Exchange/Clearing Participants/Members, Information Vendors and market participants, Mainland exchanges, overseas exchanges, investing public, media and analysts, non-governmental organisations, industry associations, professional bodies, market users, suppliers/business partners and employees.
Key Players & Governance Structure
Corporate Governance Structure – Diagram (illustrative)

Source: unknown
Key Players & Governance Structure

Key elements of an effective corporate governance system

- Well structured Board with appropriate composition, skills and independence
- Clearly defined appointment process
- Well structured committees of the Board
- Formal and transparent procedures for fixing the director remuneration
- Effective process for periodic board evaluation and renewal
- Clear definition of matters reserved for the Board
- Effective board and management relationships

- Periodic stakeholder engagement
- Continuous and transparent disclosures of financial and non-financial information
- Equitable treatment of shareholders
- Protection of minority rights

- Board involvement in strategy formulation
- Regular management reporting on strategic initiatives
- Healthy challenge and debate of management assumptions

- Clearly documented frameworks for risk management and internal audit
- Dedicated risk and audit committees with oversight on assurance functions

- Effective process for managing conflict of interest, related party transactions and insider trading;
- Establishment of adequate mechanisms that enable anonymous reporting of observed unethical practices

Source: unknown
Key Players & Governance Structure

Questions from the Board

➢ Does the board clearly understand its oversight mandate and role?
➢ Is the Bank adequately organized to execute the strategy?
➢ Is the Bank’s existing strategic direction still viable? Is it consistent with the strategic vision, risk/reward trade-off and expectations of shareholders?
➢ How is the implementation of the strategy proceeding?
➢ Are there other strategic options that should be pursued at this time?
➢ How does the strategy change under stress conditions, or during an economic downturn?
➢ How does the Board communicate its strategy to senior management? Is there buy-in?
➢ How does the Board assess the risk-reward payoff of strategy?
➢ What are the dependencies, and inter-dependencies involved in achieving the strategy?
➢ How well has the strategy been executed in the past? What changes need to be made to improve strategy implementation going forward?
3. Financial Sector Development & Corporate Governance
Financial Sector Development & Corporate Governance

Factors contributing to Financial Sector development

Some common causal factors can be identified to inhibit Financial Sector development:

➢ Rapid financial sector liberalization unsupported by measures to encourage prudent risk management;
➢ Inappropriate and unsustainable macroeconomic policies, such as loose monetary policy and excessive fiscal spending;
➢ Exchange rate arrangements that lack credibility, including unsustainable exchange rate pegs;
➢ Poor transparency and accountability arrangements for economic and financial policies;
➢ Industry protection and policies that impede the efficient allocation of resources in the economy; and
➢ Weak corporate governance has contributed to financial instability
Financial Sector Development & Corporate Governance
Summary of causes for weak corporate governance

Lack of Board Independence
- The chairman of the board served on majority of the sub-committees
- Insufficient numbers of independent non-executive directors
- The board did not drive ethical compliance across the Bank
- No evidence of board evaluation and external reviews

Non-Regulatory Compliance
- The compliance unit did not implement a framework to co-ordinate the accurate and timely issuance of reports to
- There was no process to drive a compliance culture across the bank (*no sanctions for compliance breaches and alignment with performance management process*)

Critical success factors/service delivery commitments

Poor Credit Risk Management
- Non-compliance to loan approval limits and responsibilities (*management override*)
- Override of segregation of duties (*single approval of loans*)
- Approval and disbursement of loans to related entities (*unfavourable terms to the bank*)
- Weak collateral management (*lack of collaterals or collaterals not perfected*)

Internal Audit Failures
- The internal audit function did not perform governance reviews to assess the adequacy and effectiveness of key board and governance activities
- The internal audit function has not been reviewed by an external entity to assess its level of compliance
Financial Sector Development & Corporate Governance
KPMG Corporate Governance Framework

Aims to help corporate leaders understand corporate governance responsibilities and improve their performance and governance standards

Source: KPMG's Board Advisory Services
## Financial Sector Development & Corporate Governance

