Corporate Governance in Serbian Banks

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The question of corporate governance in banks was initiated again after the financial crisis in 2007 occurred. Some authors find that one cause could be found in an inadequate corporate governance. According to this, robust analyses are performed in order to find whethes and where the errors were made in corporate governance of banks and other financial institutions. The paper especially focuses upon the characteristics of the regulatory framework for the implementation of corporate governance in Serbian banks and point out the shortcomings and potential problems in that process.

1. Introduction

The banking industry has a specific function in maintaining the stability and integrity of the financial system on the world level. These are complex institutions that do business beyond the borders of one country and offer services that are far beyond the traditional commercial banking. Banks differ from non-financial institutions by the public funstion they perform and the position of institutions of trust they enjoy in the society.

The significance of corporate governance in financial institutions, and accordingly, in banking, has especially gained in importance upon the beginning of the financial crisis in 2007. Furthermore, ceratin authors go as far as to maintain that the cause of the crisis is an inadequate corporate governance. A large number of principles and regulations in the field of corporate governance has been adopted in recent years, nevertheless, their implementation could not make the corporate governance officials prevent the crisis [23]. When a number of banks and other financial institutions suffer problems or go out of business during the crisis, then the question of whether the corporate governance in these institutions was adequate is fully justified.

Analysts and regulators are still conducting in-depth analyses of this issue to find out whether and where errors were made in the corporate governance domain in banks and other financial institutions. It is very important to pursue the analysis into how the corporate governance problems can be solved in order that some future financial crises should be prevented or mitigated. Similarly, new directions in research should be sought for as well as possible reforms of corporate governance in the post-crisis period.

An adequate corporate governance is undoubtedly of paramount importance for both companies and banks. Corporate governance entails a set of relations between the company management, the board of managers, the shareholders and other stakeholders [20]. Observing the the principles of adequate corporate governance significantly contributes to the increase in the investors' trust and consequently to their decisions as to investments.

Corporate governance in banks, according to the general principles of corporate governance means the manner in which banking business is governed and controled. It includes establishing a respective set of goals to be achieved, however, also the methods to achieve these goals and the methods of monitoring the extent to which they are achieved. Accordingly, risk management, as an integral part of banking business and bank governance is an important component of corporate governance. Every important participant in corporate governance of the bank is responsible for a certain domain of risk management. The key participants of corporate governance in banks are shareholders, executive board, board of managing directors, internal and external audit, regulators, broad public, etc. [8].

Corporate governance in banks is especially important for developing countries such as Serbia. It helps achieve the stability of the banking system and also restore and retain the trust of depositors and other stakeholders.

In the following chapter, upon a survey of literature, specific features of corporate governance are highlighted both from the point of view of regulatory institutions and in the light of financial crisis and its effects on the problem. Then follows the analysis of corporate governance in the Serbian banks and the key elements and problems in the process are discussed.

2. Literature survey

The quality of corporate governance on developing markets have been a topic of a research conducted by Ananchotikul and Eichengreen (2009). The research has shown that there has been a significant progress in a large number of countries in the last decade or so. The improvements are most often recorded in the countries whose government is steady, followed by the countries in which foreign investors were ready to lobby in favour of reforms and where other countries in the region conducted similar reforms and influenced one another. The research has also shown that the development of corporate governance has brought considerable benefit in terms of the depth and solvency of the financial market.

The problem of corporate governance is reflected in the agency problem, that is, the principle – agent problem between shareholders and managers. Levin (2003) believes that the agency problem is more evident in banks in comparison with the non-financial sector, due to information assymetry being higher in the banking sector. The agency problem itself differs in dependence of the ownership structure of the bank. In case of dispersive ownership, the agency problem arises between the management and the minority shareholders, whereas in case of concentrated ownership it is present between the majority and the minority shareholders. According to Köhler (2010), such a situation implies that the regulations related to corporate governance should be adjusted to the specific ownership structure of the bank, rather than to the harmonization of national regulations.

In their work, Sullivan and Spong (2007) analyse the extent to which risk taking in banking is dependant of the bank management and the ownership structure, as well as the manager's and bank owner's personal traits. They primarily explored the effect that the ownership interests of the manager, the control by the majority shareholders and the extent to which managers and majority owners have a concentrated ownership in the bank affect the extent of the bank's risky behaviour. The conclusion they have drawn is that when the effects of the manager or owner is highly concentrated in a certain bank, variations in returns are smaller. Especially, the banks in which the key players have a significant portion of their money under risk, do business in a safe and stable manner.

