ANALELE ŞTIINŢIFICE ALE UNIVERSITĂŢII „ALEXANDRU IOAN CUZA” DIN IAŞI
Tomul LIV Ştiinţe Economice 2007

WHY ARE BANKS SPECIAL? AN APPROACH FROM THE CORPORATE GOVERNANCE PERSPECTIVE

VASILE COCRIŞ[*]
MARIA CRISTINA UNGUREANU[*]

Abstract

High standards in the governance of banks and firms are very important for economic growth. Banks have a critical position in the development of economies due to their major role in running the financial system. The banking industry is unique because it is simultaneously consolidating and diversifying. There is a significant public dimension to the banking firm; bank managers function in the light of two distinct sets of interests: one is the private interest, internal to the firm, and the other is the public interest, external to the firm. Previous literature analyses the implications of banks' specific attributes on their corporate governance framework. It emphasises two major aspects: greater opaqueness and greater regulation. Whether these attributes have a weakening effect on the traditional corporate governance mechanism is a matter debated by most research papers on the subject. This study is done on the specific characteristics of banks from the point of view of current economic framework, and the implications of these characteristics on the governance of banks. This paper analyses the environment with increased regulation of the banking firm, as a governance control mechanism.

Key words: Banks; Corporate governance, Regulation and supervision; Stakeholders, Basel Accord

1 Introduction: Importance of banks and their governance

Corporate governance provides the framework in which the bank business is administrated by setting corporate objectives, and monitoring and achieving those objectives. Banks' governance is subject of particular importance and challenges due to the role of banks in economy and the current regulatory environment.

Recent financial market crisis following the announcement of heavy losses by major banks on exposure to mortgage-backed securities has reinvigorated an ongoing debate on whether banks have a corporate governance framework and regulatory environment that enables them to successfully manage such crisis. As a result, the debate on banks' governance has raised new challenges. The topic of banks' governance has been approached to a lesser extent than the governance of non-bank firms. Most authors agree that extended research is necessary.

Significant attention has been given to the role of banks in the corporate governance of other firms. In many countries, especially the developed ones where banks dominate as providers of credit, banks are among the most important sources of external governance for firms. Banks' governance, including their ownership structure and regulation has a

[*] Professor, PhD, Department of Finance, Faculty of Economics and Business Administration, "Alexandru Ioan Cuza" University, Iasi, e-mail: vcocris@uaic.ro
[*] PhD student, Department of Finance, Faculty of Economics and Business Administration, "Alexandru Ioan Cuza" University, Iasi, e-mail: mariacristina.ungureanu@unige.it

significant impact on risk and valuation, determining their performance and stability of the banking sector. Sound governance mechanisms in the management of banks has led to an efficient mobilisation and allocation of funds, improving the governance systems of firms that benefit from funding, thereby lowering costs of capital and accelerating economic growth.

High standards in the governance of banks and firms are very ***important for economic growth***. Banks have a critical position in the development of economies due to their major role in running the financial system.

The banking industry is somewhat unique because it is simultaneously consolidating and diversifying (Koch and MacDonalds, 2002). Previous literature analyses the implications of banks' specific attributes on their corporate governance framework. Two aspects are emphasised: greater opaqueness and greater regulation. Whether these attributes have a weakening effect on the traditional corporate governance mechanism is a matter debated by most research papers on the subject.

This research studies the specific characteristics of banks in the view of the current economic framework and the implications of these characteristics on the governance of banks. The paper analyses the increased regulation environment of the banking firm, as a governance control mechanism.

Visentini (1997) states that the observed forms of corporate governance of banks emerge in the course of their operations as entities having to respect the private interest of owners, on one hand, and the public interest in the overall stability of the system, on the other hand.

2 Special attributes with impact on the governance of banks

The importance of banks for the stability of the financial system places them in a particular position of the ***principle-agent framework***. The classical principle-agent problem is clearly present in the case of banks, mainly through the conflicting risk preferences between banks' shareholders and managers. As for any firm, bank shareholders have an incentive to raise risk by increasing leverage through a higher equity stake. Managers prefer adopting a risk-averse approach because their human capital is at stake. The principle-agent problem is amplified by other aspects that are specific in the case of banks:

- Bank failures lead to negative externalities
- Agency problems are enhanced by the inefficient monitoring of banks by depositors and other stakeholders
- Information flow is complex due to the opaque environment in which banks operate
- Banks are heavily regulated; the regulator itself is a bank stakeholder
- Diversification of activities within a bank conglomerate intensifies agency problems between corporate insiders and small shareholders

In order to avoid conflicts, additional rules and practices – "corporate governance procedures" – have been instituted to address gaps in contractual specifications of rights and obligations of stakeholders and to enhance transparency of relevant information about banks.