### Building Effective Corporate Governance in Banks

**Key Governance components for banks**

<table>
<thead>
<tr>
<th>Governance Operating Model</th>
<th>Terms of Reference of board and sub-committees</th>
<th>Executive management and management committees</th>
<th>Governance culture</th>
<th>Governance monitoring and reporting</th>
<th>Secretariat practices</th>
</tr>
</thead>
<tbody>
<tr>
<td>Matters reserved for Shareholders and board</td>
<td>Role of the Chairman and other members</td>
<td>Responsibility, accountability and authority of CEO</td>
<td>Employees’ knowledge and understanding of bank’s values</td>
<td>Board performance evaluation and professional development</td>
<td>Corporate secretary policies and procedures</td>
</tr>
<tr>
<td>Structure and composition of board and sub-committees</td>
<td>Decision making structure and process</td>
<td>Organizational structure and three lines of defense</td>
<td>Employees’ competencies and practicality of KPIs/targets</td>
<td>Monitoring across 3 lines of defense</td>
<td>Convening general meetings of shareholders</td>
</tr>
<tr>
<td>Reporting lines of board and sub-committees</td>
<td>Agenda and board’s time allocation to various agenda items</td>
<td>Management committees and mandates</td>
<td>Belief and commitment to the bank’s risk management processes</td>
<td>Framework effectiveness reviews</td>
<td>Convening board and sub-committee meetings</td>
</tr>
<tr>
<td></td>
<td>Quorum and attendance</td>
<td>Decision making structure and process</td>
<td>Incentives / performance/ and compliance</td>
<td>Reporting mechanism</td>
<td>KPIs and performance assessment process</td>
</tr>
<tr>
<td></td>
<td>Minutes of meetings, action plans tracker and follow of action plans</td>
<td>Minutes of meetings, action plans tracker and follow of action plans</td>
<td>Code of conduct, grievance and whistleblowing mechanism</td>
<td>Annual governance report</td>
<td></td>
</tr>
</tbody>
</table>
Financial Sector Development & Corporate Governance

The way forward for financial sector development

Key focus of Corporate Governance in improving financial sector development is the alignment between the bank processes and its strategic goals and objectives, whilst ensuring compliance with regulations and contribute to drive both competitive advantage and shareholder/stakeholder value.
Financial Sector Development & Corporate Governance

Questions from the Board

➢ What are the inhibiting factor for financial performance?
➢ What are the causes of weak corporate governance?
➢ What are the four pillars of corporate governance framework?
➢ What are the key governance components in building and effective corporate governance in banks?
4. Risk Governance
Risk Governance
There’s more to Risk Governance than just Risk

Effective risk governance – a concept that emphasizes the central role of risk management and board oversight on the relevant activities - requires five key components:

i. risk appetite statement,
ii. delegation of authority that allows for timely and accurate decision making,
iii. risk limit monitoring,
iv. risk-return-based decision making (Net Interest Income Attribution) and
v. risk-return-based performance evaluation (RAROC).

The risk appetite statement sets the parameters within which a firm must operate. The second two components monitor employee activities to help the firm remain in compliance with its risk appetite. The last two components provide incentives for employees to make decisions that are optimal and consistent with a firm’s risk appetite statement and its strategic objectives.
Risk Governance
Banks face many risks of which operational risk is key

Credit Risk
The risk of financial loss resulting from a counterparty failing to fulfil its obligations, or from a decrease in the credit quality of a counterparty resulting in a loss in value.

Market Risk
Market risk is the risk of losses in on and off-balance sheet positions arising from adverse movements in market prices.

Operational Risk
The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

Interest Rate Risk
The risk of loss arising from adverse changes in the overall and relative level of interest rates for different tenors.

IT System Risk
Information technology system contains certain risks for banking activities. The risks may arise from using software, transmission line, systems which are prone to be compromised and can be a severe crisis for the bank.

Liquidity Risk
It is the risk that the Bank is incapable of generating sufficient cash flows at reasonable expense to meet expected and/or unplanned payment obligations.

Credit Concentration Risk
Concentration risk describes the level of risk in a bank’s portfolio arising from concentration to a single counterparty, sector or geography.

Macro Environment Risk
Macro factors can be related to country’s economic scenario or world’s economic conditions, but these factors influence the institution to great extent.
The Basel Committee on Banking Supervision issued the guidelines for Capital adequacy (the Basel II Accord) in 2004, requiring banks to determine the minimum capital to set aside to cover unexpected losses arising from their financial and operational risks. Following the global economic crises in 2008 which resulted in restructing of risk management approach and regulation of the financial sector, came the “Basel III Accord” in 2010.

