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Banking Governance : Conceptuel Framework

EL HALOUI Soukaina
Doctoral student in management sciences
University Mohammed V
Structure research : LARMODAD
Rabat, Morocco

CHEMLAL Mohamed
Professor of higher education
University Mohammed V
Structure research : LARMODAD
Rabat, Morocco

Abstract:- This study aims to define the conceptual framework of corporate governance and to show its specificity in the banking field. This concept does not benefit from an official definition like that of internal audit, which makes its perception by researchers different. As far as we know, there are four forms of governance: family governance, technocratic governance, shareholder governance and partnership governance. In the banking sector, international prudential regulations are heavy (BASEL I, BASEL II, BASEL III and BASEL VI), as the environment in this field is complex in terms of risks. In this context, we will highlight the risk of bank governance.

Keywords : *Governance, Banking, Regulation.*

I. INTRODUCTION

In a context marked by strong international prudential regulations. Banks are obliged to comply with these regulations, which are based on the lessons of previous crises. The primary objective behind banks' compliance with these regulations is to ensure financial stability.

The Bank for International Settlements (BIS) is "*the bank of central banks*". Created in 1931 after the Great Depression, it is the oldest international financial organization (Baudouin, 2019). It was founded as part of the Young plan to reschedule German war reparations under the 1919 Treaty of Versailles (Couppey-Soubeyran and Nijdam, 2018). The BIS assists central banks in their role of promoting monetary and financial stability, and supports international cooperation in this field (Baudouin,2019).

In addition, the BIS "*promotes exchanges and collaboration between central banks and authorities responsible for ensuring financial stability, carries out strategic research, acts as a counterparty for central banks in their financial transactions, and may act as agent or representative in international financial operations*"(Baudouin ,2019).

The Basel Committee was set up in 1974, following the collapse of the Herstatt Bank. Its main members are the governors of ten central banks, known as the "*Group of Ten*" (Debly, 2019). This committee brings together the banking supervisors of 27 member countries (Debly, 2019) : Australia, USA, Germany, Canada, India, South Africa, Belgium, Brazil, China, South Korea, Spain, Switzerland, Saudi Arabia, France, Hong Kong, Argentina, Italy, Netherlands, Japan, Luxembourg, Mexico, Italy, United Kingdom, Russia, Singapore, Sweden, Indonesia, Turkey, China and Spain. The European Union, represented by the ECB and the European banking supervisor (MSU), is also represented (Couppey-Soubeyran and Nijdam, 2018).

This committee determines the modalities of international cooperation to strengthen prudential control and improve the quality of bank supervision. It is called the BCBS because it is based at the BIS headquarters in Basel (Siliadin, 2019).

The aim of this research is to highlight the specific nature of bank governance. To do so, we will first present the origins of governance, and outline its various concepts and forms. We will then discuss the risk of bank governance and international prudential regulation.

II. ORIGINS AND USES OF THE CONCEPT OF GOVERNANCE

The word "governance " comes from the Greek "kubernan", meaning "*to steer a chariot or ship*". This Greek word evolved into the Latin "gubernare", meaning "*the government of men*" (Cabane, 2018).

according to Dufour et al (2021), the French term "gouvernement" has two meanings: "*one, general, relating to the manner of governing, the other, more precise, designating a regal institution*".

Table 1. The development of the Old French term "gouvernance".

Century and/or Year	Events
13th century	Was used as equivalent to "*gouvernement*" which means, "art or manner of governing".
1478	Since then, it has been used to represent "a few territories in Northern France with a special administrative status, before it was also applied, in an entirely domestic context, to the position of governess".
14th century	The emergence of the term "*governance*", in Great Britain.

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The 1980s	The reappearance of the words "*gouvernance*" and "*governance*", which had not been used for centuries, gradually being replaced by "*gouvernement*". Until then, governance had meant "in fact the art of governing, the tools of government, the administration and management of a state in the broadest sense; there was even some confusion with the institution, the government".
20th century	The adoption of "corporate governance" by economists and specialists.

Source : Based on Cabane P. (2018), p.27.