An aspect that distinguishes banks from other firms is their ***capital structure***, which is unique in two ways (Macey and O'Hara, 2003). Firstly, banks have little equity relative to other firms and receive 90% of their funding typically from debt. Bond holders and depositors provide the rest. Secondly, banks hold illiquid assets that often take the form of loans without maturity. Banks have liabilities in the form of deposits that they issue to creditors or depositors, thus creating liquidity for the economy.

A mismatch between deposits and liabilities may cause a collective-action problem among depositors. This can cause the failure of a bank, with externalities effects. Consequently, the liquidity function may create problems in the governance of banks. High loan growth raises bank capital requirements, as regulators consider most loans to be risky assets. One regulatory measure against such risks is the deposit insurance, which is considered successful in achieving what had been a major objective of banking reform for at least a century, namely the prevention of banking panics. We address this aspect of deposit insurance later in the paper, when approaching the regulatory environment of banks.

Banks react to these risks through different mechanisms. Different size banks pursue different strategies. Small- to medium-size banks continue to concentrate on loans but seek to strengthen customer relationships by offering personal service. Large banks respond through securitisation, a process of converting assets into marketable securities (Koch and MacDonald, 2002). These strategies reflect banks' governance control.

Equity ownership of banks is generally different from the ownership structure of non-bank firms. Generally, banks have a concentrated equity ownership, which makes it more difficult for small equity holders to exert influence over the management of banks. Controlled ownership by large investors may also affect the interest of debt holders – either diffuse or concentrated – and on other stakeholders, leading to a more complex corporate governance environment for banks.

As with all publicly-owned firms, the diffuse and concentrated ownership of banks are aspects that influence their governance mechanisms. Diffuse ownership can effectively exert corporate control: directly through their voting rights and indirectly through electing the board of directors. Information asymmetries are an impediment for shareholders and debt holders to exert control over management. In the case of banks, due to their opaqueness, diffuse shareholders and diffuse debt holders find it difficult to exercise control. This situation is managed by more concentrated ownership and increased regulation.

Concentrated ownership enhances firms' control and monitoring of its activity through a better flow of information. Large shareholders and large debt holders are more effective in exercising their rights, thus having more control over management. This context should theoretically lead to better governance of firms. In practice, evidence shows that large shareholders may exploit their interest in the firm, thus undermining its governance. A legal system that prevents large shareholders controlling a bank from taking advantage of the small and diffuse stakeholders has the potential to stimulate good corporate governance.

Appropriate transparency and disclosure is one of the main principles of corporate governance. This principle is applied to a lesser extent in the banking sector. The ***opaqueness of banks*** is factored by their sensitive operational environment: loan operations to individuals, to large entities and to governments, capital funding of firms, banks' interaction with Central Banks and governments.

Notwithstanding the lack of transparency, the performance of banks is not heavily affected by this issue. One explanation is that the risk of banks' failure is not as high as the risk of non-financial firms' failure. It is often argued that banks are "too large to fail", in reference to the major stakes that governments have in these entities. In addition to funding the economy, banks also perform in a political context, which enhances the gravity of a potential failure.

Information gaps exist at the level where regulators and supervisors with imperfect information about banks seek to design rules and procedures that induce banks to behave in desirable ways. Information asymmetries make it difficult for the market participants (depositors, equity holders, other creditors and rating agencies) to monitor and control bank managers. As a result, entities such as states and prudential supervisory bodies dominate the banking sector in order to minimise the risk of failure. Regulations that enforce a better flow of information between banks' stakeholders are set at national and international level.

Literature presents different points of view with regard to the transparency of banks. Levine (2004) examines the implications of opaqueness for the governance of banks by diffuse equity holders and diffuse debt holders. Opaqueness may help controlling holders to exploit their stake, to facilitate the manipulation of loan operations and compensation packages. This comes at the expense of the long-run health of the banks, their diffuse shareholders and their diffuse debt holders. The opaqueness of banks may weaken market competitive forces, affecting the efficiency of the securities market. All stakeholders are negatively affected, including diffuse shareholders, customers and governments. Morgan (2002) states that "banks appear to be among the more opaque industries, but not the most opaque one". Macey and O'Hara (2003), based on a statement by Furfine (2001), argue the notoriously opaqueness of banks' balance sheet and the effects of technology on the difficulty of monitoring banks by traditional regulation and supervision. Flannery et al (2002) consider that special government supervision can enhance banks' transparency.

