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The Role of Risk Management in Corporate Governance

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Abstract

Failures of banks' governance and risk management functions have been identified as key causes of the 2007–2008 financial crisis. This article reviews the empirical literature that investigates the relationship between governance structures and risk management functions as well as their impact on banks' risk taking and performance. I first discuss risk management's responsibilities and relevance for a value-maximizing bank. The business nature of financial institutions and their funding structure, together with explicit and implicit government guarantees, set them apart from nonfinancial firms. I argue that conventional governance structures alone may be unable to restrain risk taking in banks and thus the presence of a strong and independent risk management function becomes necessary to monitor and control enterprise-wide risk exposures. Recent evidence shows that a strong risk management function, compatible with the appropriate business model and culture, can restrain tail risk exposures at financial institutions and promote long-term value maximization.

Keywords

banking (/keyword/Banking), risk management (/keyword/Risk+Management), risk taking (/keyword/Risk+Taking), corporate governance (/keyword/Corporate+Governance), ownership structure (/keyword/Ownership+Structure), board expertise (/keyword/Board+Expertise), executive compensation (/keyword/Executive+Compensation)

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