Are the corporate governance standard in banks in the CEE countries low hanging fruit?

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29 December 2011

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Executive Summary and Keywords

The dominance of foreign capital in banking sector in the CEE countries created vulnerabilities that have been a contributing cause of recent financial crisis in the region. The question is whether the corporate governance structure of banks seemed to constrain or rather stimulate the potential unfavourable scenario, in which the controlling investors would be improving their difficult financial situation at the cost of their subsidiaries during the financial crisis of 2008.

The aim of the study is to evaluate corporate governance practices in banks that were listed on stock exchange during the financial crisis 2007-2009 in selected CEE countries: Czech Republic, Hungary and Poland. Those three economies managed to maintain relatively strong position of banking sector during the recent financial crisis in contrast to many Western and some Eastern countries.

The quantitative and qualitative analysis focuses on structure and practice of supervisory board based on data gathered from survey sent to the banks, their financial statements, reports on corporate governance and supervisory boards' report on their activities. The results of the research may be of interests not only to academics, but also to managers, in particular in banks, and regulators.

The research confirms that banks in CEE continue being role models for non-financial companies in implementing good standards of corporate governance. The findings reveal that bank's supervisory boards in the selected CEE countries during the financial crisis of 2008 met the high standards of corporate governance with regard to the number of independent members, appointing independent member on the position of the chairman and chairman of audit committees. The study shows that during the crisis banks in the CEE countries themselves strived for improving corporate governance practices and they made some effort to implement post-crisis recommendations related to establishing risk and remuneration committees and appointing Chief Risk Officer. Banks listed in the Czech Republic and Hungary lag behind those listed in Poland with respect of frequency of audit committee meetings and supervisory board's engagement in risk management.

Increasing number of board committees with larger number of seats for independent board, provided that they do not have majority votes, can be implemented fairly quickly and relatively inexpensively. However the factual improvement of corporate governance of banks depends on professional qualities of the independent board members, their level of engagement in committee activities as well as their ability and willingness to challenge the existing contractual arrangements, in particular those that undermine the position of minority shareholders or other stakeholders such as depositors. It seems that implementing high corporate governance standards with regard to board composition and its committees is just low hanging fruit and could not have significant impact on the potential unfavourable scenario, in which the controlling foreign investors would be improving their difficult financial situation at the cost of their subsidiaries based in Poland. Implementing regulation recommended by the international organization such as European Commission that are well suited for large widely held corporations will not improve corporate governance standards of banks in countries where their ownership structure is closely held.

Keywords: corporate governance, regulation, banking, CEE.

1. Introduction

Building sound corporate governance practices in the banking sector in Central and Eastern Europe since transition to a market economy commenced had two main motives. On one hand, it was essential for attracting private owners with capital and expertise. On the other hand, it was necessary for achieving and maintaining confidence of depositors in banking organization.

The banking system in the Central and Eastern Europe countries was restored at the beginning of 90s. after being repressed by the socialist economic regime for almost five decades. The period of transition of banking system from monobank to two-tier structure was very much affected by restructuring process of banks, their privatization, increasing competition and lastly consolidation. All the proceedings ended up with creating healthy commercial banks that, in particular in Poland or in the Czech Republic, have stronger position during the recent financial crisis than their counterparts abroad both in Western and some Eastern countries.

Prior to the wake of Lehman Brothers large inflows of foreign financing have indeed contributed to credit booms and foreign currency lending, mostly done in euro or Swiss franc, in the CEE, especially in the Baltic states and Hungary. One of the key receiving sectors of the lending was real estate. For example, foreign currency loans as a share of total private sector lending reached nearly 80% in Estonia, whereas in the Czech Republic less than 15% (Kattel, 2010). Similarly to the Czech Republic, Poland also was able to avoid massive lending in foreign currency as started later than in other CEE countries.

The relatively strong position of the Czech and Polish banking sector during the financial crisis in 2008-2009 is a consequence of a traditional business model. The funding model is based primarily on customers' deposits. Therefore, during the crisis of 2008 domestic banking sector characterized high levels of balance sheet liquidity. Additionally, financing of loan expansion mainly by primary deposits resulted in minimum dependence on funds from foreign markets, and only marginal use of loan securitisation.