Table 2. Different uses of the concept of governance

Type of governance	Definitions and characteristics
Governance	All the mechanisms needed to negotiate the various interests of companies. The exercise of political power, and control in the administration of corporate resources for economic and social development.
World governance	The set of processes by which collective rules are drawn up, decided, legitimized, implemented, controlled and placed at the service of a global economy that would bring order, justice, freedom and efficiency.
Global governance	It is not limited to the official institutions and organizations involved in drawing up and disseminating the standards and rules governing the world, but also includes state institutions and intergovernmental cooperation.
Social governance	It articulates and associates political institutions, social actors and private organizations, in processes of elaboration and implementation.
Corporate governance	Corporate governance is defined as "the system in which the management of firms is controlled by all economic actors. It is not only the owners who should exercise this control, but also creditors, employees, customers, public authorities, etc. This ideal approach to governance leads to a concept of corporate citizenship, managerial decisions are supposed to take into account the interests of the various stakeholders".

Source : Frioui M. (2004), « La problématique de la gouvernance dans le management public : cas de la Tunisie et du Maroc » , Revue marocaine d'audit et de développement, n°19 , p.71.

A. The concept of corporate governance

There are many attempts to define corporate governance. In this paper we present the main definitions.

The Institute of Internal Auditors (IIA) defines corporate governance as "*Device comprising the processes and structures put in place by the Board in order to inform, direct, manage and steer the organization's activities with a view to achieving its objectives.*"(IFACI, 2012) cited by (El harchaoui, 2019). This definition is translated by IFACI.

In the Cadbury report (1992) "*Governance is the system by which companies are directed and controlled*" cited by (Cabane, 2018). This definition is sober and aims to link transparency with corporate governance.

For Charreaux (1997) , corporate governance is defined as "*the set of mechanisms that have the effect of delimiting the powers and influencing the decisions of managers, in other words that govern their conduct and define their discretionary space*".

Commelin (2001) defines it as " *a system in which the management of a company is controlled by all economic actors. It is not only the owners who should exercise this control, but also creditors, employees, customers, public authorities, etc. This ideal approach to governance leads to a concept of corporate citizenship, in which managerial decisions are supposed to take into account the interests of the various stakeholders*".

According to the Moroccan Code of Best Practices in Corporate Governance, "*Corporate Governance encompasses all the relationships between the company's management and its governing body, shareholders and other stakeholders, with the aim of creating value for the company*"(Moroccan Code of Best Practices for Corporate Governance, 2008).

All these definitions have important characteristics. In summary, Cabane (2018) proposes the following definition : "*Governance is a system for defending the company's interests, and for managing, controlling and ensuring the company's long-term viability, specifying the powers, responsibilities and relationships of shareholders and management, and ensuring that the objective of creating value for all stakeholders is taken into account. More concisely, governance could also be defined as the way in which power is organized and exercised to steer the company*".

III. FORMS OF CORPORATE GOVERNANCE

A. Family governance

Family business governance is still very much in evidence. "*In France, 60% of companies with sales of over 50 million € are controlled by families*" (source: Forbes, 2017) cited by (Burlaud et al, 2021)

This form of governance is characterized by "*family finance*" and remains the relevant governance mechanism beyond general meetings and boards of directors (Altintas and Kustosz, 2018)

Family business governance tools include the family charter, which is to the family what articles of association are to a company. The specificity of this charter lies in its adaptability to each family. In this way, it acts as a catalyst for the business and the family (Almaleh, 2016).

The creation of added value is one of the challenges of governance for all stakeholders. Transparency must be introduced at the right times and in the right places; it requires strong involvement, intelligible communication and ad hoc training to avoid misunderstandings (Huet and Neiter, 2016).

B. Technocratic governance

"Technocratic" or "managerial" governance matches "*the appropriation of power within companies by salaried executives and managers*" (Burlaud et al, 2021). It produces more contractual and objective relationships at the heart of the company than others with family governance. Under this form of governance, general management offers employees who make a measurable contribution opportunities for advancement. (Burlaud et al, 2021)

Companies with managerial governance are led by growth- and innovation-minded managers who are competent and able to steer complex entities (Burlaud et al, 2021). This model has improved the development of diverse, headquartered groups with large workforces, since they need the resources to integrate new activities, think about development and carry out external growth operations. However, in the face of all the advantages that this model represents, managerial governance has even led to situations that jeopardize the company's long-term viability, in the event of a failure to rebalance power to the benefit of shareholders and the company's other stakeholders. This was the case at Crédit Lyonnais in the late 1980s (Burlaud et al, 2021).

C. Shareholder governance

According to Jensen and Meckling (1976), an agency relationship is defined as "a contract *under which one or more persons engage another person to perform some service on their behalf which involves delegating some decision making authority to the agent*". The principal is the shareholder, while the agent is the manager. The relationship between these two bodies forms the basis of the shareholder approach.

