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The importance of applying the governance in the Algerian banking system

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ملخص:

أصبح الاهتمام الكبير بموضوع حوكمة الشركات ضرورة حتمية في كل الاقتصاديات .

ويعتبر القطاع المصرفي أحد أهم الجوانب التي يجب تطبيق مبادئ الحوكمة فيها لضمان الاستقرار النظام المالي والاقتصادي ككل. ويعتبر النظام المصرفي العامل الرئيسي في قيادة أي مرحلة انتقالية لأ ي ا اقتصاد ،وقد ساهمت لجنة بازل في تطوير إدارة المخاطر المصرفية والعمل على تحقيق الاستقرار المصرفي ،لذلك نهدف من خلال هذه الدراسة تحديد مدى تطبيق النظام المصرفي الجزائري ل مبادئ الحوكمة المصرفية وفق بازل في ظل المتغيرات المصرفية الحديثة وازدياد حدة المنافسة..

كلمات مفتاحية : . الحوكمة،الحوكمة المصرفية ،لجنة بازل ، مبادئ الحوكمة المصرفية،النظام المصرفي الجزائري

Abstract :

After financial and economic scandals and crises, great attention to corporate governance has become necessary in all economies and sectors.

The banking sector is one of the most important aspects in which the principles of governance must be applied ,to ensure stability of the financial and the whole economic system.

The Basel Committee has contributed in development of banking risk management And work to achieve banking stability by focusing on setting important principles to applying governance in banking system.

So in This study we aim to investigate the applying of banking governance principles in algerian banks .

Keywords : corporate governance,banking governance,Algerian banking system, Basel commitee, banking governance principles

1. INTRODUCTION

The issue of inefficiency in management and abuse of power in some institutions at the international level, especially in the United States of America, In the early 1990s, In addition to the Southeast Asia crisis of 1997, Which proved to be a crisis of confidence and administrative corruption, One of the main reasons for the emergence of corporate governance. Although there are several alternatives to the term.

2. Corporate governance

2.1 Definition of corporate governance

Studies suggest trading the term corporate governance for more than a quarter of a century .But despite this some experts confirms that the term was not known before 1970. So generally corporate governance refers specifically to the set of rules, controls, policies, and resolutions put in place to dictate corporate behavior. Proxy advisors and shareholders are important stakeholders who indirectly affect governance, but these are not examples of governance itself. The board of directors is pivotal in governance, and it can have major ramifications for equity valuation.

And to define corporate governance, we try to give some definitions that provided by competent international institutions :

The definition of the Organization for Economic Co-operation and Development (**OECD**): Governance is a system by which business organizations are guided and controlled, where it works to define the structure and framework for the distribution of duties and responsibilities among company participants such as the board of directors, directors and other stakeholders.[1]

The Institute of International Auditors has defined corporate governance in Tone of the top magazine which is published by the same institute that it is « Operatios that are performed through the procedures used by stakeholder representatives ,in order to provide the supervising and controlling risk management ,and to ensure adequacy of controls ,to acheive the objectives and to maintain the value of the the company through the performance of governance »[2]

The definition of the Inernational finance corporate : «corporate governance is the system which is through it institutions are managed and effectively controlled,and it is interested in organizing the relationship between directors ,sharholders and stakeholders.Also the application of the corporate governance in a good way led to acheiving sustainable development of the company »[3]

Corporate governance is the system by which corporate functions are managed.Also corporate governance consists in the rules and procedures that determine the decision making ,controlling and monitoring processes within the company ».[4]

Corporate governance is the acceptance by managmement of the inalienable rights of shareholders as the true owners of the corporation and of their own role as trustees on behalf of the shareholders.It is about commitment to value ,about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company.[5]

So from the previous definitions we can give the basic characteristics of the governance system in the following points :[6]

- An integrated system of financial and non-financial control through which the institution is managed and controlled.
- is a set of rules and incentives that guide the management of institutions to maximize their profitability and value in the long term.
- is a set of laws, rules and standards that define the relationship between the management of the institution on the one side and shareholders and stakeholders or parties associated with the institution on the other.