The Basel II framework which is built on three pillars is aimed at achieving the following:
- **Pillar 1**: Align minimum capital requirements with risks taken by Banks
- **Pillar 2**: Bridge the gap between minimum capital requirements and remaining risks; enhance the risk management method for supervision and control; ensure regulatory review of the quality of bank’s risk estimation and capital planning processes
- **Pillar 3**: Enhance soundness and safety of the financial system through regulation of market forces

The key Implications of Basel III include:
- increased quality and quantity of capital,
- reduced leverage ratio,
- increased stress testing
- increased stable long-term balance sheet funding, and
- strengthened risk capture

The Basel III framework aims at promoting a more resilient banking sector, respond to the deficiencies in existing financial regulations through strengthening of global capital and liquidity rules.

### Timelines (CBN and Basel)
- **Dec 2005**: Parallel run of both Pillar 1 and 2 minimum capital
definitions
- **Jan 2006**: Pillar 1 minimum capital
- **Oct 2009**: Pillar 1 minimum capital
- **Nov 2011**: Pillar 2 minimum capital
- **Dec 2012**: Pillar 3 minimum capital
- **Jan 2013**: All Pillars will be in use

### Pillar 1
- **Minimum Capital Requirements**
- **Supervisory Review Process**
- **Disclosure & Market Discipline**

### Pillar 2
- **Minimum Capital**
- **Leverage Ratio**
- **Risk-based Capital Requirements**
- **Liquidity Risk Management**

### Pillar 3
- **Market Discipline**
- **Systemic Risk and Internal Models**
- **Capital Adequacy**

### Key Themes
- **Capital ratios**: Quality, consistency and transparency of capital bases
- **Leverage ratios**: Will be moved into Pillar 1 requirements
- **Liquidity coverage ratio**: Including key ratios, will be introduced
- **Net Stable Funding Ratio**: Will be introduced as a minimum standard
- **Capital buffer**: will become effective

### Key Pillars
- **Pillar 1**: Minimum capital
- **Pillar 2**: Supervision Review
- **Pillar 3**: Market discipline

### Objectives
- The Basel III framework aims at promoting a more resilient banking sector, respond to the deficiencies in existing financial regulations through strengthening of global capital and liquidity rules.

### Challenges
- **Process**: Additional focus on risk appetite and development of risk appetite frameworks
- **Information**: ICAP (Internal Capital Adequacy Assessment Process)
- **People**: Create incentives for using capital models

### Benefits
- **1**: Better align regulatory capital to underlying risk and provide incentives to enhance risk management capabilities
- **2**: Maintain absolute levels of capital while recognizing the relative levels of risk across institution
- **3**: Introduce a risk sensitive framework to robustly quantify the organization’s risk profile and ensure financial stability
- **4**: Create rules that would enable the organization hold sufficient capital to cover its risks and protect depositories
- **5**: Refine regulatory capital charges and align regulatory capital with economic capital with a flow on effect on risk adjusted performance management (for e.g. via the use of RAMDC)
KPMG Advisory - Risk Consulting
Financial Risk Management
Basel II/III

Key Considerations

GOVERNANCE
- Improve risk management organizational structure, policies and procedures
- Clarify the responsibilities of the board of directors, senior management, risk management and related business units

TOOLS
- Develop proper risk measurement tools to improve capability of overall risk identification, measurement and management under the Basel III rules

TECHNOLOGY
- Strengthen data management to effectively resolve the problem of missing and low-quality data
- Improve IT system to facilitate implementation of risk metrics

CONTROLS
- Reinforce internal control and internal audit, to build a skilled team able to conduct internal review and control mechanisms based on Basel II/III framework

CAPITAL & LIQUIDITY STRATEGY
- Assess the impact of the Basel III framework on banks’ capital adequacy and liquidity needs and make adjustments to its growth, capital and liquidity management strategy

Basel II/III Ratios, Action Plan and Timelines

<table>
<thead>
<tr>
<th>Basel II/III Requirements (CBN and Basel)</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Common Equity Capital Ratio (Basel)</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Minimum Tier 1 Capital as a % of Total RWA (Basel)</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Ratio of Tier 1 capital to Tier 1 capital, after making deductions for intangible assets but before deductions of investments (CBN)</td>
<td>26.0%</td>
<td>26.0%</td>
<td>26.0%</td>
<td>25.5%</td>
</tr>
<tr>
<td>Minimum Regulatory Capital Adequacy Ratio (CAR) for national and international banks in Nigeria (CBN)</td>
<td>10.375%</td>
<td>10.375%</td>
<td>10.375%</td>
<td>10.375%</td>
</tr>
<tr>
<td>Capital add-on for Domestic Systemic Important Banks (D-SIBs) in Nigeria (CBN)</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Counterparty/Risk Buffer (Basel)</td>
<td>1,200%</td>
<td>1,200%</td>
<td>1,200%</td>
<td>1,200%</td>
</tr>
<tr>
<td>Leverage Ratio (Basel)</td>
<td>Parallel run: 1 Jan 2015 – 1 Jan 2017 (CBN)</td>
<td>Adjustment to definition and calibration</td>
<td>Migration to Pillar 1</td>
<td></td>
</tr>
<tr>
<td>Phase-in of deductions from Common Equity Tier 1 including amounts exceeding the limit for Deferred tax assets, mortgage servicing rights, and financials (Basel)</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Capital Instruments that no longer qualify as non-core tier 1 capital or tier 1 capital (Basel)</td>
<td>Phased out over 10 year horizon, beginning 2017</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Stable Funding Ratio (Basel)</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
<td>50%</td>
</tr>
</tbody>
</table>