The ownership problem in terms of corporate governance in banks is interesting for a large number of researchers. Much research has been conducted as to the manner in which the type of ownership affects corporate governance, risk management and bank's performance and whether the ownership structure is an essential determinant of corporate governance (Tandelilin et al., 2007). The analyses have revealed that the ownership structure is not essentially important for corporate governance. In order that they should implement the corporate governance principles adequately, bank managers should be cautious about the relationships between corporate governance, risk management and bank performance [4]. The research conducted by the above mentioned authors has shown that the banks that pursue the practice of good corporate governance have a better opportunity to improve performance and reduce risk.

As regards the ownership structure in banks, Caprio et al. (2007) conducted a research into the ownership of 244 banks in 44 countries. With the exception of a number of countries in which the laws on shareholder protection are extremely strict, banks generally do not have a wide spread ownership. Out of 44 countries in the sample, 21 countries do not have a wide spread ownership in banks among ten largest banks. Banks are most frequently family or state owned. The research conducted by these authors has shown that the ownership structure is an important mechanism in bank management.

In their work, Staikouras et al. (2007) explored the relationship between two vital factors of corporate governance: the size of the board of managing directors and the relations between the independent members of the board, on one hand, and the bank performance, on the other. The reesarch was conducted on a sample of 58 large European banks in the 2002 – 2004 period. The findings have proved that the profitability of the banks is negatively correlated with the size of the boards of directors of the banks, while the composition of the board is in a majority of cases of no importance for the bank profitbility.

Talking about boards of managing directors, there is a difference in the manner of work and in the role of the single-stage and the two-stage boards of directors, however, no significant advantage of either model has so far been identified (Nikolić and Erić, 2011).

The research carried out by Beltratti and Stultz (2009) analyses the effect on the bank performance as well as the reasons certain banks fared better in such conditions. Although the bank performance in the July 2007 – December 2008 period was poorest since the times of the Great Depression, there were significant differences in the return on shares of large banks in that period. The analysis has shown that the banks whose board of directors had closer relations with shareholders had poor performance in the period of crisis. The banks that were doing business in the countries where requirements concerning capital were stricter and where the rgulator was more autonomous in his work had better performance. Besides, large banks with more equity capital and more largely financed out of the deposits in 2006, earned significantly higher returns during the crisis.

3. Corporate governance in banking

The process of corporate governance in banks has a complex framework. Due to functional differences between banks and other corporations, banks are subject to a stricter prudential regulation of capital and risk. These differences are further reflected upon the corporate governance practice in banks [13].

From the banking industry point of view, one part of corporate governance includes, among other things, the method in which the board of directors and the upper-level management manage the banking business. This refers to goal setting and strategy formulation for the banks to achieve these goals, defining the tolerance to risk for the bank, managing the bank on a daily basis, protection of depositors' interests, meeting their obligations to shareholders, however, paying attention to the interests of other stakeholders in the banks, too. All corporate activities have to be in accord with a safe and steady manner in which the bank operates, which is in harmony with the prudential and regulatory framework.

Due to the importance corporate governance has in achieving the banking goals and risk management in banks, the Basel Committe on Banking Supervision, with the Bank for International Settlements, adopted in 1999 the Principles for Enhancing Corporate Governance in banking organizations. The document was additionally modified in 2006, and also includes the principles of corporate governance adopted by the Organization for Economic Co-operation and Development in 2004. Finally, under the impact of the crisis, these recommendations were modified once again in 2010, in order to promote a quality corporate governance in banks. The document adopted by the Basel Committee, therefore, is void and does not pretend to be a regulatory framework, but presents guidelines and recommendations.

The Basel Committee Recommendations highlight the importance of the role of the board of directors, especially the role of autonomous directors and the upper-level management in banks. In addition, special attention is paid to the role of internal and external audit, to the function of internal control, to transparency in management, to the role of the supervisor in promoting and assessment of the quality of corporate management [2]. Important elements of an adequate corporate governance in banks are the following [8]:

- Well established corporate strategy;
- Clear delegation of responsibilities, decision making and authority appropriate to the given level of business risk in the bank;
- Powerful function of financial risk management;
- Respect for certain corporate values, rules of business doing and behaviour code;
- Introduction of financial and managerial incentives to the board of managing directors and to employees, in the form of compensation, promotion and penalties;
- Transparency and an adequate information flow both internally and towards broader public.