Banks in Poland and in the Czech Republic did not invest in risky derivatives and subprime-related assets that yielded high returns or granted mortgage credits to low income working individuals. Over the last decade they were improving proceedings related with enlarging deposits and granting well-collateralized credits under strict standards and loan provision criteria. The conservative business model was reinforced by foreign strategic investors. The owners – usually large financial groups – let their subsidiaries generate profit chiefly from dynamically expanding retail banking activities, while the management of securities and derivatives portfolios were usually concentrated in their branches in international financial centres. The belated, conservative banks' policy, that was in addition supported by over-prudent behavior of the supervision authority, paradoxically protected Poland and the Czech Republic from a severe financial crisis in 2008.

Currently, banking sector in most of the CEE countries is well buffered, but risks remain. Most of banks are controlled by foreign strategic investors that are part of global financial groups mainly from the EU. Some of the blockholders have large portion of other than banking services at stake, which potentially increase operating risk. The difficult financial situation of parent companies has an impact on their subsidiaries operating in CEE. For example in Poland three out of ten largest banks were on sale because of financial troubles of the parent company. Despite very good financial standing there were difficulties to find a buyer for two of them, what make a pressure on systemic risk. The dominance of foreign ownership created vulnerabilities that have been a contributing cause of recent financial crisis in the region. It poses a question whether the practice of corporate governance of banks in CEE can add to or constrain the financial crisis in the CEE counties.

The aim of the study is to evaluate corporate governance practices in the banking sector during 2007-2009 in countries of CEE with the significant size of banking sector: Czech Republic, Hungary and Poland. The structure of the paper is organized as follows. Section two, preceded by introduction, explains the specificity of corporate governance of banks in CEE. In the third section an overview of banking regulation is provided. Fourth section outlines a methodological approach to the study. In the next section the findings related to composition and structure of bank's supervisory board in the selected countries of CEE are discussed. In the last section conclusions are presented.

2. Specificity of Corporate Governance of banks in CEE

In the course of banks' privatization, despite of using selected methods, there was a trend towards highly concentrated ownership structure. That is consistent with the view that effective corporate governance can be only established through blockholdings in case of poorly developed legal framework or capital market (Shleifer and Vishny, 1997). Blockholders possess appropriate incentives to effectively monitor managers, who are not capable of expropriating investors and maximizing their own utility instead of maximizing the return on shareholders' investments. In CEE they also brought corporate governance expertise and tools to ensure meeting the obligation of accountability to them. Hence, the main conflict of interest lies between large investor and minority shareholders. The protection of minority shareholders from potentially expropriating controlling shareholder constitutes for the core corporate governance problem in the CEE countries.

Banks operating in the CEE countries developed insider corporate governance system with highly concentrated ownership structure in foreign hands. Presence of large blockholders undermines external corporate governance mechanisms such as hostile takeovers and proxy fights. They are rather ineffective not only because of highly concentrated ownership structure, but also due to the fact that capital market is rather illiquid.

Most of the foreign banks preferred to enter the CEE region using subsidiaries rather than branches (Hryckiewicz and Kowalewski, 2010). The tendency slightly changed after the EU accession, when the number of foreign branches increases dramatically and eventually declines during the financial crisis. Nevertheless, the assets held by subsidiaries still dominates the banking sector in emerging countries (see tab.1). The relatively small reliance of foreign banks on branches in the CEE is associated with unfavorable attitudes of host regulators toward this mode of entry (Cerutti et al., 2007) and their participation in acquisition of privatized local entities.

Table 1. Subsidiaries vs foreign branches: number and its share in total assets

Kraj	Czech		Hungary		Poland	
	2001	**2009**	**2001**	**2009**	**2001**	**2009**
Number of subsidiaries	20	21	26	23	46	42
Number of branches	10	12	0	3	0	7
CI's assets to total assets in % for subsidiaries	64.24	77.97	56.04	50.12	69.22	62.59
CI's assets to total assets in % for branches	12.76	11.71	0	6.19	0	5.02

Source: Allen, F., Gu, X., Kowalewski, O. (2011), "Corporate governance and intra-group transactions in European bank holding companies during the crisis", mimeo.

A strong presence of global financial groups is an integral part of the corporate governance model applied in banks in CEE that has very important consequences. On one hand, banks, being subsidiaries of foreign entities, are exposed to potential conflict of interests and asymmetric information that affect larger parties than in case of a parent company, namely blockholder, minority shareholders, bank managers, depositors, and borrowers (Dermine, 2006). The interests of depositors and borrowers should be safeguarded by the regulator. Due to the fact that the foreign subsidiaries are separate corporations that are fully subject to the host country's jurisdiction, the agency problems may arise between the parent bank and local bank managers. Usually, the blockholder controls adequately bank managers by imposing on them functioning within organizational matrix, and hence has access to sufficient information on their actions. That may lead to mistreatment of minority investors, which is perceived as the most significant corporate governance conflict.