CBN Basel II/III Guidelines

- The Central Bank of Nigeria (CBN) has mandated banks to report their Capital Adequacy Ratio (CAR) annually with the minimum CAR set at 6.5% for national and international banks respectively. It also requires the use of Basic Indicator Approach (BIA) for operational risk and The Standardised Approach (TSA) for market and credit risk capital computations.
- Credit Risk – TSA
  - Use of TSA for calculating the credit capital requirement is supported by external credit assessments.
  - Classification of exposures should be based on the nature of the counterparty or the technical characteristics of the transaction.
  - Assignment of different risk weights to each exposure should be based on the ratings provided by the Credit Assessment Institutions (CAI) or specified for certain exposure categories.
- Operational Risk – BIA
  - Banks adopting the BIA for operational risk must hold capital equal to 1% of 3-year average annual gross income.
  - Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating this average.
- Market Risk – TSA
  - Use of TSA for calculating the market risk capital requirement involves summing up individual capital requirement for positions and settlement risks in interest rate-related instruments, equities in the trading book, foreign exchange and commodity risk.

Why KPMG

Methodology
- A tested Methodology

Tools
- Tailored tools including KPMG’s Basel Assessment Template, supporting technology tools for the Basel II/III Business Cap-Analysis and Data Cap-Analysis Services

Knowledge & Industry Experience
- Strong technical Basel II/III knowledge
- Industry Focus & Regulatory Experience

Multi-Disciplinary Team
- Multi-disciplinary team with deep competencies that deliver enhanced, value-adding services

Quality Assurance
- Established procedures for quality control, including technical and inter-office reviews that ensure globally consistent deliverables of the highest quality.

How KPMG Can Assist
- Basel II/III Cap Analysis/Implementation Planning, PMO setup and self assessment
- Basel II Training to organizational stakeholders including the board, senior management, business unit heads and internal audit
- Credit, market and operational risk management, including regulatory capital calculations, infrastructure implementation and governance
- Instrument Volatility & Model Validation
- Establishing sound and practical data governance, collections, and management
- Internal Capital Adequacy Assessment Process (ICAAP) Stress Testing
  - Risk Appetite statement articulation & Risk Management governance structures
Risk Governance

A key enabler to effective corporate governance system is the establishment of a risk governance framework...

- **Risk Appetite**
  A well defined risk appetite framework that lays out the types and magnitude of risks the company is willing to take.

- **Delegation of Authority**
  An actionable risk appetite statement achieved by translating risk appetite directives into risk limits on key operating metrics.

- **Risk Limit & Monitoring**
  Established framework that defines processes and delegates authority to manage risk in a timely and accurate manner.

- **Risk-Return-based Decision making**
  Utilisation of risk return metrics to prioritise business opportunities to ensure that those with the best risk-adjusted returns are undertaken first.

- **Risk-Return-based Performance Evaluation**
  Compensation policies that provide incentives for decision makers while keeping “decision takers” motivated.
Risk Governance
Corporate Governance Principles for Banks – Basel (BCBS)

Principle 1: Board Overall Responsibilities
Principle 2: Board Qualifications and Composition
Principle 3: Boards own Structure and Practices
Principle 4: Senior Management
Principle 5: Governance of Group Structures
Principle 6: Risk Management Function
Principle 7: Risk Identification, Monitoring or Controlling
Principle 8: Risk Communication
Principle 9: Compliance
Principle 10: Internal Audit
Principle 11: Compensation
Principle 12: Disclosure and Transparency
Principle 13: The Role of the Supervisors

Source: Basel Committee on Banking Supervision; Guidelines Corporate Governance Principles for banks 2015
Risk Governance
Questions from the Board

