CORPORATE GOVERNANCE OF CREDIT INSTITUTIONS – BETWEN PERFORMANCES, SOCIAL RESPONSIBILITY AND PROMOTION OF ETHICAL VALUES

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Abstract: The international financial crisis started in 2007 brought to the fore the fragility of the banking system, for which the axiom "When confidence was gone, the crisis arose", coupled with an acute need to rebuild public confidence in the banking system in general, refers directly to the commands of social responsibility and promotion of ethical values. Because they were too much concerned with the performance indicators, notably the profitability, but also with the level of their salaries, incentives, compensations, bonuses, special pension rights, the management of the banks with problems have ignored their obligations in terms of social responsibility, considered they are "too big to fail" and flagrantly violated ethical values.

JEL classification: G21, G30

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1. INTRODUCTION

The financial crisis that started in the heart of international financial industry and is acting in concentric circles over the entire world economy has brought up old issues on the defense of ethical values. The trigger of the crisis was in real estate, but the real causes are related to the empowerment of financial markets which were removed from the real economy under the cover of globalization that made possible deregulation. *"Mortgages are not toxic by itself; but post securities built on mortgages are toxic. The remuneration schemes that determine the decisions of managers and market agents and an irresponsible behavior on their part were toxic*"[1]

Banks have ethical obligations both to their customers and to society. The issue of ethics in banking is seen both in terms of financial and banking legislation as it is regulated at national and international and of its own rules of conduct and banking practices. In recent years trends to develop codes of conduct and banking practices recommended by professional associations for bank staff have emerged.

[1] Daniel Dăianu, Capitalismul încotro, Editura Polirom, Iaşi, 2009, p. 16.

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2. CORPORATE GOVERNANCE IN CREDIT INSTITUTIONS

The development framework of a financial sector in general, of a bank in particular, takes place in a competitive, but also extremely volatile, market environment, "the evaluation of a bank's financial condition and viability focuses, usually, on analyzing the particular aspects such as shareholders' structure, profile and risk management, financial statements and portfolio's quality and structure, policies and practices, human resources and information capacity"[2].

Being considered public entities, the banks were involved in developing a new category of managerial and economic relations and processes, characterized by the new concept of Corporate Governance as it has been defined by the Cadbury Report, respectively "all the principles, rules and regulations which provide the administration and management by managers of enterprises, in the interest of current and potential investors of those entities"[3].

Specialized economic literature has recorded a number of differences of nuance, starting from the way Corporate Governance is defined, as can be seen from the analysis of Table 1.

Table no 1 Definitions of Corporate Governance

Nr.	Definitions of Corporate Governance	Source
1	Corporate Governance is the system by which companies are directed and controlled.	Cadbury Report (Great Britain)
2	Corporate governance refers to the set of rules applicable to direct and control a company.	Cardon Report (Belgium)
3	Corporate Governance is the organization of administration and management.	Recommendation of Belgian Companies Federation
4	Corporate Governance represents the goals under which a company is run, as well as the main principles and frameworks governing the interaction between the company's management groups, owners and other entities directly affected by the company's provisions and businesses (in this context, known as stakeholders). The stakeholders include employees, creditors, suppliers, customers and the local community.	Norby Report and Recommendation (Denmark)
5	Corporate Governance describes the legal and factual regulatory framework for managing and supervising a company.	Code of Initiative Berlin
6	Corporate Governance, in the sense of the set of rules under which companies are directed and controlled, is the result of norms, traditions and patterns of behavior developed by each economic and legal system.	Peters Report (Netherlands)
7	Corporate Governance is used to describe the system of rules and procedures used in the management and control of a listed company.	Recommendation of the Capital Market Commission (Portugal)
8	Corporate Governance involves a set of relationships between a company's management, its board of directors, shareholders and other stakeholders. Corporate Governance also provides the structure through which company's objectives are set and the means of achieving these objectives and monitoring performance are determined.	OECD Principles, Preamble

[2] Herbert van Greuning, Sonja Brajovic Bratanovic, Analiza şi managementul riscului bancar, Ed. Irecson, Bucureşti, 2003, pag. 21

[3] Raport privind guvernanța corporativă în România, OECD, Decembrie, 2001, pag. 16

9	Corporate Governance includes that structure of appropriate relationships and responsibilities in a group, consisting of shareholders, board of directors (supervisory board) and managers appointed to develop the competitive performances required to achieve the primary objective of the corporation.	Millstein Report for OECD

Source: Processing after Alexandru Rusovici, Stere Farmache, Gheorghe Rusu[4]

Corporate Governance relies mainly on:

- Supremacy of law, common law, commercial law and tax law regulations;
- Respect of property rights;
- Respect of contractual commitments (rights and obligations);
- Removal of protectionism as a state policy;
- Fiscal and contractual discipline and an optimal report between regulation and deregulation.

It was noticed the impact of culture on corporate governance systems at level of the UE member states, so that some countries (UK, Ireland) focus on competition and market mechanisms, while other countries (Germany, Netherlands) are oriented towards cooperative and consensus relations as results from analysis of the factors affecting Corporate Governance systems presented in Table 2.