Minority shareholders complain, in particular, about lack of equal treatment with regard to the access to financial information. Banks in CEE countries reveal quite often financial statements publicly after their parent companies. It means that a blockholder has privileged access to financial information. Theoretically, a parent company should get information about a subsidiary at the general meetings. In practice, information requested by a parent company is sent from certain department of subsidiaries to indicated unit of headquarters of a parent company, quite often without noticing the management board of the subsidiaries. The corporate governance problem is reinforced by lack of comprehensive regulation regarding capital groups.

On the other hand great portion of regulations binding for banks operating in the region is created abroad. Banks with the majority of foreign capital come under double regulations both domestic and from the country, where the parent company is located. Most of blockholders that are listed quite often on the largest stock exchanges in the world, enforced adoption of a very broad set of laws and regulation as well as very high corporate governance standards (Gandy et al. 2007, pp. 104).

Banks in the CEE countries are not provided with any corporate governance code for deposit-taking institutions. Their practices in this field are shaped by law and internal regulation. Banks that are listed on stock exchange are required to implement the set of corporate governance rules called Corporate Governance Code. In Czech Republic, *Corporate Governance Code based on the OECD Principles* was introduced in 2001 (amended in 2004). Its compliance is voluntary and cannot be enforced. The structure of the document is based on the OECD Principles date as of 2004. It does not reflect specificity of the Czech corporate governance problems as well as recent recommendations withdrawn from the crisis. In Hungary (*Corporate Governance Recommendations*) and in Poland (*Code of Best Practice for WSE Listed Companies*) codes were in force in 2002 and later amended in 2007, 2008 and in 2005, 2008, 2010 respectively. It is based on the “comply or explain” principle, which gives the market clear and unequivocal information about company’s compliance. The Hungarian and Polish codes, to a larger extent than the Czech, are adjusted to specific domestic conditions and were amended few times in order to better respond to external or internal challenges.

3. Overview of banking regulation in CEE

Banking laws and regulation in CEE are rather recent in comparison to the developed countries. Over the years of transition process banking law’s amendments were made in order to adjust with the EU legislation. Nowadays, it is completely aligned with the EU legislation. As far as the disclosure and transparency of financial markets are concerned both improved highly as a consequence of implementing the European regulation on Markets in Financial Instruments Directive (MiFID). It aims at better investor protection, promoting competition in financial sector as well as increasing market disclosure.

At the beginning of 90s. the banking structure changed and monobank was replaced by a two-tier structure. A central bank and a number of commercial banks were established. In general, two approaches towards building banking sector in transition economies from the CEE region can be distinguished: entry of new private banks or rehabilitation of existing state-owned banks. In Czech, Hungary and Poland the latter prevailed. The banking reform encompassed recapitalization of existing banks along with an extensive program to develop them institutionally, mainly through restructuring followed by privatization.

The number of banks was increasing primarily due to widespread foreign penetration. Global financial group become eager to buy stakes in the EEC countries as the regulatory environment strengthened. After finalizing the privatization of state-owned banks consolidation process occurred. Reduction in number of banks in the second decade of transition process resulted mainly from strengthening bank's market position or from the amalgamation of foreign banks subsidiaries and branches operating in the same country as well as from mergers and acquisitions on the EU markets (see table 2). At the end of 2009 in the Czech Republic there were 39 banks, whereas 87% of their assets were controlled by foreign investors, in Hungary and Poland 67 (61%) and 35 (70%) respectively. In the Czech Republic and in Hungary the largest stake of banks' assets were in hands of Austrian (25% and 15% respectively) and Belgian investors (20% and 10%, correspondingly). In Poland, at the end of 2009 there were 41 banks controlled by foreign investors with the largest share held by Italian, followed by German, Dutch and US. In contrast to the Czech Republic and Hungary, all 10 largest banks in Poland are listed on stock exchange. All of them possess a blockholder that exercises of voting rights from at least 60% of shares. More than half of listed banks shows that the stake in hands of controlling investor is not smaller than 70% of votes at the general meeting. The regulator usually allows to exercise their voting rights from no more than 75% of shares.