- Recommending the Risk Appetite Statement to the board for approval and monitoring the actual risk against the board-approved appetite
- Assisting the board in executing its duties with respect to risk and capital management as required by regulation
- Monitoring the Bank’s evolving risk profiles and reporting findings to the board
- Monitoring the level of available capital, both current and projected, and reporting to the Board on the adequacy of available capital relative to the evolving risk profile of the Bank
- Ensuring the appropriate disclosure of our risk and capital management status and activities
- Reviewing the adequacy and effectiveness of risk management processes and the completeness of risks coverage
Risk Governance

Questions from the Board – Risk Appetite

➢ How satisfied are you that the board is providing effective oversight of the risk appetite through its governance process?

➢ Are the objectives of the board’s responsibility for risk understood?

➢ Has the board played an active part in the approval, measurement, monitoring and learning from the risk appetite process?

➢ How would you rate the effectiveness of the organization’s process for identifying, assessing, managing, and reporting risks in relation to the overall risk appetite? What are the major areas for improvement?

➢ Do you believe there are risks considered to be above the organization’s existing risk appetite that need to be reduced?

➢ What are the significant risks the Board is willing to take? What are the significant risks the board is not willing to take?

➢ What steps has the board taken to ensure oversight over the management of the risks? Do board members have an adequate, up-to-date appreciation of the nature, types and sources of risks faced by the organization?
Risk Governance
Questions from the Board – Risk Management

➢ Has the board and management team reviewed the capabilities of the organization to manage the risks that it faces?

➢ Does the board truly understand the interdependencies and how events or conditions occurring simultaneously can spell disaster?

➢ Does the board have the necessary blend of business and industry knowledge and experience to assess risk?

➢ Does the board understand the differences between risk capacity, risk tolerance and risk appetite?

➢ Does the board have a framework within which to make meaningful judgments around risk tolerance and risk appetite?

➢ Does the board interrogate management’s assessment of risk – or does it accept it too readily?

➢ Does the Bank have sufficient infrastructure (systems and people) to monitor risk?

➢ Is the risk appetite and tolerances appropriate (in terms of the Bank’s internal and external environment?)

➢ Can, and should, the Risk Bearing Capacity be increased?
Risk Governance
Questions from the Board – Stress Testing

➢ Which assumptions have the biggest impact on the stress scenario?
➢ Are stressed scenarios “plausible” or just an “interesting academic exercise”
➢ What are the impacts of risk mitigants and management actions?
➢ What is the impact on earnings and capital from potential economic downturns?
➢ Should management teams across business lines apply a consistent and coherent approach/program to stress testing?
➢ Under which scenarios is the business model seriously endangered? In which scenarios would the largest sensitivities lead to major losses?
➢ Which risk drivers are relevant to the business? Over what time horizon?
➢ How should (top-down) scenarios be translated into the relevant risk drivers, and what severity should be applied?
➢ What level of sophistication in describing and modeling of scenarios should be applied to capture their essence?
➢ How are second order effects and feedback incorporated?
➢ To what degree will the business receive outside help (from investors, central bank, government)?
Risk Governance

Questions from the Board – Capital Adequacy

➢ Is there a system in place that relates risk to the Bank’s capital level as part of its assessment of capital adequacy?

➢ How do the Bank’s capital levels compare to regulatory standards and those of your peers?

➢ Where is risk concentrated?

➢ Are long-term capital targets consistent with short-term goals?

➢ Does the Bank’s capital planning consider the potential difficulties of raising additional capital during times of stress and economic downturns?

➢ Over what time horizon is capital adequacy being assessed?
5. Board Governance
Board Governance
Type of ineffective Board

Rubber Stamp Board
- Executive-led board
- Ratifies management’s ideas without challenge
- Hardly considers alternatives

Myopic Board
- Short-term needs of investors considered
- Focuses on financial impact
- Lack of diversity of board members
- Tendency to micro-manage

The Dreamers
- Insufficient focus on current issues
- Fails to identify and/or manage key risks
- Unrealistically optimistic
Board Governance
Key Elements of an Effective Board (1/3)

 Balanced Board Team

 Defined Governance Structure and Practices

 Effective Board Dynamics and Culture

 Clarity of Role and Authority

 Effective Board Leadership

 Board Evaluation and Renewal Process

An Effective Board
Board Governance
Key Elements of an Effective Board (2/3)