In order that corporate strategy be well established in the today's complex environment, the management is required to have a developed system of strategically oriented management accounting as support to strategic planning of bank growth and development, i.e., to strategic decision making. The management accounting system in a competitive environment has to support the bank strategy, which is not possible if it does not include the elements of strategically oriented management accounting. The stress is on a good relationship between the management accounting and the bank strategy [9].

The differences among banks as financial institutions and corporations certainly have a significant effect upon the differences in view of corporate governance among them. These differences primarilly refer to the following aspects of business [13]:

- Banks have the function of creating solvency that results from liquidity gap between the two sides of the bank balance sheet. The essence of banking is that banks willingly accept the gap that exists in the time structure between their assets and liabilities. As a consequence, the very existence of banks essentially depends on an immediate and constant access to assets, whether these are deposits, short-term financing on inter-bank market, financing on the security market, or financing by the central bank as the ultimate source of finances. It is this urgent need of banks for solvency that was clearly visible in the period of financial crisis when all possible sources of finances dried up at the same time and for all banks, so Central banks had to intervene to prevent the collapse of the banking system in those countries. Hence an important lesson the regulators had to learn from the financial crisis is to require a stricter prudential regulation related to solvency risk in banks and management of that risk;
- Banks are institutions with a high level of leverage, that is, their capital structure differs significantly from that of corporations, since they are largely financed from debts;

- The bank balance sheets themselves are far less explicit and clear at first sight in comparison with the balance sheets of the companies in other industries;
- Banks are closely related one to another, due to the fact that they do a large portion of their business with other banks. Hence their direct rivals are simultaneously their important partners in business. The connections among banks are primarily seen in the interbank money market, over-the-counter market of derivatives and in the foreign exchange market. Due to such a situation, the banking sector is highly subject to the domino effect, since problems in one bank are promptly spread to other banks in the system, and even broader;
- Due to the liquidity gap between assets and liabilities, banks may be endangered by the withdrawal of creditors, regardless of whether they are depositors, investors into credit securities, or other banks. In case large sums are withdrawn, the liquid assets of the bank can very fast be drained. Even a solvent bank can go out of business in case of collective, panicky withdrawal of its creditors;
- Due to all above listed, banks are, much more than other corporations, controlled and regulated institutions. Regulation primarily refers to the amount of risk banks can take, but also to the bank's exposure to one entity or a group of related entities, etc.

The crisis underlined the importance of a strong corporate governance in banks. It is in this sense that the chairman of the Basel Committee and the president of the Netherlands bank Not Wellink commented: "A careful implementation of corporate governance by banks, together with a strict control and monitoring by the governor can ensure the safety and quality of banks as well as the stability of the financial system."

The Basel Committee on Banking Supervision stated certain problems that arose in the period of the beginning of the financial crisis and adopted the principle for enhancing corporate governance in banks. The principles of this new, improved corporate governance, fourteen in total, refer primarily to the role of the board of managing directors, the qualifications of the members and the composition of the board of directors, the importance of the independent members of the board, the importance of an adequate risk management, the compensation system in the bank, etc. [3].

The role of the board of directors is essential in view of the overall banking business, risk management, overall organization and bank management. The board of directors adopts and monitors the risk management strategy taking into account the long-term interest and the safety of the bank. Furthermore, it is in charge of the implementation of the corporate governance principle in banks, as well as of corporate values and rules of behaviour in the institutions. In addition, the responsibility of the board of managing directors is to supervise the work of the upper-level management in the bank and coordinate their work with the general strategy of business doing. In performing these duties, the board of managing direcors has to take care about the interests of shareholders, depositors and other important stakeholders in the bank.

As to the qualifications of the board of managing directors members, they must have an adequate knowledge and experience relevant for the bank's business activities. The board of managing directors has to clearly understand the role it plays in the corporate governance of the bank. In addition, the members of the board must have certain competencies and personal qualities required for the office they hold. The board of managers also has to define the corporate governance practice for their own work and take care that these principles are observed, and, if necessary, improved. Furthermore, the practice of an adequate corporate governance means that the bord of managing directors also includes independent candidates that have a required knowledge, qualifications and reputation to perform the defined duties, but who will also devote their time and make efforts towards accomplishing their tasks.

