

## AGENDA ITEM 6

### **SIXTH MEETING OF THE ADVISORY GROUP CEBU, PHILIPPINES, 14<sup>TH</sup> AUGUST 2006**

#### **MEASURES TO PROMOTE GOOD CORPORATE GOVERNANCE IN PUBLIC AND PRIVATE FINANCIAL INSTITUTIONS IN THE APEC REGION**

##### **Issue**

The attached paper was presented at the Montreal meeting but due to time constraints it was not considered. It is represented for consideration and advice by the Group.

The Group is asked in particular to advise on the last two Recommendations contained in the Summary and Recommendations of the report on the ABAC/ABA/PECC Symposium, Melbourne, 19<sup>th</sup> October 2005, which are set out below:

- ... the Advisory Group should continue to give emphasis  
In its collaboration with public agencies in
  - promoting the implementation of Basel II in banking  
in the APEC region (working in particular with SEACEN,  
BIS, ADB, IMF and the World Bank and regional regulatory  
agencies and the ABA and PECC)
  - developing further initiatives – similar to the symposium –  
in encouraging discussion and advocacy in the region on  
good corporate governance in APEC's financial sectors
- and to work with the Institutes of Directors in East Asia (IDEA)  
economies in promoting Professional Directors Program and to  
supporting the further development of the Corporate Governance  
Scorecards at macro and micro level presently being undertaken  
by the IDEA (an outline of this proposal is included in the Report  
“A way forward for corporate governance in the Region”,  
(appended to the Summary and Recommendationa (attached)).

*Coordinator*

*1<sup>st</sup> August 2006*

## AGENDA ITEM 6 (ATTACHMENT)

### MEASURES TO PROMOTE GOOD CORPORATE GOVERNANCE IN PUBLIC AND PRIVATE FINANCIAL INSTITUTIONS IN THE APEC REGION

#### Background

As a primary objective of the Advisory Group, ABAC, PECC and the ABA, strongly support measures to promote good corporate governance. Improving corporate governance is seen as a key challenge on ABAC's agenda, following the ruinous impact of failures in governance in major western corporations during the 90's and in some emerging economies as manifest by the Asian financial crisis. More recently, governance has become integral to the implementation of Basel II in the region's banking systems. A supervisory regime with a primary focus on the internal risk management capabilities of banks and on the integrity of banks' relationships with supervisory authorities, requires a deep commitment in both the public and private sectors to measures to improve governance – in both sectors.

ABAC, PECC and the ABA have focused on ways to promote better governance through industry groups in the region's financial sectors and more broadly. We also intend to give more focus to the issue in discussion with regulators at the public/private dialogue in Kuala Lumpur on 8/9<sup>th</sup> August 2006 – see Agenda Item 7.

A major symposium to promote good corporate governance was convened in Melbourne, 19<sup>th</sup> October 2005 – by ABAC, PECC and the ABA. A copy of the Summary Report and Recommendations is attached at Attachment 1 to this note. The report and recommendations have been presented to APEC Finance Ministers and broadly disseminated.

ABAC FWG is currently considering further additional work on this subject in collaboration with the Institute of Directors of East Asia.

#### Recommendations

- Review and consider the attached report and provide advice  
And guidance on points you deem relevance
- Consider whether additional measures ought to be pursued by the Group, ABAC and PECC, and if so advise which bodies would be most relevant in pursuing these endeavours.

Attachment

## **ABAC/ABA/PECC SYMPOSIUM, MELBOURNE, 19<sup>TH</sup> OCTOBER 2005**

### ***PROMOTING GOOD CORPORATE GOVERNANCE AND TRANSPARENCY IN APEC FINANCIAL INSTITUTIONS***

## **SUMMARY REPORT AND RECOMMENDATIONS**

### **Introduction**

The symposium, sponsored by ABAC, ABA and PECC was held in conjunction with the ABA's 22<sup>nd</sup> Annual Meeting in Melbourne. Around 90 people attended including banking representatives from the Asia Pacific Region, senior financial system regulators, senior representatives of regional and international financial institutions, representatives of industry and professional associations and institutes and academics and post graduate students from Australian universities. The ANZ bank helped in promoting and in administering the symposium and sponsorship support was provided by the State Government of Victoria, the Australian APEC Study Centre, the Australian Institute of Securities Finance and Banking and by the Monash University Graduate School of Business. (A detailed report and a copy of the program is available on the ABAC website)

The symposium sought to:

- promote discussion and understanding of corporate governance principles and practices and whether special governance arrangements ought to apply to financial sector institutions in APEC's public and private sectors
- to consider the roles of industry associations, institutes of directors and the professions in promoting and disseminating good corporate governance principles and practices in public and private agencies
- to develop public private partnerships to promote dissemination and training of principles and practices

### **General summary of discussion of the key issues**

- *the importance of good governance in APEC's financial institutions*
- regulators and representatives of multilateral agencies and private financial industry representatives and professional groups noted that good governance in financial intermediaries is especially important to support economic growth, financial system stability and the development of capital markets – governance in banks should be more ambitious than for non-financial firms

- improved governance in financial institutions – in both the public and private sectors
- in emerging markets in the APEC region is particularly important in supporting economic growth and the integration and the deepening of capital markets
- the essential value of good corporate governance in financial sectors is the confidence it brings to the community of savers and investors, domestic and cross-border and in the role of markets; good governance promotes competition in markets through highest standards of disclosure and it also promotes innovation and risk taking in well regulated markets; the implementation of Basel II across banking systems in the region should be given priority and implementation supported by capacity building initiatives
- good governance in central banks and banking supervisory agencies must support their commitment to maintaining financial system stability, and their legitimacy empowered by law; a central bank should act independently in the conduct of monetary policy
- a financial supervisory agency should have the highest reputation for probity and should have strong governance processes in place in financial management, audit and risk management ; banking regulators should be committed to implementing the core principles of banking supervision promoted by the Bank for International Settlements – which should include fit and proper persons tests, independent boards and effective risk management processes
- in a sound supervisory system a supervisor should not entertain an option by an intermediary not to comply with regulatory requirements
- regulators should use their powers wisely, avoid excess but also take action when needed; they should seek to add value to the community and where necessary seek wider authorisation if that is judged to add value
- a significant challenge in economies where there is a predominance of relationship banking is to provide incentives for the development of alternative sources of finance - through policies and incentives which encourage the growth of debt and equity markets, give priority to strengthening the rule of law and the enforceability of rights - these policies will likely be most effective in dealing with corruption and cronyism
- there are compelling reasons why APEC economies and in particular emerging economies should participate in the IMF/World Bank FSAPs and ROSCs programs

***- philosophy and principles of good governance***

- good governance should not be seen just a concept relating to the behaviour of corporations and markets; good or bad governance goes to the heart of the

development process and the way in which economies are administered and to the quality of justice and law

- while some essential qualities of governance – trust, integrity, probity – have not changed and are not subject to change, the development process itself and the changing dynamics of markets and industry structures and ownership are clearly necessitate an evolving perspective of governance principles
- principles of governance proposed by the OECD, PECC and other reputable bodies are broadly supported and relevant to the APEC region
- the support for OECD, BIS and PECC principles of governance, reflects the value of those principles in supporting modern business and a rising appreciation of the needs effective risk management and perhaps also because the principles are not overly prescriptive and do leave room for sensible interpretation by institutions to which they relate
- while business does support improved governance and disclosure arrangements, it is concerned about any tendency to over-prescriptive regulation, the burden of compliance, duplication in regulatory arrangements and the complexities caused by conflicting needs of different regulatory authorities; the extra territorial reach of the Sarbanes Oxley Act is a matter of some concern
- there is empathy with the view that overly prescriptive, black-letter law is inimicable to good governance and to good business conduct; certainly the view by Australian business, but shared by others, is that a principles based approach and one with the emphasis on disclosure is a much preferred model of governance; ultimately, business is about creating value and good governance should support that process
- within a principles based approach and one involving internationally agreed standards as proposed by the OECD, local interests and cultural values should be recognised as necessary in supporting growth and development; attempts at mandating, in governance arrangements, detailed and different values may well deter growth
- governance does need to reflect evolving circumstances and the qualities inherent in good business relationships, ethical behaviour and relationships developed voluntarily between parties, rather than being driven by "regulatory compliance"
- within the firm, governance arrangements will evolve – as awareness of good risk management is seen as central to corporate success and development – and may well coalesce around models which reflect independent risk management review and process, business line management and independent audit; information sharing between these groups is likely to be critical to effective governance

### ***- governance and the regulatory burden***

- the finance industry generally, strongly supports the rationale for effective supervision and good governance but wishes to participate closely with governments and regulators in the design of regulations with a view to reaching the right balance between financial system stability, business efficiency and the burden of compliance
- the finance industry considers progress in a number of areas that require government action as important for the success of efforts to improve corporate governance practices in emerging markets; these include improving the transparency and enforceability of legal and regulatory requirements; ensuring that supervisory, regulatory and enforcement bodies have adequate authority; providing effective and efficient insolvency frameworks and effective enforcement of creditor rights; facilitating disclosure of information; and setting good examples of proper corporate governance practice in government-owned and controlled corporations.