Improving the flow of information through increased disclosure enhances market discipline. This is the rational behind the third pillar of the Basel II Accord[1].

From a generic perspective, banks are viewed as any firm with a broad range of stakeholders. In the case of banks, the ***stakeholder groups*** includes shareholders, who contribute to the formation of capital, as well as other categories who have a direct interest, such as: governments and regulators, staff, depositors, creditors and the general public. Table 1 summarises the responsibilities of key bank stakeholders for bank governance and risk management. Key stakeholders are grouped in three categories: Systemic, Institutional and Consumer.

There is a significant public dimension to the banking firm. In the banking context, depositors' savings and government interests are at stake (Macey and O'Hara, 2003). When the social costs of an outcome exceed the private costs of an outcome, there is a negative externality effect. In this case the failure of a bank can influence the functioning of the entire banking system. The special nature of banking requires that management duties are more extensive than those of other directors. Bank managers function in the light of two distinct sets of interests: one is the private interest internal to the firm and the other is the public interest external to the firm. Referring to corporate governance models and viewing a comparison between the Anglo-American and the Franco-German models, Macey and O'Hara (2003) note the strange fact that paradigms of corporate governance differ on the basis of national boundaries rather than on the basis of the indigenous characteristics of the firms being governed. The Anglo-American corporate governance approach focuses on the interests of maximizing shareholder value, while the Franco-German model considers the interests of all stakeholders. Across sectors, the two authors find a hybrid approach, in which most firms are governed according to the US model. The banking sector is governed according to the Franco-German paradigm. The governance of banks is targeted at the interest of its all stakeholder groups.

Table no.1 - Key stakeholders and responsibilities in bank governance and risk management

Key Players	***Responsibility for Risk Management***	***Importance***	
		Policy Level	***Operational Level***
Systemic			
Legal and Regulatory Authorities	Optimise	Critical	n/a
Bank Supervisors	Monitor	Indirect monitoring	Indirect
Institutional			
Shareholders	Appoint key players	Indirect	Indirect
Board of Directors	Set policy	Critical implementation	Critical

Executive Management	Test compliance with board policies and provide assurance regarding corporate governance, control systems and risk management process	Indirect compliance	
Audit Committee / Internal Audit	Evaluate and express opinion	Indirect (evaluation)	
External Auditors			
Consumer	Act responsibly	n/a	Indirect
Outside Stakeholders / Public	Act responsibly	n/a	Indirect

Source: Van Greuning, Bratanovic (2003)

Competition related to financial products and the takeover activity in the banking industry are mechanisms for improving the corporate governance of banks. However, competition cannot act on its own; it must be sustained by the regulatory environment.

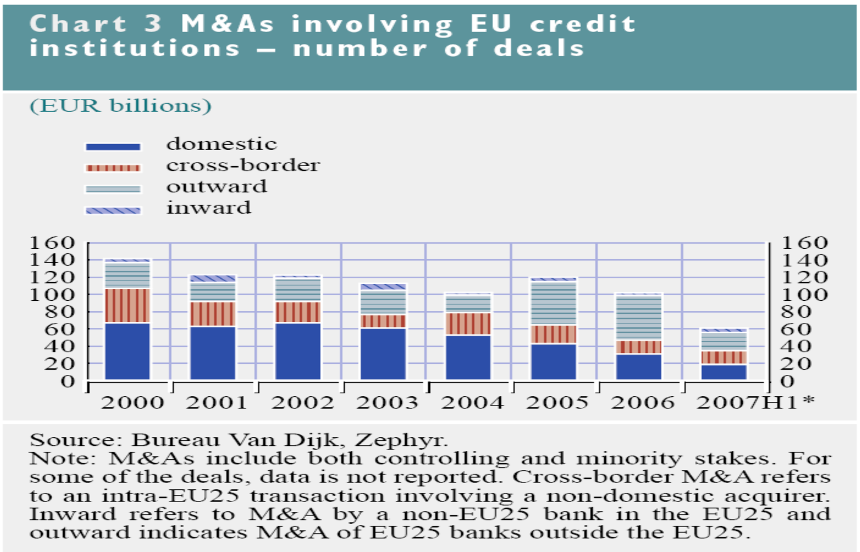
Shleifer and Vishny (1997) state that product competition, although being the most powerful force towards economic efficiency, cannot solve the problem of corporate governance. Analysing the takeover element, the two authors consider it as a second corporate governance mechanism only in the US and the UK markets. Levine (2004) analyses the effects of opaqueness on the competition in the banking sector. The opaqueness of banks can weaken competitive forces, affecting product competition and the takeover activity. The author observes that product market competition is less frequent in the banking sector due to the personal relationships that banks establish with their clients.