Table no 2 Factors affecting Corporate Governance Systems

Great Britain, Ireland	**Germany, Netherlands**
Market culture	Consensus culture
Orientation towards market	Orientation towards relationship
Short-Term Strategy	Long-Term Strategy
Greater orientation towards the capital market	Greater orientation towards the loans (debts)
Relatively Larger Capital Market	Relatively Smaller Capital Market
A relatively small influence of shareholders who have a position of control over the company's ownership	A relatively large influence of shareholders who have a position of control over the company's ownership

Source: Processing after Alexandru Rusovici, Stere Farmache, Gheorghe Rusu[5]

The framework of corporate governance should be developed taking into account the following coordinates:

- Stimulation of organizational performance;
- Corporate governance practices should be transparent, enforceable and consistent with the applicable national law;
- Division of tasks between supervisory and regulatory authorities must be clearly specified and be conducted in the interest of general public;
- Supervisory, regulatory and executive authorities must perform their tasks in a professional, transparent and objective manner.

Corporate governance refers to the manner in which the bank is run, including setting its strategic objectives and its risk profile, based on the premise that management protects the shareholders and depositors' interests leading daily activities based on the normal coordinates of profitability and risk, being defined by a set of elements that include:

[4] Alexandru Rusovici, Stere Farmache, Gheorghe Rusu, Manger în misiunea de audit, Ed. Monitorul Oficial, Bucureşti, 2008, pag. 126

[5] Alexandru Rusovici, Stere Farmache, Gheorghe Rusu, Manager în misiunea de audit, Ed. Monitorul Oficial, Bucureşti, 2008, pag. 127

- Well defined organizational strategy able to reflect the appropriate collective and individual effort;
- Establishing some clear responsibilities through a decentralization of decision consistent with the bank's risk profile;
- Management of financial risk by developing an appropriate environment of control, assumed throughout the organization;
- Codes of conduct, standards of behavior and appropriate monitoring systems;
- Financial and managerial incentives granted depending on the bank's objectives, performance and ethical values;
- Internal communication based on transparency and adequate information for the general public.

3.PERFORMANCE OF CREDIT INSTITUTIONS BETWEEN RISKS AND SOCIAL RESPONSIBILITY

The performances of banking system take primarily into consideration the ability to achieve added value. In addition to this objective, performance can materialize in the following:

- maximization of profit, respectively increase of share capital;
- increase of services' quality;
- development, expansion and diversification of activities;
- maintain and improve the bank's reputation.

The bank's ability to achieve any of these objectives is directly influenced by environmental factors in which it operates[6]. Banks are influenced by a number of factors belonging to the external environment. The ability of banks to maximize their shareholders' capital or to fulfill other objectives is limited by restrictions from the external environment due to the particular nature of banking activity itself.

There are five key domains in which banks are different - either in terms of the nature of activity or the extent of regulation – from other commercial companies:

1. *Nature and property of resources*. A bank's resources are primarily financial and a significant proportion of these resources as depositors' funds, belonging to both customers and bank;
2. *Regulation*. Banks' activity is regulated by law and central bank the one that decides which institutions can function as banks and gives them authorizations (licenses) of operation. With the authorization granted, the commercial bank must comply with other requirements related to capital adequacy indicator, the indicator of liquidity, minimum mandatory reserve ratio, reporting of the data required for surveillance and control.
3. *Arbitration between risk and profitability*. Banks must achieve risk management, while maintaining or increasing profitability. Managing and minimizing risk is a much more important element in banking than in any other company.
4. *Long-term continuity of banking*. Unlike other companies that may enter or leave the market depending on which one can achieve profitability, banks have to serve their customers, both in times of economic difficulties and in times of prosperity.

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[6] Aurel Manolescu, Management general, Ed. Keysys, Oradea, 1997, pag. 122

5. *Interdependence between banks and their customers.* The type of interdependence between a bank and its customers is unique in the commercial world. It is based on trust and a set of mutual obligations, which is the essence of that relationship.

Banking laws and banking regulations aim primarily at harmonizing the banking system in our country with those of countries with developed market economy, because the regulatory environment is necessary for banks:

- to lend on a prudential and ethical considerations;
- to maintain stability;
- to support governmental economic policies;
- to manage the risk of investors' funds.

The main regulatory restrictions and prudential rules for banks are:

- liquidity indicator is a percentage of bank deposits and other liabilities, which must be kept in cash, or other assets that can easily be turned into cash to meet customers' requirements, when they want to withdraw their funds;
- the capital adequacy indicator calculated as the ratio between capital and risk-weighted assets, should be at least 8%;
- loans given to one borrower may not exceed 20% of bank's capital and reserves;
- total loans to employees or shareholders of the bank may not exceed 20% of bank's capital and reserves;
- total open foreign currency position may not exceed 10% of capital and reserves;
- a bank's investments in a non-banking company shall not exceed 20% of that company's capital and 10% of bank's funds;
- Central Bank's approval is required for the holding of shares above 5% of a bank's capital by a person or entity and for any subsequent increases too.

