Corporate Governance Reform in DFIs: Lessons Learned from World Bank Experience

GLOBAL SYMPOSIUM ON DEVELOPMENT FINANCE INSTITUTIONS
INTRODUCTION TO CORPORATE GOVERNANCE AT THE WORLD BANK

• 15 years of experience on corporate governance reform
• Three product areas:
  • Governance of financial institutions (focus on DFI / SFI, 20+ institutions in 10 countries)
  • Corporate governance regulation (corporate governance ROSC, 85 assessments in 55 countries)
  • Governance of infrastructure finance
• Diagnostics / capacity building / training
# SPECIAL GOVERNANCE CHALLENGES FOR DFI

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- Private FIs: Value maximizing, Disciplined controller, Clear legal framework, Professional boards, Private sector remuneration, Market discipline, Monitoring and disclosure, Private sector labor standards.
- DFIs: Multiple/conflicting objectives, Low ownership capacity, Outdated legal frameworks, Politicized boards, Public sector remuneration, Soft budget constraints, No or low disclosure, Over-staffing.
GOVERNANCE AND PERFORMANCE: KEY SUCCESS FACTORS

High-capacity Ownership Unit

- Modern legal and regulatory framework
- Clear Mandate
- Effective board appointment policy
- Strong performance monitoring framework

Strong Board of Directors

- Accountability and division of roles
- Well identified social and commercial indicators

- Appropriate strategy
- Risk Governance in line with strategy

Effective and Accountable Management

Performance
A strong ownership unit is key to the overall governance of DFIs. But most governments do a poor job of acting as the owner of DFIs and other state-owned financial institutions.

**Challenges**

- Governments don’t prioritize the ownership function
- Governments have difficulty implementing modern corporate governance practices
- State is owner, policy-maker, customer, and market regulator
- Political interference in the operation of the DFI
- Opacity/Low disclosures

**Impacts**

- Low ownership capacity
- Lack of formality
- Lack of clear legal framework / ownership policy
- Lack of clear roles and responsibilities
- Multiple/conflicting objectives
- Conflicts of interest
- Non-commercial operations
- Confusion about mandate and objectives
- Corruption


✓ Establish an ownership policy that clarifies:
  • Rationale and objectives
  • Mandate
  • Assign responsibilities to different players (including supervisory)

✓ Clarify organizational responsibilities:
  • Invest resources
  • Build capacity
  • Good: build institutional capacity within line Ministry
  • Better: assign the ownership function to a strong central ownership agency

✓ State should “stick to its knitting” and focus on:
  • Appointing board members
  • Monitoring and assessing performance and impact
BUILDING A STRONG BOARD OF DIRECTORS: CHALLENGES

- Boards are often composed of a mix of political, government, and stakeholder representatives -- with little commercial or financial skills needed to exercise board responsibilities and with little or no independence and objectivity.
- Political interference and lack of a clear process for the nomination and appointment of boards
- Unclear roles and responsibilities
- Typical results:
  - Weak and highly politicized “rubber-stamps”:
    - Political or policy goals may be met….but those goals may supersede interests of DFI
  - Boards are beholden to politicians and government officials
  - Boards composed of Ministry officials / retirees / politicians
  - Weak chairmen
  - No role in selecting chief executives
  - Lack of private sector financial sector experience
  - Lack of structures that support strong board function (committees, charters, training)
PROFESSIONALIZING DFI BOARDS: SOLUTIONS

✓ Put in place a structured and transparent nominations process -- board composition is central to a board’s functioning and performance

✓ Define and implement board responsibilities - through regulation / law charters

✓ Improve board efficiency -- through creation of board committees and better board processes

✓ Allow the board to appoint and monitor the CEO – increases both strength and relevance of board, and accountability of management

✓ Implement and refine board training and evaluation – to constantly improve performance
A WORD ON RISK GOVERNANCE...

- The “standard model” of risk governance is a work in progress in most of our client countries.
- Required institutions are nascent or missing:
  - Knowledgeable boards
  - Management (CROs)
  - Policies and procedures
- Some DFIs are making or considering changes to business models – without changing risk governance
ANOTHER WORD ON A DFI’S LEGAL FRAMEWORK....

✓ **Legal framework can be hard to change**—DFIs often come with their own constituting law with old-fashioned governance rules and which are hard to change.

✓ **Many DFIs are outside of the purview of regulators**—which also reduces exposure to modern CG regulation.
MAIN TAKEAWAYS

- DFIs have made major improvements in CG over past 15 years.
- But in many countries – the risks remain. Key lessons learned from our work:
  - Governments are not well organized to act as owners in most countries, resulting in political interference, confused roles and responsibilities, and undeveloped CG policies
  - Formal policy (often reflected in the legal and regulatory framework) can be improved
  - Mandates are often informal, and not always followed
  - Creating professionalized boards of directors remains a work in progress
- DFIs lost credibility 20 years ago because of what we now -- would call corporate governance challenges - constant focus required to improve practices (and delegitimize bad practices)
Thank you