Taking the European Union (EU) as a relevant area of study, consolidation in the banking sector has continued since 2000, with signs of deceleration (ECB, 2007). The number of credit institutions fell, while the total assets of the banking sector continued to grow significantly. This process is closely related to mergers and acquisitions (M&A) activity within the banking sector. Research shows that the number of M&A transactions has been declining overall since 2000, with the exception of cross-border deals of EU banks in third countries, which have been increasing. In 2006 the decrease in the number of M&As was accompanied by an increase in the value of such transactions, mainly as a result of large domestic deals. While domestic consolidation has continued in 2006, no major changes appeared in the EU cross-border banking landscape compared to the previous year. Table 2 presents the trend in the M&A cross-border activity within the EU.

Despite active consolidation, there have been few hostile takeover bids in the banking sector. There are several reasons for this phenomenon (Adams and Mehran, 2003). Firstly, banking laws and regulations impose significant delays on any hostile bid. Secondly, many stakeholder groups can use delays to organize opposition to a regulated acquisition and influence the decision of the regulator. Thirdly, the medium of exchange in hostile offers is typically cash that the acquirer must borrow. Banks are unwilling to borrow funds for acquisition purposes as they are already highly leveraged. Finally, the large block ownership reduces the probability of success in a hostile offer.

The decrease in product competition and the tension present in the cross-border takeover activity may stimulate competition for good governance of banks. Supervisory practices could be further developed via benchmarking based on best practices.

Table no. 2 - Evolution of M&As in the EU banking sector



3 Increased regulation and supervision

As banks became more important for the overall success of the economy, in addition to using banks to finance expenditures directly, governments find it important to control them through regulation, imposing several restrictions on their activity. In the corporate governance context, a regulatory framework represents a guide to the context, meaning, objectives and implementation of specific regulations. It designs regulations that assist banks in achieving principles of best practice for the bank, enhancing its corporate value and ethics.

How do countries regulate their banks? Depending on the approach taken by various states, the regulatory framework is prescriptive or market-orientated. Regulators adopting a prescriptive approach limit the scope of activities conducted by financial institutions, allowing the risk that regulations do not follow market developments and prevent financial innovation. Regulators subscribing to a market-orientated policy encourage financial institutions to operate more freely in a market that is believed to function effectively, with financial risks being self-controlled. This way, financial institutions are the ones who regulate the market and the role of the regulator is to facilitate the process of monitoring risk management. Market participants are also involved in designing the regulatory environment.

Following recent principles and guidelines issued by economic and financial authorities, the developments in financial markets and changing market conditions, the trend is for regulators to adopt a market-orientated approach. Politics, culture and traditions in many countries also influence the approach of regulators, which makes it difficult to harmonise the regulatory process across a certain economic area (e.g. across the EU). The objective is to optimise the risk management process exercised by banks.

Central Banks have a significant role in regulating the banking system. According to Healey (2001), the involvement of Central Banks in their lender of last resort role and monetary policy objectives has led them to be intrinsically interested in the stability and general health of the financial system. Concerns over the moral hazard that might result from the emergency assistance and the potential cost of financial instability in turn led Central Banks to take a closer interest in the behaviour of individual banks. Often, but not always, this resulted in the Central Banks supervising and, if necessary, regulating the banking system.

Regulation in the banking industry is enhanced by the intervention of international supervisory bodies, such as the World Bank, the International Monetary Fund, and Central European Bank (ECB). In Europe, the ECB found a Banking Supervisory Committee, by which supervisors would inform the Eurosystem as soon as any problems in the banking system arise (ECB, Annual Report 1999).