As a consequence of consolidation process the level of concentration (measured by the share of the five largest banks in total banking sector assets – CR5) increased and as of the end of 2009 equaled slightly above 60% in the Czech Republic, 60% in Hungary and almost 50% in Poland (Raiffeisen Research, 2010). The level of concentration of the Polish banking sector is slightly over the average EU level and one of the lowest among countries of CEE.

Table 2. Selected features of banking sector in the Czech Republic, Hungary and Poland as of 2009.

Country	Czech Republic	Hungary	Poland
The number of banks	39	35	67
Banks' assets controlled by foreign investors	87.%	70%	61%
Independent supervision authority over financial institutions	No	Yes	Yes
Deposit insurance system	Yes	Yes	Yes
Savings limit/Coverage under deposit insurance system before the crisis	25 000 EUR/ 90%	1-6 million HUF/90%	up to 1000 EUR/100% 1000-22 500 EUR/ 90%.
Savings limit/Coverage under deposit insurance system	50 000 EUR/100%	50 000 EUR/100%	50 000 EUR/100%

Source: Own analysis based on data from Schich S., Financial Crisis: Deposit Insurance and Related Financial Safety Net Aspects, OECD, 2008 and CEE Banking Sector Report, Raiffeisen Research, 2010.

The strong position of controlling blockholders, that concern themselves with the highest possible return on their equity, could threaten the interests of well recognized banks' stakeholder – depositors. The latter cares about the rest of bank's liabilities (debt). Therefore, solid banks' supervision authority was highly required to monitor and constrain the management activities effectively controlled by blockholder. In order to protect the interests of depositors prudential regulation of banking activities and deposit insurance modeled on the European Union directives and recommendations worked out by the Basel Committee on Banking Supervision were gradually introduced starting from early 90s. With this regard the significant role was performed by the banking supervision authority that quickly caught up to the Western standards.

The banking supervision authority, according to the Basel Committee on Banking Supervision as of 1997, is responsible for ensuring that foreign subsidiaries are well supervised within its borders. The crisis did not bring new solutions with this respect despite various suggestions (The de Larosière Group Report, 2009) aiming at strengthening the European system of financial supervision. The most recent proposal delivered by the European Commission (2010a) have not discussed the problem of corporate governance in foreign bank subsidiaries.

The role of the banking supervision is not only protecting depositors by ensuring security of funds accumulated on bank accounts, but also assuring proper functioning of this market, its stability, security and transparency. With this regard regulator competes with the blockholder for control over a bank. The global financial groups are interested in maximizing the value of the whole group, which potentially, in particular during financial crisis, may be conflicting with measures adopted by other banks' stakeholders – government and supervisors – towards greater stability of banking sector. Actions taken by supervision authority is mainly related to risk management and compliance of banking operations with provisions of the Banking Law, by-laws and the decision on the issue of license for the establishment of a bank.

In the Czech Republic central bank serves as a supervisory authority of the financial market. The Czech National Bank oversees the banking sector, the capital market, the insurance industry, pension funds, credit unions, bureaux-de-change and payment system institutions. Hungarian and Polish banking supervision is a part of wider authority that perform its supervisory functions over financial institutions. It was required since global financial groups became very significant players in banking sector in those countries and they have highly contributed in spread in cross-sector financial products.

In contrast to the Czech Republic, in Hungary and in Poland there is integrated independent authority that is responsible for the authorization and supervision of the financial institutions. The Hungarian Financial Supervisory Authority (HFSA) was established in 2000 as governmental body and in 2010 changed to a self-regulatory publicly financed body operated and managed independently.

In Poland, from 1989 till 1997 banking supervision was a part of the central bank. In 1997 supervision of banking activities was performed by an independent Commission for Banking Supervision (CBS). Decisions and tasks specified by the CBS were carried out and coordinated by its executive body - the General Inspectorate of Banking Supervision still located within the National Bank of Poland. In 2008 supervision of the financial market merged with financial supervision creating the Polish Financial Supervision Authority (PFSA). Responsibilities of the PFSA are wide-ranging including undertaking measures aimed at ensuring reliable operations of the financial markets in order to maintain its stability, safety and transparency. PFSA also deals with new issues such as: clients' complaints, financial education, preparing codes of best practice and monitoring compliance to it. All of them were of low or non importance before.