### ***- promoting good governance – benchmarking and the role of the professions***

- benchmarking governance performance in emerging Asian economies is developing and at the macro level it is providing useful information on the quality of governance and investor perceptions; at the micro level, benchmarking of companies listed on stock exchanges and their value performance against governance indicators is also demonstrating the benefits of improved governance in firms – these factors point to the importance of this work and the role that industry associations and institutes of directors in economies can play in promoting benchmarking and implicitly, in promoting better corporate governance
- the role of the professions, such as auditors, actuaries, lawyers, is integral to governance, particularly in corporate affairs and as such, the professions should be seen as important in contributing to the promotion of improved governance both in public and private sectors

### **Summary Conclusions**

- improving governance is important for communities, business and regional and global economic and financial integration; in banking, the implementation of Basel II and its focus on risk management is a major development
- high quality governance in all aspects of financial systems – public and private – is critical given the central role of finance in economic growth and development

- internationally governance standards, promoted by the OECD and the BIS are broadly endorsed as highly relevant to the APEC region and should be implemented in financial communities
- cultural factors governing relationships in individual communities should be fully recognised as economies attempt to adapt to internationally agreed standards; "there is no one size fits all" and overly prescriptive directives about corporate behaviour ought to be avoided
- governance in terms of probity, personal integrity and "the right way of behaviour" is unchanging and at the heart of business relationships; governance is also an evolving concept and reflective of changing business structures and ownership and management, and as such subject to societal pressures to fairly reflect the interests of groups and society broadly within an acceptable legal framework
- the tendency however for governments to bend to pressure to over prescribe on how business relationships should be conducted is a critical aspect of the governance debate; how far good governance should be reflected in black-letter law or developed on a principles based approach is a relevant issue for further consideration in APEC
- governance is seen at micro level in terms of within a firm or corporation; at the national level, in terms of the way in which governments relate to their citizens and businesses through the conduct of ministries and various agencies; good or better governance in an economy will help support regional economic integration
- measures to improve governance, through benchmarking at the macro and micro level are very important in supporting economic growth and the social enhancement of emerging markets, and capacity building to do this should be a major APEC priority.

## **Recommendations**

- APEC economies should be encouraged to implement Basel II and in so doing, bank regulatory agencies and banks encouraged to develop improved risk management capacities
- improved risk management is as relevant to all financial services sectors as it is to banking and risk management processes and techniques should be encouraged and promoted by non-bank financial regulatory agencies and by non-bank private sector financial institutions
- banking and other financial sectors ought to develop measures for fit and proper persons tests for appointments to boards and senior management positions and to implement independent audits

- information, transparency and accountability are critically important factors that are at the essence of good governance and should be given priority by APEC financial institutions in both the public and private sectors
- financial regulator agencies and financial policy arms of APEC economies should usefully review their own governance arrangements to ensure they comply with highest governance standards
- APEC economies and in particular emerging economies should participate in the IMF/World Bank FSAPs and ROSCs programs which are aimed to support the development financial system infrastructure
- the Advisory Group on APEC financial system capacity building should continue to give emphasis in its collaboration with public agencies in :
  - promoting the implementation of Basel II in banking in the APEC region (working in particular with SEACEN, BIS, ADB, IMF and the World Bank and regional regulatory agencies and the ABA and PECC)
  - developing further initiatives - similar to this symposium - in encouraging discussion and advocacy in the region on good corporate governance in APEC's financial sectors

and to work with the Institutes of Directors in East Asian (IDEA) economies in promoting a Professional Directors Program and to supporting the further development of the Corporate Governance Scorecards at macro and micro level presently being undertaken by the IDEA (an outline of this proposal is included in the Report "A way forward for corporate governance in the Region" attached to this summary )

*ABAC Australia*

*3<sup>rd</sup> November 2005*

***ATTACHMENT***



( *TO SUMMARY AND RECOMMENDATIONS* )

**A WAY FORWARD FOR CORPORATE GOVERNANCE IN THE REGION**

Jesus P. Estanislao  
Chairman, Institute of Corporate Directors

Introduction

- Despite different nuances and varied claims made in various statements regarding corporate governance in many economies of East Asia, acceptance of corporate governance principles has now become widespread in the Asia Pacific region. Practices, however, continue to vary widely. Every economy has homework to do to align its corporate governance practices with the more generally accepted principles, taking due consideration of its own circumstances.
- The challenge to get this homework done has to be faced locally: each economy would have to do it in its fashion and according to its own preferences, priorities and pace. Nonetheless, through regional cooperation, the different economies in the region could force the pace faster, should they wish to, and benefit from lessons learned as further initiatives are undertaken in other economies.
- What are the possibilities for regional cooperation in corporate governance moving forward in the Asia Pacific region? How might the more advanced economies---such as Australia, New Zealand as well as those in North America---support initiatives undertaken voluntarily and for mutual support in various economies wishing to move forward at a faster pace, and taking into account real constraints they may be facing?