Main regulatory impediments to the banking activity refer to:

- Entry of new domestic and foreign banks
- Capital requirements
- Restriction on bank activities
- Safety net support
- Disclosure of accurate comparable information
- Ownerships structure

Restrictions on bank entry might be caused by a natural monopoly in the banking industry, by information asymmetries and particular information that individual banks possess. Also, banks may demand barriers to entry in order to limit competition; accordingly, some regulators respond to these demands, to help them maintain political control. However, restricting competition in banking can have negative effects. A particularly important study by Guiso, Sapienza and Zingales (2004) examines the impact of different degrees of restrictions on bank competition across different regions of Italy. Banking law of 1936 restricted entry, which had substantial effects on the economy. In regions with less financial development and less competition in banking there was less access to credit, the entrepreneurship was negatively affected. The importance of banking competition explains the emphasis on financial liberalisation since the 1990s and the move towards reforms of prudential regulation in Italy and around the world.

Once other entry criteria have been met, bank entrants need to comply with the ***minimum amount of capital*** that is required to enter a market and the minimum prudential capital/asset ratio as banks grow. Capital requirements constitute a buffer against any unexpected losses and can affect risk-taking by bank owners, thus it is the centerpiece of government intervention. Minimum capital requirements are an important aspect in determining the amount that bank owners have at risk (Lamoreaux, 1994). Pillar I of the Basel Accord provides a model-based approach to establishing minimum capital requirements for banks, as an international standard. Generally, the positive effect of capital adequacy regulations on limiting banking risks is emphasised. Capital adequacy aligns the incentives of bank owners with the depositors and creditors. There are also opinions that argue the effect of capital adequacy requirements on the reduction of risks. The cost of regulatory compliance needs to be taken into account and banks can themselves set an optimal capital structure without any regulatory requirement. The rational of capital adequacy regulations is to avoid the financial contagion.

Legal restrictions on bank activities are critical for banks and define their activity. This comes from a public interest view. Governments see them as mechanisms that may easy market failures and enhance bank performance, providing financial stability. By contrast, there are theories which sustain banks to engage in a broad range of activities. Market discipline promoted by the private interest views regulatory restrictions as limiting economies of scale and risk management. Such restrictions may also reduce the franchise value of banks and limit the incentives for prudent behaviour. There are various degrees to which national regulatory authorities allow banks to engage in non-traditional activities. Such activities refer to the business of securities, insurance and real estate.

The ***safety net*** available to banks is a major component of banks' regulatory framework, because it affects the stakeholders' incentives to monitor banks. The safety net has two components:

- The lender of last resort
- The deposit insurance system

The *lender of last resort* component promotes market discipline to the extent that the Central Bank provides unsubsidised support to illiquid but solvent banks and allows uninsured creditors to suffer losses. The adoption of the *deposit insurance system* in the US in 1934 was followed by many other countries, whereby a ceiling is established on the total size of the deposit insurance fund. This system is often labeled as the source of moral-hazard problem in banking. It can facilitate risk-taking to the extent that it discourages depositors to monitor banks.

Calls for greater ***transparency and disclosure*** often indicate a failure to provide useful and timely information. This requirement is greater when the information lacks consistency or performance. Regulatory authorities have a responsibility to address the availability of information. Traditionally, bank legislation has been used as a way to force disclosure of information, involving the compilation of statistics for monetary purposes rather than the provision of information necessary to evaluate financial risks. The current trend approached by most regulatory authorities is for minimum yet regular disclosure of prudential reports and other relevant information.

Governments impose strong regulations on the banking system, by restricting their ***ownership structure*** in order to avoid the concentration of power and control of banks. The impact of investor protection laws on banks may differ from their impact on non-bank laws. Strong shareholder protection laws may enhance the governance of firms by limiting the expropriation of minority shareholders. In the case of banks, small shareholders may lack the means to govern banks. An effective legal protection of small shareholders may reduce the need for controlling shareholders and also their impact on the governance of a bank. The impact of ownership structure and government regulations on banks' risk depends on the role of the large owners in managing the banking firm and on the investor protection regulations. A properly managed bank operating in an effective legal environment may achieve an efficient management of risk.