- Identification of responsibilities within and ensuring the rights of all parties involved in the organization

2.2 The need for Corporate governance

We can refer to the need of appling Corporate governance in the following points:[7]

- Corporate governance is beyond the realm of law.
- Corporate governance is about ethical conduct in business.
- Corporate governance is a key element in improving the economic efficiency of a firm.
- Corporations need to recognize that their growth requires the cooperation of all the stakeholders ; and such cooperation is enhanced by the corporation adhering to the best corporate governance practices.
- A corporation should be fair and transparent to its stakeholders in all its transactions.
- The credibility offered by good corporate governance procedures also helps maintain the confidence of investors to attract more patient ,long-term capital,and will reduce the cost of capital .this will ultimately induce more stable sources of financing.
- Often ,increased attention on corporate governance is a result of financial crisis.
- The faillure to implement good governance can have a heavy cost beyond regulatory problems.

2.3. Benefits of corporate governance practices :

The application of corporate governance is important for the following points :[8]

- Improved reputation and perceptions in corporations.
- Increase in transparency.
- Reduction in Run-In with the law.
- Role clarity it is essential to have a clarity in the roles of the owners and the management people.
- Increased profit margins.
- Reputation bulding with corporate social responsibility.

- Better rapport with the bank, and this results in building confidence with the financial side

2.4. The principles of corporate governance

Corporate governance is based on a set of principles, which is the basis for the application of this system.

The ICGN global governance identified the general principles (board role and responsibilities, leadership and independence, composition, composition and appointment, corporate culture, risk oversight, remuneration, reporting and audit, shareholders rights).[9]

The organization for economic cooperation and development (OECD) identified six basic principles as follows:[10]

-Ensuring the basis for an effective corporate governance framework: The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

-The rights of shareholders and key ownership functions: the corporate governance system should protect and facilitate the exercise of shareholders rights.

-The equitable treatment of shareholders: the corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. So all shareholders should have the opportunity to obtain effective redress for violation of their rights.

-The role of stakeholders in corporate governance: : the corporate governance framework should recognise the rights of shareholders. Wich established by law or through mutual agreements, and encourage active co-operation between corporations and stakeholders in creating wealth, jobs,and the sustainability of financially sound enterprises.

-Disclosure and Transparency: : the corporate governance framework should ensure that timely and accurate Disclosure is made on all material matters regarding the corporation.

-The responsibilities of the board : the corporate governance system should ensure the strategic guidance of the company ,the effective monitoring of management by the board ,and the board's accountability to the company and the shareholders.

3. Governance banking system

The application of governance in banks is more important than other institutions, because the collapse of banks may lead to the collapse of the entire financial system and this leads to a financial crisis, which may turn into an economic crisis, this negatively affects the macroeconomic situation.

The Bank of International Settlements (BIS) defines governance in the banking system as The methods by which banks are managed through the Board of Directors and senior management, through which the manner of setting objectives and protecting the interests of shareholders and stakeholders.

In the light of the prevailing law and regulations, and to ensure the protection of the interests of depositors.

3.1 The objectives of banking governance

The objectives of applying governance in banking sector are represented in the following points:[11]

- Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business, therefore, is central to economic health. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the banking sector and the economy as a whole.
- . Corporate governance determines the allocation of authority and responsibilities by which the business and affairs of a bank are carried out by its board and senior management, including how they:
- set the bank's strategy and objectives;
- select and oversee personnel;
- operate the bank's business on a day-to-day basis;

- protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognised stakeholders;
- align corporate culture, corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations; and
- establish control functions

3.2 Basel banking governance principles:

Basel Committee is a technical advisory committee not based on any international agreement, established by a decision of the governors of the central banks of the industrial countries to study the aspects of supervision of banks, and from which the decisions of the Commission does not have any mandatory or legal status. Nevertheless, the rules agreed in Basel have a strong impact on legislative processes via the commitment of its members to implement them, and-as its rules (are applied more than 100 jurisdictions worldwide)-the agreed standards obviously put pressure on other countries to follow suit.[12]