The practice of an adequate corporate governance in banks means that the identification, control and risk management are performed permanently, both on the level of the bank and on the level of an individual business unit. The bank should have an independent risk management fuction (in the person of the Chief Risk Officer, etc.) with enough authority, autonomy, resources and access to the board of managing directors. The risk management unit and internal control have to be informed at all times about the change in the risk profile of the bank, but also with the novel developments in the field of external risk sources.

An efficient risk management requires a powerful internal communication throughout the bank and through reporting to the board of directors and the upper-level management.

The last, but not the laest item of corporate governance refers to the system and structure of compensations, and especially coordination of compensations to those working on the risks taken. The principles of corporate governance adopted by the Basel Committee refer to the document adopted by the Financial Stability Forum, " Principles of good compensation practice" as regards recommendations for defining an adequate compensation system in banks [7]. The basic idea included in these principles is to create a basis for an effective compensation management, and that these are harmonized with the risks taken, that an effective control is performed by the supervisor and that stakeholders themselves participate in compensation systems. The compensation practice in large financial organizations is believed to have significantly contributed to the 2007 crisis. Namely, the high short-term profits resulted in ample bonuses to the employees, without any attention being paid to the long-term risks that emerged. The ides of the adopted principles is to reduce incentives for taking high risks that may result from compensation schemes. Insufficient attention paid in the past period to the risks taken used to result in exceptionally high bonuses in financial industry, and the boards of managing directors failed to identify the link between compensation schemes and risk management in financial institutions [7]. The listed principles say that compensation has to be harmonized with all types of risk taken, that the board of managing directors has to actively monitor the creation and functioning of the compensation systems, to control and harmonize them. Compensation for each employee in the firm has to be in harmony with the risk this employee takes on behalf of the institution.

National governors include the Basel principles of corporate governance into the legislation and other regulatory acts in order that banks have a powerful system of corporate governance that would ensure and maintain trust of clients in banking institutions. Corporate governance is important for the banking system operations itself, but also for the economy as a whole. The regulators should evaluate corporate governance in the banks on a regular basis.

The financial crisis that began in 2007 also brought into light the problems in corporate governance in banks. The new standard of capital adequacy, defined in the Basel III standards, requires considerably stricter rules of bank regulation, with an aim to improve the bank capability of resistance to the future financial crises. One of the objectives of the measures stipulated in the Basel III standards refers to the very improvement of corporate governance in banks.

4. Characteristics of the banking sector in Serbia

At the end of the second quarter of 2011, the banking sector in Serbia includes 33 banks, however, it is expected that the number will be reduced by one bank after the merging process of two banks has been completed. Despite the tendency of reducing the number of employees in the banking sector of Serbia, this sector has the largest number of employees in the financial mediation industry, 30,000 people.

The ownership structure of the banks in Serbia is such that 21 benks are in the ownership of foreign entities, while 12 banks are owned by national entities. The foreign entities – owners of the banks come from 11 different countries (Austria, Greece, France, Italy, Slovenia, Belgium, Russia, the USA, Cyprus, Germany, and Hungary). Out of the banks owned by national entities, 8 are owned by the state as a majority owner or the largest individual shareholder, while 4 banks are owned by national private persons. 76% of profits of the Serbian banking sector is in the banks owned by foreign shareholders, as well as 73% of total assets and 71% of total capital and the number of employees.

The net assets of the banks at the end of the second quarter of 2011 amounts to RSD 2,476 billion or around € 24 billion, while the total capital of the banking sector of Serbia for the same period is RSD 520 billion or slightly more than € 5 billion [6]. A majority of the most important business categories such as deposits, credits, capital, total assets, earnings, etc. belong to a group of about ten largest banks, while the other, small banks have a modest share in the mentioned categories.

Serbian economy is rather bankocentric, due to companies being generally financed from banking loans. This fact is clearly evident from the fact that the share of banks in the overall balance sheet sum of the financial sector of Serbia amounts to around 91.8%, the share of financial leasing creditors amounts to 3.6%, the pension funds have a share of 0.04% (data comprised from [11] and [15]).