Which laws and regulations enhance the corporate governance of banks? ***Empirical evidence regarding regulatory restrictions*** by Barth et al. (2006)[2] find major cross-country diversity in bank supervisory and regulatory practices. For example, minimum required capital ratios around the world vary from 4% to 20%. Actual capital ratios vary from almost 0 to almost 80%. About 50% of all countries offer explicit deposit insurance, a more than threefold increase in the last twenty years. The study also shows that securities activities are the least restricted in countries, while real estate activities are the most restricted. Only 4 of 152 countries actually prohibit banks from engaging in securities activities. In contrast, 48 countries prohibit them from engaging in real estate activities. Insurance activities are not far behind, with 39 countries prohibiting banks from engaging in these activities. The research shows that explicit deposit scheme is most common among high-income countries with almost 70% of these countries having established such a scheme. Such schemes are least common among low-income countries, with approximately 14% of these countries having established one. Government ownership of banks varies from 0 to 98% of total banking system assets. Foreign bank presence varies from 0 to 100% of a country's banking sector. Nevertheless, the results of the studies reveal regional coordination and harmonisation of bank regulations. Caprio et al. (2007) show that regulatory restrictions on ownership structures are often not well enforced, proving ineffective in preventing family ownership of banks. Their research reveals that banks around the world are generally not widely held, despite government restrictions on the concentration of bank ownership.

Approximately 75 percent of major banks have single owners that hold more than 10 percent of the voting rights. Of these controlling owners, more than half are families.

There are ***arguments for and against strong government regulation of banks***. One standard rationale for government regulation of banks is that shareholders and depositors cannot exert enough control over management, due to the complex and opaque environment in which banks operate. Regulators are concerned with the effect governance has on the performance of the banking industry, because the state of the overall economy depends on its performance. Differences in the operation of financial and nonfinancial institutions have led many to view regulatory oversight of the industry as a critical element of banking firm governance. By contrast, some evidence finds that empowering direct official supervision of banks and strengthening capital standards do not lead to improvements in banking performance and social welfare.

However, bank supervisory and regulatory policies that facilitate private sector monitoring of banks improve bank operations. This endorses Basel's II pillar on market discipline and a more limited role for the government that focuses on information disclosure. Fostering market discipline by introducing mechanisms for prompt corrective action is a viable solution for sustaining governance.

4 Bank regulation and governance in the EU context

We conducted analysis of bank corporate governance in the EU, looking at its unique regulatory and supervisory framework, which has been consolidating and harmonising. Risk management is one of the main drivers for banks' compliance with corporate governance principles. Accordingly, risks should be measured consistently and aggregated, to be efficiently managed by systems operated on a wide-system basis. Basel Accord acknowledged this aspect by applying its three pillars at a consolidated level.

Basel is currently applied across the EU pursuant to the Capital Requirements Directive[3], which became effective on January 1, 2007, although the effective date was delayed by one year for banks following the most advanced approaches. The EU addressed some of the Basel requirements through recent amendments made to the fourth and seventh company law directives[4]. These amendments stress the importance of the application of corporate governance practices, by requiring listed companies to publish a corporate governance statement, as part of their annual report or in a separate report. The statement should include reference to corporate governance codes, the "comply or explain" approach relating to the code and information on internal controls and risk management systems.

In the case of banking firms, the latter requirement is implicit. Risk management is of utmost importance not only for banks' own activity and governance system, but also for the financial market as a whole. The enforcement of corporate governance codes is a complex matter for companies in all industries. The banking industry should apply corporate governance principles through its ongoing activity, primarily because of the risky environment in which they operate. The financial crisis that affected the global market in August 2007 is an example of an event risk, which will probably lead to further developments in bank regulation and corporate governance control mechanisms.

Given the consolidation of the financial markets, the increased cross-border banking activity and the growing complexity of financial institutions, consolidated supervision is a mechanism that can accomplish an efficient regulatory and governance environment for banks operating across EU borders. Consolidation is accomplished through convergence of practices across countries; convergence in bank supervision is closely linked to the harmonisation of regulations. The regulatory and supervisory regimes in various countries have become harmonised by virtue of their common membership in region unions or international organisations.

Nevertheless, the convergence process is under current review and implementation in the EU. The Committee of European Banking Supervisors (CEBS) overlooks the banking practices by providing advice to the European Commission on banking policy issues and promoting cooperation and convergence of supervisory practices across the EU. CEBS fosters corporate governance principles in the EU banking sector.

CEBS published a report in June 2006 on the progress on supervisory convergence in banking[5]. The process is focused on three main areas:

- Fostering supervisory convergence, which has as main priority the implementation of the Capital Requirements Directive, with guidelines on transparency and disclosure of supervisory rules and guidance (supervisory disclosure), the advanced approached for credit and operational risk and cooperation between home and host supervisors (supervisory review process).
- Enhancing cost-efficiency of the EU system, contributing to the finalisation of common frameworks for reporting that allows banking institutions to use a common set of templates and data formats when transmitting financial and prudential data to supervisors.
- Improving cross-border supervision, by providing guidelines on cooperation between consolidating and host supervisors and on fostering a common European supervisory culture.