The Basel Committee was formed under the name of "Committees of Banking Supervision and Supervision». The Commission is composed of the following 10 countries: Belgium, France, Canada, Germany, Italy, Japan, Holland, Sweden, United Kingdom, United States, Switzerland, and Luxembourg. The Basel Committee works to stimulate banks by following appropriate principles and standards in the field of banking supervision and international organizations are obliging countries to follow these rules as part of the IMF and World Bank's financial reform programs. The Basel Committee aims to achieve a number of objectives, the most important of which are the following points**:**

- Work to stabilize the banking system, especially after the aggravation of the external debt crisis of third world countries, and the excessive banks and especially international in providing loans to these countries, which led to the weakening of their financial centers.

- Keeping abreast of modern banking issues and variables in light of financial and banking globalization through modern banking mechanisms and techniques.
- Eliminating an important source of unfair competition in banks for developed and developing countries, by setting minimum capital efficiency.
- Working on developing methods of controlling banks and facilitating the circulation of these methods among central banks.

Corporate governance failure, especially whithin financial institutions, has been at the core of many problems during the global financial crises and numerous corporate and organizational scandals and failure..Many governments have responded by issuing louder calls for increased regulation In this light, it is positive that the Basel Committee on Banking Supervision is currently improving its Principles for Enhancing Corporate Governance via the consultation paper, Corporate Governance Principles for Banks.[13]

The comitte of basel issued report on the banking governance in 1990,to be modified in 2005 and February 2006,then it issued an update version entitled "enhancing corporate governance for banking organizations".The application of banking governance includes the following principles:[14]

- **Principle 1**: Board's overall responsibilities : The board should define appropriate governance structures and practices for its own work, and put in place the means for such practices to be followed and periodically reviewed for ongoing effectiveness
- **Principle 2**: Board qualifications and composition : The board has overall responsibility for the bank, including approving and overseeing the implementation of the bank's strategic objectives

- **Principle 3:** Board's own structure and practices : Board members should be and remain qualified, individually and collectively
- **Principle 4**: Senior management : Under the direction and oversight of the board, senior management should carry out and manage the bank's activities in a manner consistent with the business strategy, risk appetite, incentive compensation and other policies approved by the board.
- **Principle 5**: Governance of group structures : In a group structure, the board of the parent company has the overall responsibility for the group and for ensuring that there is a clear governance framework appropriate to the structure, business and risks of the group and its entities.
- **Principle 6**: Risk management : Banks should have an effective independent risk management function, under the direction of a Chief Risk Officer (CRO), with sufficient stature, independence, resources and access to the board.
- **Principle 7**: Risk identification, monitoring and controlling : Risks should be identified, monitored and controlled on an ongoing bank-wide and individual entity basis. The sophistication of the bank's risk management and internal control infrastructure should keep pace with changes to the bank's risk profile, to the external risk landscape and in industry practice.
- **Principle 8**: Risk communication :An effective risk governance framework requires robust communication within the bank about risk, both across the organisation and through reporting to the board and senior management
- :**Principle 9**: Compliance : The bank's board of directors is responsible for overseeing the management of the bank's compliance risk. The board should approve the bank's compliance approach and policies, including the establishment of a permanent compliance function.
- **Principle 10**: Internal audit : The internal audit function provides independent assurance to the board and supports board and senior

management in promoting an effective governance process and the long-term soundness of the bank. The internal audit function should have a clear mandate, be accountable to the board, be independent of the audited activities and have sufficient standing, skills, resources and authority within the bank.