Among the analyzed countries the supervision authority in Poland seemed to be the most extensive and prudent both before and during the crisis. Preceding the crisis a few pre-emptive proceedings were taken regarding liquidity risk following Basell II and the CAD. In 2006 PFSA issued recommendation S related to the best practice in mortgage credit exposure that increased the cost of mortgage credit granted in foreign currency. In 2007, it passed the resolution regarding liquidity risk. All regulators' activities contributed to the fact that banks in Poland are not concerned with liquidity crisis. Also, in the Czech Republic liquidity has not caused has any problems so far.

During the crisis supervisory authority required collecting data of wider range. Banks became obliged to inform immediately about transactions in terms of decreasing of quick assets and internal limits against domestic or foreign institutions. Those actions concentrated on liquidity risk limitation and currency risk limitation. Furthermore, in Poland supervisory authority issued a recommendation encouraging banks to allocate total profit to bank's equity, without paying dividends in order to boost own capital. It was not obligatory, however most banks in Poland implemented it.

In all analyzed countries there is another entity, that in addition to the central bank and supervisory authority, is a part of the security net for deposits safety - deposit insurance fund, which performs two functions. First, in case of bank bankruptcy it repays deposits gathered by one individual up to guaranteed amount. Second, it provides banks threatened by bankruptcy with financial aids. All banks and branch offices of foreign banks are obliged to participate in the system and contribute to it. In Czech Republic, there is Deposit Insurance Fund that was established in 1994. Similar entity functions in Hungary - National Deposit Insurance Fund, established in 1993 and in Poland - Bank Guarantee Fund, established in 1994. According to the recent law amendments with regard to law adjustment to EU Directive 2009/14/EC the guarantee limits for deposit up to 50,000 euro are fully covered. The increase in compensation amount as well as shorter time for deposit insurance payments were necessary to boost depositors' confidence in the banking system.

4. Methodology

This section presents a description of the research design, sample and data collection procedures. In order to generate credible data of appropriate range a mixed approach was used: a questionnaire survey and gathering certain information on supervisory board composition and structure from firms' financial statements, their reports on corporate governance and supervisory boards' reports on their activities.

The sample of interest for the study is composed of all listed banks in the three selected countries of CEE: the Czech Republic, Hungary and Poland. At the end of 2009 there were two banks listed on the Prague Stock Exchange, however one was cross-listed, two banks listed on Budapest Stock Exchange and finally 14 banks listed on Warsaw Stock Exchange.

Due to very low free-float (less than 1% of all shares) and three banks were excluded from the survey as a problem of corporate governance is not relevant to them. Their combined share in capitalization of the banking sector on the Warsaw Stock Exchange was below 0.01%. Shortly, one of them was withdrawn from the stock exchange.

The research questionnaire was sent to the listed banks from the three countries of CEE. It consisted of 23 open questions divided into three sections: composition and practices of supervisory board, composition and practices of supervisory board committees and policy's disclosure, in particular with regard to executive compensation. There was additional section, comprising of 7 questions, that referred to the key challenges in the area of corporate governance of banks and anti-crisis measures related to corporate governance of banks undertaken during 2007-2009. The questionnaire was addresses to the president of the board and submitted to the board support departments in those banks where it existed otherwise to the investor relations departments. After several days the mail was followed up with an telephone request.

We received responses from nine out of eleven banks listed on Polish stock exchange. Five banks answer all questions and four passed over questions about key challenges in the area of corporate governance of banks and anti-crisis measures related to corporate governance of banks undertaken during 2007-2009.

5. Supervisory board composition and structure

In three selected countries the two-tier corporate governance system prevails. There are two distinct entities: board of directors in Czech and in Hungary or management board in Poland and supervisory board. The latter is legally obliged to oversee constantly a company. Supervisory board members are appointed by a resolution of the general meeting. The management board is in charge of day to day company's business, making strategic and operational decisions. Its members are appointed by the general meeting in Czech and Hungary and by the supervisory board in Poland.

Table 3. Selected features of corporate governance system in Czech Republic, Hungary and Poland.