This form of governance is particularly relevant to" *the governance exercised by shareholders in firms characterized by at least partial separation between share ownership, and hence the assumption of financial risks and rewards, and the decision-making power exercised by operational managers*"(Fama and Jensen,1983) cited by (Bonnet, 2020).

The shareholder approach defends the interests of shareholders and is accompanied by important financial information, whether for institutional investors or even small shareholders.(Burlaud et al, 2019)

In this model, the manager's objective is to create shareholder value, "*that is to say to increase the total market value of the company over the long term*" (Jensen, 2002). In this way, the company is judged on its ability to create value, not on its financial strength or profitability. (Nafssi and Bahoussa, 2018)

In any case, shareholder governance is limited to "*a disciplinary role in the behaviour of managers, with the aim of aligning their behaviour with the interests of shareholders alone*". Olivier and Guillaume, 2008) cited by (Anouar, 2017).

D. Partnership governance

In the context of this approach, Charreaux (1997) defines the governance system as "*the set of mechanisms designed to reduce conflicts with the firm's partners, which are considered costly*".

The list of stakeholders originally included customers, employees, lenders, suppliers and the company. (Freeman and Reed,1983)

Meier and Schier (2008) considers the increase in heterogeneous, hard-to-achieve objectives to be the main drawback of the partnership governance model. This drawback highlights the issue of controlling the conformity of the organization's actions with these objectives. In addition, it underlines the importance of critical resources contributed by stakeholders, who in return expect their interests to be satisfied.

Meier and Schier (2008) concludes that, "*the relationship between the various stakeholders leads to questions in terms of value creation. As soon as stakeholders have specific expectations of the company in which they operate, and demand particular information on the state of these productive entities, it is because each of these stakeholders is involved in creating value*". Furthermore, the problem of measuring the contribution of each stakeholder arises in the context of incentive methods coordinated by the company to encourage stakeholders to adopt efficient and responsible behavior. The common goal is to create maximum value for all partners.

The most important advantage of this model is that it tries to safeguard the interests of several stakeholders. It can be a source of competitiveness for suppliers, customers and the company itself. (Burlaud et al, 2019)

IV. BANKING GOVERNANCE: RISKS AND REGULATIONS

The Basel Committee on Banking Supervision (BCBS) defines corporate governance as *"the set of relationships between a company's management, its board of directors, its shareholders and other stakeholders, which establish the framework within which the company's objectives are set, as well as the means of achieving and monitoring their realization*". The committee adds that "*Corporate governance contributes to defining the allocation of powers*

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and responsibilities, as well as decision-making mechanisms".(Sama, 2020),

A. Bank governance risk

Governance risk refers to the fact that a bank faces financial losses and/or sanctions, due to inappropriate or non-compliant management choices made by its executives. Governance risk is in fact an operational risk, but it is frequently distinguished from this family to assert its importance in the potential exacerbation of other risks (Siliadin, 2019), . It comprises three risks (Sène, 2021) :

- **Strategic risk** is defined in the same way as the risk of loss arising from the ineffectiveness or failure to implement the strategies laid down by the Board of Directors and general management.
- **Management risk** is the risk of loss arising from weaknesses in the support of one or more areas of the bank : operations management, commercial management, audit and control, credit administration, etc.
- **Reputation risk** is the risk of loss arising from the negative impact on customers of negative information about the bank, whether true or not.

B. Basel Accords I : Cook ratio.

The "Basel 1" accords are the first Basel accords, instituted in 1988. One of the most important measures was the introduction of the "Cooke" ratio (Debly, 2019), This ratio is "*a minimum solvency ratio*" (Siliadin, 2019), in addition "*This is a prudential ratio of minimum capital requirements. This ratio is based on the commitments entered into by the banking establishment, and their associated risk*"(Debly, 2019), . This ratio imposes solvency requirements on banking institutions, which are as follows (Debly, 2019) :

- "Tier 1, Tier 2 and Tier 3 capital / total credit commitments > 8%.
- Tier 1 capital/ total credit commitments > 4%."
- Tier 1 capital comprises share capital, reserves and retained earnings. Tier 2 and Tier 3 equity include additional items such as subordinated debt.(Debly, 2019)
- This agreement has had the following effects (Debly, 2019) :
- Considerable improvement in banks' equity capital.
- The inclusion of off-balance sheet commitments in the risks incurred by banks.
- Limitation of regulatory arbitrage and the introduction of greater harmony between supervisors in the methods used to assess capital adequacy.
- The main limits of the Cooke ratio are (Debly, 2019) :
- Risks related to credit activities are the only risks that fall within the scope of the ratio.
- The weightings used to determine the Asset Amounts are based on the nature of the counterparties and not on their actual risk of default.
- It is not linked to the quality and nature of the risk specific to each bank.