- **Principle 11**: Compensation : The bank's compensation structure should be effectively aligned with sound risk management and should promote long term health of the organisation and appropriate risk-taking behaviour
- **Principle 12**: Disclosure and transparency : The governance of the bank should be adequately transparent to its shareholders, depositors, other relevant stakeholders and market participants.
- **Principle 13**: The role of supervisors Supervisors should provide guidance for and supervise corporate governance at banks, including through comprehensive evaluations and regular interaction with boards and senior management, should require improvement and remedial action as necessary, and should share information on corporate governance with other supervisors

4. The Algerian banking system and the implementation of the Basel standards for governance

For Algerian banking system ,we have noticed that Algeria is late in applying the governance principles of Basel convention.Where the central bank of Algeria issued the instruction **N°94-97** on 29 /11/1994. which is succeeded in making banks and Algerian financial institutions interested in Basel 1 decisions ; and this include most rates are related to the rules of caution.In addition to that instruction ,several instructions which are compatible with Basel 1 decisions .But even so, there are differences between standard control in Algeria and Basel committee standard. While Basel 2 convention has not been formally applied ,only in som texts concerning the regulatory side.As we refer to differences in risk weighting by Basel committee and the same side in Algeria.

But in light of global developments and changes ,especially those are imposed by the world financial crisis on 2008 ;Algeria was interested in legal and legislative measures ,which regulates the banking sector in Algeria and ensure financial stability ;such as the issuance of order **N°10/04** on 26 August 2010 .And this is important in the risk control side .So these measures are aimed at enabling the central bank of Algeria from early detection of weaknessess .

The financial stability committee has also reviewed the indicators of financial rigidity, and it is eleven (11) minimum indicators with the suggestion of other indicators.

on 2010,the importance was given to periodic evaluation of the stability of the financial and banking system by rigidity test that was adopted in 2007.In addition to this ,the importance was given also to encourage information exchange between different authorities which manages the financial sectors , such as central bank,the banking comittee, the public treasury ,the organization committee of stok exchanges,insurance companies,control committees.[15]

For the application of Basel 3 agreement, there is no law has been issued in this aspect ;but it was issued the regulation **N° 14/01** on 16 february 2014 . the regulation includes the raise of the capital adequacy ratio from 8% to 9.5% in all banks and Algerian financial institutions between the private legal funds ,the total loan risk ,the operational risks and market risks.The regulation is effective from1 octobre 2014 ;with the possibility of increasing this ratio by the banking committee ,if it is necessary.This coincides with the start of work with Basel 3 decisions.[16]

The Algerian banking system benefited under the MEDA programme (In light of relations with the European union)amount of 23.25 million euros to modernize the Algerian banking system and this includes the implement of the banking governance according to Basel standards.

5. CONCLUSION

The development and stability of the banking system is one of the most important elements in the management of any stage of an economy, this necessitates addressing the challenges of globalization and the developments in the banking environment. Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Banks serve a crucial role in the economy by intermediating funds from savers and depositors to activities that support enterprise and help drive economic growth. So from this study we conclude the following points:

- Corporate governance is the collection of mechanisms, processes and relations by which corporations are controlled and operated. Governance structures and principles identify the distribution of rights and responsibilities among different participants in the corporation (such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders) and include the rules and procedures for making decisions in corporate affairs. Corporate governance is necessary because ofthe possibility of conflicts of interests between stakeholders; primarily between shareholders and upper management or among shareholders.

-Good governance is a key element in improving the economic efficiency of banks, while the opposite may affect economic and financial stability.

- Compliance with Basel standards for banking supervision of the capital adequacy ratio is necessary to address recent banking developments and the application of the governance system.

-Despite efforts in the Algerian banking system, these efforts remain insufficient to make the Algerian banking system able to face the challenges to its development. Which stand in the way of these efforts. Among them are Basel's decisions as a fundamental aspect of applying the principles of governance.

So it is difficult to concider that the implementation of Basel's governance decisions has been highly successful on the performance of the Algerian banking system. .So we can say that we have noticed the lack of appling corporate governance system in the sector of Algerian banks. . Because of that we suggest through this study that the sector of Algerian banks need important efforts to adopt the concept of governance in order to benefit its advantages.

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