Country	Czech Republic	Hungary	Poland
Corporate governance system	Compulsory two tier-system (board of directors and supervisory board)	Optional*(board of directors and supervisory board or council of directors)	Compulsory two tier-system (management board and supervisory board)**
Corporate Governance Code	Voluntary	Comply or explain	Comply or explain
Board Independence	Criteria described in CG Code, does not set minimum number of independent board members	Criteria not described, referred to the EC recommendation as of 15 February 2005, does not set minimum number of	Criteria not described, referred to the EC recommendation as of 15 February 2005, at least two

		independent board members	independent board member
Audit Committee	mandatory for public-interest entities	mandatory for public-interest entities	mandatory for public-interest entities
Compensation Committee	Recommended by the CG Code with majority participation of independent board members	Set up by the general meeting and consists of members of the Managing Body, the Supervisory Board and the executive management, although the majority should be independent board members.	Not directly recommended
Gender Diversity	Not mentioned	Not mentioned	CG code recommends balanced proportion of women and men in management and supervisory board.

(*) Option to choose one-tier/two-tier system.
(**)The European company, that is very rare, may choose between one-tier/two-tier systems.

Source: Own based on data from EBRD, Corporate Governance Codes.

Strengthening of the oversight role of supervisory board is a high priority of corporate governance in CEE. The corporate governance codes make a pressure on its members to meet the following requirements: independent, highly competent and ability to make self-assessment in order to increase the minority shareholder rights' protection. Independent board members tend to be seen as neutral in company evaluation, more inclined toward overseeing management board in the interests of the company not in the interests of a certain investor, capable to take impartial position during board discussions and more apt to improve supervisory board's proceedings.

The analysis shows that the average size of supervisory board was almost 9 members (see table 4) . It largely goes beyond local standards for Poland as the average size of listed companies is 4-5 members (Deloitte&Touche, 2007). 44% of supervisory board members held degree in economics, 17% in law, 7,5% in engineering, 16% graduated from other studies and in case of the rest of 16% the education details were not available. Only 8% of supervisory board members were women. 7 out of 14 banks had women board participation. In case of 6 banks it was just one board member. Only one woman held function of chairwoman.

Table 4. Selected characteristics of banks and their supervisory boards.

Bank	No of SB Members	No of Independent SB Members	Chairman of SB is independent	Assets Size (000 euro as of end 2008)	% of votes exercised by the largest shareholder as of end 2008	Location	Origin of stategic investor	Private or previously state-owned (PSO)
PKOBP	7	6	Yes	32 541 000	41%	PL	PL	state-owned
Pekao	9	6	Yes	31 622 271	59%	PL	I	PSO
BRE	10	5	Yes	19 798 006	70%	PL	D	PSO
INGBSK	8	4	Yes	16 683 557	75%	PL	NL	PSO
BZWBK	8	5	Yes	13 862 064	70.5%	PL	IR	PSO
Millenium	11	5	Yes	11 292 043	65.5%	PL	PO	PSO
Handlowy (Citi)	12	6	Yes	10 198 050	75%	PL	US	PSO
Kredyt	9	5	Yes	9 282 589	75% (but 82,5% shares)	PL	B	PSO
BPH	13	4	Yes	3 793 027	66%	PL	US	PSO
BOS	8	5	Yes	2 679 888	77%	PL	PL	state-owned
Nobel Bank	5	0	No	1 342 852	74%	PL	PL	private
KB	9	2	No	25 952 709	60.35%	CZ	F	PSO
OTP	5	2	Yes	35 280 000	dispersed	HU	HU	PSO
FHB	6	4	Yes	824978000(*)	dispersed	HU	HU	PSO
Mean	8,6	4,2						
Median	8,5	5						

Almost all banks listed in Poland exceeded the criteria set in the corporate governance code as they had more than two independent board members (see tab. 4). Only one bank informed that it did not comply to the rule by having none independent board member. 6 out of 11 listed banks notified that at least half of the board consisted of independent board members. In Hungary and in the Czech Republic the corporate governance codes do not specify the number of independent board members. It should enable to make independent judgments. In Hungarian banks at least one third of supervisory board members were independent. The Czech bank lagged behind given that 20% of mandates were held by independent board members. On average, there were four independent board members, although the median value was slightly higher five. Most of the independent board members did not have industry experience. 12 out of 14 banks reported that the chairman of supervisory board was independent. In both countries there was employee representatives' participation in the supervisory board. Furthermore, none of the banks used fit-and-proper director test to investigate whether the person with board mandate has necessary competences, skills, experience as well as ethical attitude to fulfil tasks assigned to them.