Functioning market economy requires as a precondition the existence of a banking device capable to ensure the mobilization of temporarily available cash from the economy and then direct them to cover some needs associated with the development of efficient business; "the banking device is understood as a tool correlated by organizational entities, institutional and autonomous, authorized to conduct banking operations within a country*"*[7].

4. NEED TO PROMOTE ETHICAL VALUES IN CREDIT INSTITUTIONS

In 2009 Romanian Banking Association adopted the *Code of Banking Ethics*, to which all the banks licensed to operate in our country adhered.

By the implementation of Code of Banking Ethics, ARB aims:

- to promote a proper conduct of credit institutions' employees towards the customers, authorities, banking environment, the business community, colleagues etc.;
- to strengthen customer confidence in the banking sector as a whole;
- to promote the public image, according to which credit institutions and banking staff offer products and services at a high level of quality to customers;
- to encourage and promote a better cooperation between member banks;

[7] Ioan Trenca, Metode şi tehnici bancare, Ed. Casa Cărţii de Ştiinţă, Cluj-Napoca, 2003, pag. 3

- to support a fair competition on the banking and financial market depending on market conditions;
- to promote mutual respect within the banking community.

Code of Banking Ethics applies to all credit institutions, members of the ARB. Its regulations, transposed into the internal previsions of credit institutions that were members ARB, are mandatory to all persons employed by credit institutions.

Since credit institutions outsource certain activities to third parties, the responsibility for compliance with code provisions, belongs to the credit institution that has outsourced those activities.

Provisions of the Code of Banking Ethics refer to:

- relation between credit institutions and customers;
- relation between credit institutions and authorities;
- relation between credit institutions;
- relation between credit institutions and employees;
- relation between credit institutions' employees.

The fundamental principles that employees of credit institutions must meet in the professional relationships they have with customers or authorities, with other credit institutions' employees, or other employees of the credit institution operating, are:

- moral integrity, a principle according to which employees are forbidden to solicit or accept, directly or indirectly, for themselves or for others, an advantage or benefit in consideration of the position they hold, or to abuse in any way by this function;
- impartiality and non-discrimination, principle under which credit institutions' employees are required to take an objective attitude, neutral to any political, economic, religious or otherwise interest, in the exercise of their duties;
- professionalism and transparency, a principle according to which employees of credit institutions are required to perform their duties with responsibility, competence, efficiency, fairness, clarity and conscientiousness ;
- compliance with the legislation in force, a principle according to which employees of credit institutions shall comply with law applicable to the work they perform, and internal regulations of these institutions;
- confidentiality, a principle which states credit institutions' employees obligation to not send confidential information about facts, data and information related to work, and any facts, data or information relating to persons, property, activity, business, customers' personal or business relationships, to persons not authorized to receive such information. The employees of credit institutions are obliged to preserve professional secrecy of any information or data not intended for publication, that he acquired during the performance of its functions and will not use this information for personal benefit, any deviation being punished in conformity with the law and Code of Banking Ethics. The persons who are not employees of the credit institution, but are entitled to request and receive information or data related to professional secrecy in banking, are required to maintain its confidentiality and may use it only for the purpose for which they are requested, or have been provided by law or other agreements.

- preventing and combating corruption, money laundering and financing terrorism by reporting any transactions that may relate to those and avoiding the completion of such transactions, in accordance with the law;
- the exercise by employees of financial institutions of prudential banking activities in the conduct of financial transactions, through responsible managing the credit institution's own resources and informing accurately the customers about banking products and services offered;
- social responsibility, a principle which envisages bank's involvement in solving various social problems, as well as supporting humanitarian initiatives;
- avoidance of denigration, the principle according to which the credit institutions' shall exercise their activity in good faith, according to honest practices and respecting the interests of all parties involved and the requirements of fair competition, in the specific market conditions;
- compliance with all provisions of the Code of Banking Ethics by credit institutions' employees by taking responsibility, understanding and reporting any activities likely to violate its provisions.

The regulation of any conflict of interest is performed using the Code of Banking Ethics and its special stipulations. A conflict of interest occurs when there is an incompatibility between the quality of credit institution's employee and its personal status, translated by any action or inaction that may affect the reputation of the credit institution.

5. CONCLUSIONS

Restating public confidence in credit institutions can be achieved through the proper application of corporate governance principles, respectively a properly functioning of internal audit and control, which will allow the control of both operational risks and risks of fraud and error.

It is also necessary to adopt a regulatory framework of the financial market operations that will allow proper functioning of prudential supervision done by the national authorities and international. Social responsibility of the supervision organisms of independent auditors and rating agencies is truly huge and absolutely necessary to rebuild public confidence in credit institutions.

Ethical issues, related to salaries, commissions and huge incentives that bank managements were accustomed to during the boom of trade bank, were identified by the general public and are likely to provoke strong reactions from the population, as is already happening in the heart of international financial market, on Wall Street.

Resolution of all issues pertaining to the regulation of any conflict of interest, limits of bank secrecy, financial flows to tax havens, will also facilitate the rebuilding of public confidence in credit institutions.

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