We find that progress has been made and this needs to be built upon, as the process of convergence is the cornerstone of the future for European banking supervision, regulation and governance. The actual impact of CEBS efforts will be visible only when CEBS guidelines will be operationally put into practice. There are however obstacles in coordinating supervision. One of the main concerns is that while financial regulators have stepped up their efforts to cooperate, national institutions have resisted surrendering powers.

5 Remarks

Taking into consideration the significant role of banks for the running of non-bank firms and for ensuring the stability of the overall financial system, their corporate governance systems are of major importance.

Within a national economy, a sound corporate governance system of banks increases the efficiency of firms' funding mechanisms, which accelerates economic growth. At a macroeconomic level, good corporate governance of banks enhances the credibility of the banking industry, which has positive economic effects. On the contrary, a weak governance system of banks, which overlooks the interests of its stakeholders, may have negative implications for the entire economic system.

Countries that adopt regulation on forcing the disclosure of accurate, comparable information about banks tend to have better developed banks. These policies enhance the operations and governance of banks, ensuring economic growth. Banks respond to tight regulation through mechanisms such as financial innovation, securitisation, globalisation and new technologies. We consider that these responses, if managed adequately, may have stimulating effects on the governance of banks.

References

Adams, R., Mehran, H., "Is Corporate Governance Different for Bank Holding Companies?", *FRNBY Economic Policy Review*, 2003

Bank of International Settlements, *Enhancing Corporate Governance for Banking Organisations*, BIS Publications, 2006

Barth, J., Caprio, G., JR, Levine, R., *Rethinking Bank Regulation: Till angels govern*, Cambridge University Press, 2006
Capri,o G., Laeven, L., Levine, R., *Governance and Bank Valuation*, NBER Working Paper No. W10158, 2007
Ciancanelli, P., Gonzalez, J., *Corporate Governance in Banking. A Conceptual Framework*, European Financial Management Association Conference, Athens, 2000
Cocris, V., Chirlesan, D., *Techniques of Banking Operations*, Al.I.Cuza University Publishing House, Iasi, Romania, 2006
Cocris, V., *Bank Management and Credit Risk Analysis*, Al.I. Cuza University Publishing House, Iasi, Romania, 2007
Crockett, A , *Market Discipline and Financial Stability*, FSR, Issue No. 10, 2001
Deacon, J., *Global Securitisation and CDOs*, NJ John Wiley & Sons, Ltd. , UK, 2004
European Central Bank, *EU Banking Structures*, ECB Publications, 2007
European Central Bank, *The Role of Central Banks in Prudential Supervision*, ECB Publications, 2001
European Central Bank, Annual Reports 1998-2006.
European Commission, *The Follow-Up of the Second Mapping Exercise on EU Financial Conglomerates*, Mixed Technical Group on the Prudential Regulation of Financial Conglomerates, Brussels: DG Markt, 2000
Ferrarini, G., *Prudential Regulation of Banks and Securities Firms. European and International Aspects*, Kluwer Law International, 1995
Ferrarini, G., Hopt, K., Wymeersch, E., *Capital Markets in the Age of the Euro. Cross-border Transactions, Listed Companies and Regulation*, London-The Hague-Boston, Kluwer Law International, 2002.
Ferrarini G., *Corporate Governance Changes in the 20th Century: a View from Italy*, ECGI - Law Working Paper No. 29/2005.
Financial Reporting Council (FRC), *The UK Approach to Corporate Governance*, 2006.
Flannery, M.J., Kwan, S. and Nimalendran, M., *Market Evidence on the Opaqueness of Banking Firms' Assets*, 2002
Friedman, M. and Schwartz, A., *A Monetary History of the United States, 1867-1960*, 1963
Furfine, C. H., "Banks as Monitors of other Banks: Evidence from the Overnight Federal Funds Market", *Journal of Business* 74, no.1, 2001
Healey, J., *Financial Instability and the Central Bank International Evidence", in "Financial stability and Central Banks – A Global Perspective*, Centre for Central Bank Studies, Bank of England, London, 2001
Herring, R., J., "The Subordinated Debt Alternative to Basel II", *Journal of Financial Stability*, Elsevier, vol. I(2), 2004
Koch, T., MacDonald, S., *Banking Management*, South-Western College Publications; 5th edition, 2002
Lamfalussy Report , *Report on the Regulation of European Securities Markets*, Brussels: European Commission, 2001.
Lanno, K., "The Transformation of Financial Regulation and Supervision in the EU", *Handbook on Central Banking and Financial Authorities in Europe*, edited by Donato Masciandaro, Edward Elgar Publishing Ltd., 2005
Levine, R., "The Corporate Governance of Banks", *World Bank Policy Research Working Paper 3404*, 2004
Macey, J.R., O'Hara, M., "The Corporate Governance of Banks", *FRBNY Economic Policy Review*, 2003
Morgan, D., "Rating Banks: Risks and Uncertainty in an Opaque Industry", *American Economic Review* 92, 2002