Supervisory board gatherings were organized at least once per quarter. The average number of sessions reached 7 in 2007, 6.5 and 7 for 2008 and 2009 respectively (median for 2007, 2008 and 2009 equalled 7.5). Only 2 Polish banks pointed out that the supervisory board met nine times every year during 2007-2009, which is very close to the average number of meetings for a European company (9,6) annually (Heidrick&Struggles, 2009). Any trend of increasing number of supervisory board meetings was not observed during financial crisis 2008-2009. They were organized the most frequently in banks with the significant stake controlled by the state. It may be an evidence that those supervisory boards had stronger position. It was striking that the average gathering length in the Czech Republic was 1,5 hour. In Poland, 73% of listed companies indicated that the supervisory board meetings lasted on average 2-4 hours (Deloitte&Touche, 2007).

Enhancing supervisory board's position can be achieved through the operation of its committees. The Czech corporate governance code specifies that company should establish audit, remuneration and nomination committees. The Hungarian and Polish codes leave more flexibility. The former promotes audit, remuneration and nomination committees, but indicates that supervisory board can ensure the execution of previously specified tasks through other committees. The Polish code does not limit the type and number of supervisory board committees.

Almost all banks (except from one) reported about an audit committee. In all three countries according to the EU Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, all public interest companies should established audit committee with supervisory board. There should be at least three members, among whom there should be one that meets independence criteria and has competence in accounting and/or auditing. However, in Poland a company may try to evade the obligation. In companies, where supervisory board consists of minimum number of members required by law (five), the tasks of the audit committee may be performed by the whole supervisory board. This solutions is heavily used by non financial companies.

An average size of the audit committee consisted of almost four members (median slightly lower 3.5), among whom two possessed status of independent board member (see table 5). In 12 out of 14 banks at least one third of the audit committee was formed by independent board members. 9 banks informed that the chairman of the committee was independent board member, but only in three cases he was qualified in accounting or auditing. Except from chairman no other independent audit committee member had competence in accounting or auditing. In consequences, 9 banks had no audit committee member with significant financial expertise proven by title of certified accountant.

Table 5. Selected characteristics of supervisory board committees.

Bank	No of AC Members	No of independent AC members	Chairman of AC is independent	Chairman of AC is qualified in accounting and/or auditing	No of AC independent members with competence in accounting or auditing	Risk Committee	Remuneration committee
PKOBP	3	3	Yes	Yes	0	No	No
Pekao	5	3	Yes	No	0	No	Yes
BRE	4	2	No	No	0	Yes	Yes
INGBSK	4	2	Yes	Yes	0	No	Yes
BZWBK	4	3	No	Yes	0	No	Yes
Millenium	4	2	Yes	No	0	No	Yes
Handlowy (Citi)	6	2	Yes	No	0	Yes	Yes
Kredyt	3	1	No	No	0	No	Yes
BPH	5	2	Yes	Yes	0	Yes	Yes
BOS	3	1	Yes	No	0	No	No
Nobel Bank	3	0	No	No	0	No	No
KB	3	1	No	No	0	No	Yes
OTP	3	2	Yes	No	0	No	Yes
FHB	4	4	Yes	No	0	No	Yes
Mean	**3,9**	**2**					
Median	**4**	**2**					

11 out of 14 banks, 10 Polish and 1 Hungarian, established an audit committee before 2008, when it was not legally binding, but aligned with the Corporate Governance Code. Most of the audit committees in Poland organized meetings on quarterly basis that is rather rare in comparison to an average European company that had audit committee meetings once per month on average (Heidrick&Struggles, 2009). The average number of audit committee meetings for Polish listed banks were four in 2007 whereas in 2008-2009 increased to five. 2 out of 11 banks reported on audit committee's gathering every second month. The Hungarian and the Czech banks organized the meetings less than once a quarter. In addition, they established the audit committee in 2009, when it was legally binding.

The main areas of audit committee activities are financial reporting and risk control. With regard to the latter the survey asked how the audit committee ensured effectiveness and independence of internal audit function. Only 4 banks indicated in the questionnaire that supervisory board, based on audit committee's opinion, accepted changes on the position of the head of internal audit department and other personal changes in the bank's unit, including decisions on the size of the employees' compensation and training programs. 7 banks answered that the head of internal audit department reported to the CEO and simultaneously to audit committee of the supervisory board.