The most important item in the structure of assets in the banks are granted loans on the level of 63.8% of total assets for the entire banking sector and amount to RSD 1,505 or approximately € 15 billion. Out of the overall granted credits, 55% are loans granted to economic entities, whereas 33% are credits granted to citizens. The share of placements in the securities on the level of the entire banking system is slightly less than 7% of total assets [16]. As to the currency structure of assets, it is predominantly in foreign currency – 63%, of which 84% is in euros, 8% in Swiss francs, and 8% in other currency. As regards the time structure of assets of the Serbian banking sector, it is mainly short-term, the prevailing being the demand deposits, 33% of the total assets. The assets with the time of one year have a share of 21%, and the share of the assets with the time of over one year amounts to 45%. Out of the total amount of loans granted, 55% are those granted to industrial companies, while retail credits amount to 30% of total credits. The problem bearing credits for the second quarter of 2011 amount to 18.6% of the total credit sum and are slightly rising compared to previous periods [16].

On the other hand, the total capital makes 21% of total assets. The indicator of adequacy of capital of the banking sector of Serbia at the end of the second quarter of 2011is 19.7%. In Serbia, this indicator is set to a higher level by the governor, in comparison with the Basel 8% and amounts to minimum 12%. In the time structure of liabilities, the sources of assets with the maturity longer than one year make 39% of total liabilities. Liabilities are also predominantly in the foreign currency, 63%. Out of total deposits, 56% come from retail sources, followed by the deposits of companies, 24% [16].

In the first six months of 2011, the banking sector in Serbia was profitable, so the earnings before taxes amounted to RSD 17.8 billion or € 176 million. Over 70% of the Serbian banking sector recorded business profits, which means that 9 banks out of the total number in Serbia recorded losses. The returns on assets in 2010 for the entire banking sector of Serbia amounted to 1.1%, with returns on capital amounting to 5.4%. In the second quarter of 2011, the situation improved, so the returns on assets for the Serbian banking sector are 1.4%, while returns on capital amount to 7% [16].

5. Corporate governance in banks in Serbia

As regards strict regulations, both national and the recommendations and guidelines of the international institutions, it is to be expected that the corporate governance in banks in Serbia is on a higher level than corporate governance in Serbian companies. One reason may be in that the majority of the banking sector in Serbia, 63%, is in the ownership of foreign entities that predominantly come from developed West European countries. Corporate governance in these countries appears to be on a higher level in comparison with Serbia, hence the Serbian banking sector profitted in this part as foreign shareholders brought the principles of corporate governance with them.

For a share in the capital of Serbian banks larger than 5%, the approval of the National Bank of Serbia is required. In view of this criterion, with the exception of one bank, all the banks in Serbia have a maximum of three shareholders with the ownership share higher that 5% each. Ten banks in Serbia, or 30%, are owned by one foreign owner, all the others have minority shareholders. Out of the total number of banks, 16, or 49%, have majority shareholders with over 50% share in the capital, six banks have shareholders with less than 50% of ownership share, while one bank has no shareholders with a share larger than 5%. Almost one half of the banks in Serbia have up to three shareholders in total. In banks owned by national legal or physical entities the strudture is more indented compared to the banks in foreign ownership. The top ten largest banks on the basis of the amount of assets are owned by foreign shareholders, with the exception of one among them that is a bank with a national owner, concretely in a majority ownership of the state.

What is especially important when corporate governance in banking is taken into consideration is the regulation that often includes certain elements that contribute to an adequate corporate governance. Since banks are private institutions with a public purpose, they are paid special attention as regards regulations.

The regulatory framework for the banks in Serbia is the Law on Banks and Banking adopted in 2005 and amended in 2010. This Law is harmonized with the European Union regulations as well as with the Basel standards. In addition to this basic law, the National Bank of Serbia, as a regualtor and supervisor of the banking sector in Serbia, adopted a number of regulations that set the basis for an adequate management of banks, as well as for an easier control by the supervisor. All the regulations concerning the banking sector in Serbia include the fundamentals of good corporate governance in banks, part of the Recommendations of the Basel Committee for enhancing governance and also of the Basel standards. Some specific features of corporative govenance of banks in Serbia deserve to be paid more attention to.