Padoa-Schioppa, T., *EMU and Banking Supervision*, Lecture delivered at the London School of Economics, London, 1999

Polo, A., *Corporate Governance of Banks: the Current State of the Debate*, SSRN, 2007

Prati, A. and Schinasi, G., Financial *Stability in European Economic and Monetary Union*, Princetown Studies in International Finance, 1999

Shleifer, A., Vishny, R.W., "A Survey of Corporate Governance", *Journal of Finance* 52, 1997

Schoenmaker, D., "Central Banks and Financial Authorities in Europe: what Prospects?", *Handbook on Central Banking and Financial Authorities in Europe*, edited by Donato Masciandaro, Edward Elgar Publishing Ltd., 2005

Turliuc, V., Cocris, V., Dornescu, V., Boariu, A., Stoica, S., Chirlesan, D., *Currency and Credit*, Al.I. Cuza University Publishing House, Iasi, Romania, 2007

Ungureanu, M.C., "The complexity of the global environment", *Intersections Electronic Journal*, Vol.3, No. 6, Matei-Teiu Botez Academic Society, Iasi, Romania, 2006

Ungureanu, M.C., "Corporate governance – a global challenge", *Intersections Electronic Journal*, Vol.3, No. 6, Matei-Teiu Botez Academic Society, Iasi, Romania, 2006

Ungureanu, M.C., *The Corporate Governance of Banks*, Centre for Financial Studies-Corporate Governance & Global Stock Markets, August Conference-Eltville (Germany), 2007

Van Greuning, H., Bratanovic, S., *Analyizing and Managing Banking Risk. A framework for Assessing Corporate Governance and Financial Risk*, The International Bank for Reconstruction and Development / The World Bank, 2003

Visentini, G., "Corporate Governance: the Case of Banking, Banca Nazionale del Lavoro *Quarterly Review*, Special Issue, March, 1997

Walter, I., *Financial Integration across Borders and across Sectors: Implications for Regulatory Structures*, in Jeroen Kremers, Dirk Schoenmaker and Peter Wierts (eds.), Financial supervision in Europe, Cheltenham: Edward Elgar, 2003

White, W. , "The Coming Transformation of Continental European Banking?", *BIS Working Papers*, No.54, Basel, 1998

Notes

1. The Basel II Accord established by the Basel Committee (Bank of International Settlement) describes a comprehensive measure and minimum standard for capital adequacy that national supervisory authorities are now working to implement through domestic rule-making and adoption procedures. Pillar 1 of the new Basel Capital Accord refers to the minimum capital requirement. Pillar 2 refers to the supervisory review process; it complements the minimum capital requirement of pillar 1 and looks at a bank's internal procedures to manage and control risk. Pillar 3 strengthens the role of market discipline. For the original Basel II document, see Bank of International Settlements (BIS) publications.
2. The study, based on research of 153 countries across the globe, provides a comprehensive cross-country assessment of the impact of bank regulation on the operation and governance of banks.
3. The Capital Requirements Directive (CRD), which recasts Directives 2000/12/EEC and 93/6/EEC.
4. The Fourth and Seventh Directives on the annual accounts of public limited liability companies belong to the family of "accounting directives" that form the arsenal of Community legal acts governing company accounts. Fourth Directive: annual accounts of companies with limited liability – this Directive coordinates Member States' provisions concerning the presentation and content of annual accounts and annual reports, the valuation methods used and their publication in respect of all companies with limited liability. Seventh Directive: consolidated accounts of companies with limited liability – this Directive coordinates national laws on consolidated (i.e. group) accounts.
5. See full report: "Second Progress Report on Supervisory Convergence in the Field of Banking for the Financial Services Committee", 9 June 2006