Balanced Board Team

- Mix of diverse skills, experience (industry and specific) and personal attributes
- Temperamentally balanced: mix of analytical thinkers with visionaries, conciliators with challengers, etc.
- Others e.g. diversity (age, gender, geographical), international experience, etc.
- Directors who are independent in fact and appearance
- Time commitment

Defined Governance Structure & Practices

- Clearly defined appointment process
- Well structured committees with clear terms of reference
- Transparent rolling board agenda
- Regular reporting to the Board on committee deliberation
- Defined governance policies
- Defined reporting relationships between various internal governance stakeholders
- Effective process for managing conflict of interest, related party transactions and preventing undue influence
- An effective and competent company secretariat

Clarity of Role and Authority

- Clarity of the roles of the Board, Board committees, management and shareholders
- Clarity of the roles including separation of roles of chairman from CEO
- Clarity of authorities and limits of the Board and management
- Clear definition of matters reserved for the Board/DOA
- The Board supervises management but is not involved in the day-to-day running of the Group – Board’s role is a reflective one (nose in, fingers out!)
Effective Board Dynamics and Culture

- The Board and management work together as a team
- Culture of trust and respect
- Regular and candid communication among Board members
- Probing questioning, constructive criticism and healthy challenge
- Effective listening and tolerance of dissent

Effective Board Leadership

- Involvement in strategy formulation and explores a range of strategic alternatives
- Open minded and constructively challenge management assumptions
- Identifies, understands and manages stakeholders expectations
- Performs periodic monitoring and review of status of implementation of strategic imperatives

Board Evaluation & Renewal Process

- Existence of clearly defined Board and committee goals
- Formal performance appraisal of the Board, Chief Executive and the individual directors
- Effective and constructive feedback process
- The Board is open minded about actions to address performance issues, regularly monitors progress, and makes desired
- Continuous refreshing of the board for injection of fresh minds and ideas
Board Governance
What does an effective board look like?
Characteristics of an effective Board

Obligations / Commitments / Qualities of the Administrator

- Awareness of its mission
- Professionalism
- Independence and Ethics
- Strategic vision
- Regular updating of knowledge
- Judgment and independence of mind
- Availability and attendance at meetings
- Commitment and participation
- Solidarity and Loyalty
- Respect for corporate interests
Board Governance
What Stakeholders expect of the board

- Honest exercise of powers
- Always act in the best interest of the company
- Compliance with regulatory standards

- Unfettered Judgement
- Intellectual Honesty
- Business Judgement Rule
- Effective dispute resolution

- Recusal
- Full Disclosure
- Confidentiality of Information
- No Secret profits
- Timely and relevant communication

- Reasonable Diligence
- Proper conduct and behaviour
- Effective Board Meetings
- Support committee Effectiveness

- Balanced Competing Interests
- Accountability
- Consistency
- Balance between each stakeholder group

Source: Chartered Secretaries, Southern Africa
Board Governance
Questions to the board

➢ What are the three types of ineffective board?
➢ What are the key elements of an effective board?
➢ What does an effective board look like?
➢ What are the characteristics of an effective Board Director?
➢ What stakeholders expect of the Board?
Conclusion
Conclusion

The policies and structures for promoting robust corporate governance include:

- Well designed and enforced company law, which specifies, among other matters, the duties and obligations of directors, the rights of shareholders and other stakeholders, disclosure and external audit requirements, mechanisms for the enforcement of the law, and penalties for non-compliance with the law;
- Codes of principles developed by professional or industry associations, setting out desired attributes of corporate governance, and associated educational and consciousness-raising initiatives;
- High quality disclosure requirements for banks and other companies, based on robust accounting and auditing standards;
- Measures to strengthen market disciplines in the banking sector, including privatizing government-owned banks (or at least subjecting them to effective corporate governance arrangements), removing government guarantees of banks’ liabilities, ensuring that deposit insurance and bank failure response arrangements do not significantly weaken market disciplines, and promoting a contestable and competitive financial sector;
- Effective banking supervision arrangements, with particular emphasis on supervisory policies that encourage sound governance and risk management practices;
- Leadership by example, including the adoption of robust governance, accountability and transparency practices by central government, government agencies and regulatory bodies (including central banks).

“If a board is to fully fulfill its mission – to monitor performance, advise the CEO, and provide connections with a broader world – it must become a robust team – one whose members know how to ferret out the truth, challenge one another, and even have a good fight now and then.” HBR
Thank You

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EFFICIENT CORPORATE GOVERNANCE FOR FINANCIAL SECTOR DEVELOPMENT

HOUSEKEEPING

MFW4A PRESENTATION

PANELISTS

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Q&A

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