According to the provisions of the Law, banks in Serbia are established as public liability companies by either national or foreign legal or physical entities. In the establishment process, the National Bank of Serbia has to be submitted the data on the founders of the bank, the amounts of their deposits in the bank and the number, type and nominal amount of shares acquired, and also on all the persons that will have their shares in the bank and on the basis for these shares, as well as the names of the proposed candidates for the board of managing directors and the executive board of the bank, data on their qualifications, experience and business reputation. In case the qualifications or experience of a proposed member of the board of directors or the executive board is not satisfactory, or in case his reputation does not satisfy the requirements, or in case a person to acquire a share in the bank does not satisfy the conditions for that acquisition, the National Bank of Serbia may reject the claim for setting up the bank. Regulations, therefore, prevent the moral hazard and from the very beginning give opportunity to an adequate corporate governance in banks. Besides, the situation is the same in case the proposed programme of activities of the bank, the business policy plan, the risk management procedures and internal control procedures are inadequate [25].

The Law on banks and banking clearly defines the bank organization as well as the method of its governance. What can be a potential problem or a flaw of this law is that the law provides that shareholders with 1% or more voting shares, shall not be prevented from exercising their right to direct voting. The question is what happens with shareholders whose share in the ownership is below one percent – wherther it means that they do not have equal rights, since the law provides that they can be prevented from exercising their right to vote.

The law stipulates that the management bodies in the bank are the board of managing directors and the executive board of the bank. It is their obligation to undertake any actions necessary to prevent illegal or inappropriate actions or influences that are either harmful or are not in the best interests of the bank and its shareholders and performed by persons whose share in the bank is considerable or is even a control share. The law further clearly defines the composition as well as the criteria of appointing and the scope of activities of both the board of managing directors and the executive board. According to the law, the Board of managing directors has no fewer than five members, including the president of the bank. The National Bank of Serbia provides the criteria/terms and the qualifications a person has to meet to be elected a member of the board. In any case, at least three members of the board of managing directors are required to have an adequate experience in the financial area. The law stipulates that at least one third of the members of the board of managing directors of the bank have to be persons independent from the bank, namely, persons with neither direct nor indirect ownership in either the bank or the member of the banking group to which the respective bank belongs.

As regards the executive board of the bank, this includes no fewer than two members, including the president who represents the bank. The president is not autonomous in making business decisions; according to the law, he is required to ensure a signature of one member of the executive board. Similarly to the members of the board of managing directors, the members of the executive board of the bank are expected to have a good business reputation and qualifications required by the National Bank of Serbia. The contribution in the corporate governance in banks is reflected in the provision of the law that the bank's obligation is to form a board for monitoring the business performance of the bank (the auditing board), the credit board and the board for asset and liability management. Also, it is the obligation of the members of the board of the bank to establish a system of internal controls, the function of control of the coordination in banking as well as the internal auditing function. Such provisions in the national law coincide with the Basel Committee recommendations for enhancing governance in the banks.

As regards ownership in the bank larger than 5%, regardless of whether it is a direct or indirect ownership, it has to be approved of by the National Bank of Serbia. The regulatory framework in Serbia provides that the supervisor, i.e., the National Bank of Serbia, will supervise the bank's financial standing and the statutory operations of the bank in accordance with the law. What, however, is not implemented, is a regular control of the corporate governance itself by the supervisor, otherwise recommended by the Basel Committee.

According to the Law on banks and banking [25], the policy of salaries and other compensations in the bank is also within the scope of responibilities of the board of managing directors. As this is the issue that was not paid due attention to, in its special Decision on banking risks management, the National Bank of Serbia provided the obligation of adopting an adequate policy of earnings and other compensations to the employees, including compensations to the members of the boards of managing directors. this policy is considered to be adequate on condition it is based on the implementation of the business and the strategic policies of the bank, as well as the strategy and the policies in risk management, and on condition it enhances a reasonable and cautious risk taking [17].

A significant portion of corporate governance in banks is taking care of the stakeholders' interests. One section of the Law on banks in Serbia is devoted to depositors as significant stakeholders in the bank and to the protection of their interests. It is obvious, however, that it did not function adequately and that banks did not take due care of their stakeholders' interest in the scope of their corporate governance. This issue is today better regulated by law, as the Law on the Consumer Protection was adopted in 2011, in which the relationship between the bank and the consumers of its services and stakeholders is defined in a more detailed and precise manner.

