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# МІЖНАРОДНА БАНКІВСЬКА КОНКУРЕНЦІЯ: ТЕОРІЯ І ПРАКТИКА

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# ЗМІСТ

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## RISK MANAGEMENT, CORPORATE GOVERNANCE AND INVESTMENT BANKING: THE ROLE OF CRO

After recent events of global financial crisis and further recession bank boards became more disturbed about the risk governance issues. The lesson was learned that timely risk oversight and measures to its minimization would lead to stability of a bank. That's why the foundation and ensuring of effective functioning of Risk Management Committee in bank is one of the primary goals in this context.

According to Basel Committee recommendations for enhancing corporate governance practice updated in 2010 Risk Management Committee in the lead with Chief Risk Officer (CRO) is responsible for organizing of risk management system, introduction of bank overall risk governance strategy and control of its adherence. These Principles also state that to achieve higher efficiency CRO as a senior executive should have independence.

Let's have a look on how it is realized in today's banks. First of all, some banks (especially in countries with weak or transforming banking systems) don't have special committee to deal with risks at corporate governance level. According to statistical data, in such cases risk governance is delivered to Audit Committee or CEO as one of numerous tasks.

Secondly, we must underline that in most of banks CRO is usually subordinate to CEO, in other cases – to other chief executive (e.g. CFO). To some extension it lengthens a period of reporting and, as a result, of decision-making. Such subordination models can also bring to information asymmetry and to some degree commit the principle of independence. According to recent corporate governance practice in banks CRO may also subordinate straightly to Board. This model of reporting may help to avoid drawbacks mentioned above and to enhance risk governance in the banking institution.

In the context of risk governance one must define obvious difference between its implementation in commercial and investment banks which is explained by the distinctions in their activity. Specific character of investment banking lies down in absence of cash deposits; in selling securities to entities or to the government; in matching sellers and buyers of securities; advising about mergers and acquisitions. The other peculiarity of investment banks is that it doesn't realize lending activities, so their risk tolerance level is higher versus commercial banks. Investment banks serve clients who already may have huge amounts of capital as a rule, while commercial banks (especially retail-oriented) may cater for consumer categories that need the seed capital or need to maintain routine necessities. That explains the total opposite interests among these types of banking.

Summarizing we must note that commercial and investing activity must be distinguished due to specificity of the last.

We must also underline that the problem of liquidity is urgent especially for investment banks. According to new Basel recommendations it is expected to form more reserve buffers to maintain banking activity: it is supposed to direct all retained profits to insure risks by force of risk-weighted asset generation. In this case the problems with liquidity may rise in investment banks due to absence of deposits and incomes from crediting. The effective risk governance may become the way of problem-solving. The idea of distinguishing commercial and investment banking has been suggested in Glass-Steagall Act (1933), Gramm-Leach-Bliley Act (1999), Vickers Report (2010), Volcker Rule (2012). The recommendation to separate high-risk (proprietary trading of securities and derivatives) and classical banking activities is also stated by the High-level Expert Group to reduce possible risks, both local and systemic.

The aim of the investigation is to define the role of CRO in corporate governance and to show the interrelation between the way of CRO subordination and performance of investment bank. As noticed above these problems are urgent nowadays, that totally explains the actuality of this research.

The most important outcome of our research is that investment banks which have special Risk Committee perform better after financial crisis than banks only with Audit Committee. With that the analysis of independence of Risk Management Committee shows that RMC with fewer requirements perform significantly worse than other investment banks in the sample. To sum up, investment banks with Chief Risk Officer (as separate position) got high level of SKPI, consequently, perform better.

Therefore, we can conclude that the RMC presence in general and the CRO in particular effect positively on the financial performance of investment banks.

The results of our paper can serve as a basis for further research; in consequence, we can get more fundamental findings, using another sample of investment banks.