B. BASEL II

The Basel 2 accords were signed in 2004 (Debly, 2019) . The aim of these agreements is "*to optimize the alignment of capital requirements with the risks borne by banks and to ensure better conditions of competition at international level*" (Titilokpé, 2018).

This system is based on three inseparable pillars that strengthen "*the synergies between internal and external risk control (Titilokpé, 2018), :*

- *Capital adequacy requirements (McDonough solvency ratio);*
- *The prudential supervision procedure;*
- *Market discipline (transparency in institutions' communications)".*

Unlike the Cook ratio, Basel II offers a variety of approaches, including internal methodologies that enable credit institutions to adopt an individual approach close to the risk actually incurred. (Siliadin, 2019)

Generally speaking, the application of the Basel II reform measures for credit institutions has led them to (Siliadin, (2019) :

- Complete and update their permanent documentation.
- Question their ability to guarantee the transmission and processing of data from various business lines (sales, accounting, risk management, management control) and the efficiency of their information systems.
- Finally, for internal control, the application of Basel II has produced "*new scopes to cover*", and more often than not, new skills to incorporate in order to be able to assess the control of risks inherent in the new subjects.

Despite these functional, organizational and applicative contributions, the provisions of Basel II have not protected the financial system from the spread of the sovereign debt and subprime crises (Siliadin, 2019).

C. BALE III

By exposing its flaws, the financial crisis of 2007-2008 prompted a detailed review of prudential banking regulations (Ohannessian and Waxin, 2017). The lessons learned from the crisis prompted public authorities to strengthen accountability, transparency and regulatory requirements to reinforce the qualitative and quantitative aspects of capital adequacy. In 2010, the Basel Committee published a set of updated rules on capital adequacy (Siliadin, 2019). This reform anticipates the occurrence of systemic risk, clarifies the definition of IFs and strengthens their quality. (Siliadin, 2019).

The minimum capital adequacy ratio for banks has been increased from 8% to 10.5%. (Siliadin, 2019).

D. Basel IV: Finalization of Basel III reforms

The Basel III reforms are complemented by the 2017 reforms. These reforms were "*announced in 2010. They aim to restore credibility to the calculation of risk-weighted assets (RWAs) and improve the comparability of banks' capital ratios. RWAs are a risk estimate that determines the* *minimum level of regulatory capital a bank must retain to cover unforeseen losses. A prudent and credible RWA calculation is an integral part of the risk-based capital framework*." (Basel Committee on Banking Supervision, 2017).

Table 3: Reforms proposed by the BCBS

1	Revision of the standard approach to credit risk, to improve the risk sensitivity sensitivity of the existing approach.
2	Revision of the internal method approach to credit risk, with the stated aim of limiting the use of certain internal models (particularly for low default risk portfolios).
3	Revision of the (CVA) with a revised standard approach and the elimination of the internal method.
4	Revision of the current standard approach to operational risk, which will replace advanced approach
5	Introduction of a capital buffer linked to the leverage ratio for global systemically important banks (G-SIBs).
6	Introduction of a capital floor guaranteeing that banks' risk-weighted assets (RWAs) derived from internal models cannot fall below 72.5% of RWAs as calculated according to the standardized approach.

Source : PwC. (2018), « Bâle IV : Un nouveau tsunami réglementaire ? », Lettre d'actualité réglementaire/banque, No.13, p.6. (Available on the website : https://www.pwc.fr/fr/assets/files/pdf/2018/02/lettre-reglementaire-banque-bale-iv.pdf).

What's more, the new provisions, which were due to come into force in 2022, have been delayed by the Basel Committee to January 1, 2023. The delay is evidenced by the epidemiological context of the COVID 19 health crisis. (Haloui, 2021)

V. CONCLUSION

The concept of governance has a long history. Despite attempts by several researchers to define the concept, it remains vague. Given There are several forms of governance, each with its own particularities.

The specific nature of the banking sector, banks are always exposed to a risk known as "governance risk", which comprises three risks. Although international prudential regulations are cumbersome, they do protect banks from crises that may arise.

Interesting avenues of research could be explored in this area, such as a study of the most common form of governance adopted by banks, and a study of the impact of Basel IV on the banking sector.

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