Special attention in the regulatory framework is paid to risk management in banks. The Law provides the basic guidelines and obligations of the banks in view of an adequate risk management, however, the National Bank of Serbia adopted a number of regulations as regards a more detailed approach to managing certain risks. As early as the moment a bank is established, it is necessary that it should submit to the National Bank of Serbia as detailed a risk management procedure as possible; if adequate, this procedure is accepted by the regulator. All the regulations concerning risk management are consistent with the Basel principles and recommendations. In accordance with that, the banks in Serbia are obliged to identify, measure, and assess risks they are exposed to in their operations and to manage those risks. Such a law regulation is consistent with the Basel Committee Principles for enhancing corporate governance in banks. Risk management is adjusted to the bank's size and its organizational structure, the scope of its activity and the types of business operations it is engaged in.

The implementation of the Basel II standards in Serbia commenced in 2007. The full implementation was to begin in 2011, however, it did not, due to a number of banks not being ready to meet new requirements. The full implementation of the Basel II standards in Serbia was postponed until 31st December 2011 with a trial period in reporting in accordance with the new regulatory framework of September 2011. The Basel standards were introduced into the national practice in accordance with the characteristics of the national banking system. The basic goals in implementing the Basel II standards in Serbia are still the strengthening the stability of the banking sector and the financial system; improving the risk management processes in banks as well as improving the risk-based supervision processes; improving the transparency and market discipline; harmonization with the business conditions on the internanional financial market; harmonization with the European Union regulations – the EU Directives 48/2006 and 49/2006; creating a stronger link between capital requirements and risk exposure on the bank level [18].

It is important to stress that the National Bank of Serbia has conducted several stress tests to timely identify the possible weaknesses and needs for a preventive recapitalization in case of any extremely pessimistic macroeconomic scenarios. The tests have shown that the banking sector in Serbia is "rather resistant to external "shocks", due to primarily high preventive capitalization, and owing to prudential restrictive measures of the National Bank of Serbia in the credit expansion period in 2004-2008" [14]. Indeed, due to perhaps excessive restrictive monetary policy of the National Bank of Serbia, the banking sector in Serbia was not really impaired by the attack of the 2008 economic crisis.

6. Conclusion

Banks are the major institutions that ensure an efficient raising and orientation/allocation of free money resources, that is, transfer savings into investments, in a large number of countries. Due to the importance they enjoy, banks are paid special attention to in the regulatory framework. Banking is one of the most strictly regulated industries. Due to the importance they have for the entire economy, additional attention is paid to the issue of adequate governance of banks. A very important constituent of the overall bank management process is the implementation of the corporate governance principles. Corporate governance in banks, consistent to the general principles of corporate governance, refers to the manner in which banking is governed and controlled. This entails setting an appropriate group of goals to be achieved as well as methods to achive them and monitor the extent to which they are achieved.

An inadequate corporate governance may result inro serious problems in the work of the bank. As the banking market is rather a close-knit market, the domino effect can turn the loss of one bank into losses of other banks in the system, of the deposit insurance system, the system of payments, and consequently, into excessive costs for all the participants. The similar scenario was seen with the crisis that began in the middle of 2007. All these affect the trust into the financial and banking systems, which should not be abandoned so light-heartedly. Adequate corporate governance in banks is paid a lot of attention to. Several times, and the last time was in 2010, the Basel Committee on Banking Supervision issued the Principles for enhancing corporate governance in banks to serve as guideline for both banks and regulators as regrds the implementation of an adequate corporate governance practice.

Through the regulatory framework and additional regulations adopted by the National Bank of Serbia, the recommendations of the Basel Committee on Banking Supervision for enhancing corporate governance in banks are included into the respective documents. Thus a strong basis was created for the development of an adequate corporate governance in Serbian banks. No comprehensive control of the implementation of corporate governance principle in the banking sector of Serbia has been conducted so far.

What should be additionally clarified in the corporate governance in Serbian banks concerns minority shareholders with less than one percent ownership in the bank. The question is, are their rights inferior to the rights of other shareholders as the law implies that they may be prevented from exercising their right to vote? It is very important for the entire process of corporate governance in banks that special attention is devoted to the system of compensations and pay to the boards of directors and that, in consistence with the newly-adopted decisions, the policy of pay and other compensations be adequately implemented in consistence with the corporate governance principles.

It is also to be expected that the new Law on Consumer Protection will raise corporate governance in the banks of Serbia to a higher level, as regards the protection of stakeholders' interests

Corporate governance is not a rounded and closed process; on the contrary, it is permanently amended and improved. This process is presently under way in a large number of higher developed markets. It is especially important that the process of corporate governance is permanently worked on in a developing country such as this country is.

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