The number of the supervisory board committees in banks was the highest in Poland. In fact, in Hungarian and Czech banks there were only two committees: audit and remuneration. In most of the banks remuneration committee was established after the crisis appeared in

2008. 7 out of 14 banks reported that at least one independent board member sat on the remuneration committee and 5 out of 7 informed that at least half of the committee was independent. The post crisis recommendations stressed its role in creating and implementing the general principle of compensation policy for executive board members (OECD, 2009). Just one bank can be considered as having the independent board member with relevant expertise and experience. The Czech and Hungarian banks did not provided information on the composition of the remuneration committee.

Only one bank disclose the compensation policy along with measures impacting the variable elements of the remuneration. In the questionnaire 2 other banks listed financial indicators, such as: revenue, ROAC, deposit or credit market share as well as the cost to revenue ratio, that determined the size of the executives' bonuses. The survey results show that very few banks in the CEE countries decided to change the executive remuneration during the crisis. 2 banks pointed out that bonuses for 2008 were not paid out or significantly decreased in order to avoid redundancies (malus). The supervisory board of third bank adopted resolutions on adjusting revenue by deducting all ad hoc transitions, which decreased the basis for bonus repayment.

Almost all banks disclosed executive remuneration of individual executives and non-executive board members. According to recent EU Commission post-crisis recommendations (2009/385/EC) and Directive 2010/76/EU – CRD III company should change the rules of determining variable elements of remuneration for members of the management board and disclose the policy, which will be costly regulatory initiative designed for large transnational corporations. Poland is the most advanced in terms of disclosure of remuneration of the management and supervisory board members. Since 2005, according to the Ministry of Finance's Directives on current and periodical information, listed companies must show all elements of remuneration paid out, due or potentially due, individually for all members of both corporate bodies. As far as the disclosure of the detailed remuneration policy is concerned the requirement is met by just one bank. In general, disclosure on corporate governance policies and practices in Poland and in Hungary is quite often dependent on the size of a bank. The larger bank, the more information is accessible. However, this relation is not observed in the Czech Republic, where listed banks do not have dedicated corporate governance section on their web pages.

The survey results reveal that most of the banks did not have risk committee. 3 banks notified about it and 2 out of 3 established risk committee as a post-crisis recommendation. 7 Polish banks indicated that Chief Risk Officer was appointed recently after the crisis appeared and he or she reported directly to the supervisory board or to its risk committee. 5 banks notified that there is one executive board member responsible for risk management who reported directly to the CEO. The executive is in charge of preparing all materials on risk management policy and proceedings for supervisory board meetings. Those banks stressed that reporting took place on quarterly basis, 2 other banks informed that they share the information more often at every supervisory board gathering.

Based on bank's individual needs banks in Poland established other types of supervisory board committees, among others strategy, investment, finance and IT modernization.

6. Conclusions

The research confirms that banks in CEE continue being role models for non-financial companies in implementing good standards of corporate governance. One hand to, this is due to the fact that most banks are foreign subsidiaries of large multinational financial groups that enforced adoption of a very broad set of laws and regulation exceeding local standards. On the other hand, dominance of foreign ownership in banking sector in the CEE countries induces regulator to act in very prudent way in order to protect the interests of depositors and maintain stability of financial system. The adjustment to the strict regulation is quite costly for banks operating locally.

The findings reveal that bank's supervisory boards in the selected CEE countries during the financial crisis of 2008 met the high standards of corporate governance with regard to the number of independent members, appointing independent member on the position of the chairman and chairman of audit committees. The study shows that during the crisis banks in the CEE countries themselves strived for improving corporate governance practices and they made some effort to implement post-crisis recommendations related to establishing risk and remuneration committees and appointing Chief Risk Officer. Banks listed in the Czech Republic and Hungary lag behind those listed in Poland with respect of frequency of audit committee meetings and supervisory board's engagement in risk management.

Increasing number of board committees with larger number of seats for independent board, provided that they do not have majority votes, can be implemented fairly quickly and relatively inexpensively. However the factual improvement of corporate governance of banks depends on professional qualities of the independent board members, their level of engagement in committee activities as well as their ability and willingness to challenge the existing contractual arrangements, in particular those that undermine the position of minority shareholders or other stakeholders such as depositors. It seems that implementing high corporate governance standards with regard to board composition and its committees is just low hanging fruit and could not have significant impact on the potential unfavourable scenario, in which the controlling foreign investors would be improving their difficult financial situation at the cost of their subsidiaries based in Poland. Implementing regulation recommended by the international organization such as European Commission that are well suited for large widely held corporations will not improve corporate governance standards of banks in countries where their ownership structure is closely held.

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