More Focused Training of Corporate Directors

- In the East Asian segment of the Asia Pacific region there has been considerable questioning about the role of “independent” directors, whose election into corporate boards has been mandated. Several definitions of “independent directors” have been given, and these have provoked some debate.
- Among several Institutes of Directors that have been established, particularly in East Asia in recent years, greater stress has been given to the “independence of mind” of directors rather than the “independence” of a few, or even the majority, of directors. The former is increasingly equated with professionalization, with its demands for higher level of skills and knowledge, along with a commitment to ethics and social responsibility, on directors who should each be capable of making an independent contribution to the board process. Thus, the emphasis these Institutes of Directors are giving to their “Professional Directors Program”, pitched to any and all corporate directors, whether classified as “independent” or not.
- Given the dynamics as well as increasing inter-connection between economies in the region, where directors in one jurisdiction serve also as directors in another

jurisdiction, there is an increasing need to bring the different “Professional Directors Programs” up to a regional standard. This would bring into these programs greater regional content, with live cases from across the region that would highlight the different corporate governance principles. Standards can be benchmarked so that accreditation, to comply with local requirements in various economies in the region, can be recognized across several participating economies.

- The Institutes of Directors in East Asia network (IDEA.net) have started to pursue a project to better align the different “Professional Directors Programs” with one another, with a view towards mutual recognition of accredited corporate directors, who need to comply local mandatory requirements in several economies. This initiative can, and should be, given encouragement and support. In particular, those Institutes of Directors in more advanced economies in the Asia Pacific region--such as Australia, New Zealand and those in North America---can share whatever training expertise and resources they have to benefit this regional initiative.
- There should also be greater focus on improved corporate governance of banks, taking into account requirements that have been mandated for specialized Board Committees such as those focusing on Audit, Risk, and Governance (the duties of the last committee may include nomination, performance evaluation, remuneration, continuing education, succession planning of directors).
- Alternatively, or in addition, there should also be greater focus on improved corporate governance of State-Owned Enterprises (SOEs). These provide particular challenges in each economy; but there can be a few commonalities of the issues these enterprises may face in various economies of the region. As with banks, so with SOEs: there are incipient, much more focused initiatives for regional cooperation in the training of corporate directors, and these initiatives need encouragement and support from the more advanced economies.

#### Tool for Performance Evaluation

- In the region, particularly in its East Asian segment, performance evaluation is being increasingly required. Corporate boards are expected to make an assessment of their performance relative to corporate governance principles. It is hoped that such an assessment would prod corporate boards to continuously raise the standards of their corporate governance practices.
- Under PECC auspices, several institutes within IDEA.net have entered into a mutual support arrangement, which has enabled them to come up with Corporate Governance Scorecards at both the macro and micro levels. These have been designed as tools for evaluating corporate governance practices. At the macro level, the changes in the corporate governance regime can now be monitored, including the changes in perception (on the part of investment fund managers into the region) of actual corporate governance practices. At the micro level, scores are being made of the corporate governance practices of publicly listed companies. Four economies (Thailand, Hong Kong, China, and the Philippines) have

- completed their micro CG Scorecard; Indonesia is following suit; the other economies in the region have expressed willingness to do the same.
- This initiative needs to be sustained. The example of Thailand is well worth highlighting: for the micro CG Scorecards, it has already done this for four years in a row. It is now possible to track changes, and more specifically improvements. The other economies in the region have decided to undertake the Scorecard initiative every year. Thus, in the foreseeable future, since the framework used and the approach taken are broadly similar (almost identical) in several economies, it should be possible to look at changes in CG practices, at the level of publicly listed companies, over time. A tool can be made available to prod continuing improvements in the corporate governance practices of publicly listed firms.
  - How may other economies provide support and encouragement? They can encourage greater regional cooperation in this regard. To date, the economies that have done the Corporate Governance Scorecards have undertaken this initiative on their own, with their own resources and on the basis of their informal networks. Additional encouragement and support should now be provided so that the initiative should continue to be undertaken by many more economies in the region and to ensure that the regional framework and approach are maintained and improved.

### Conclusion

- In the package of further steps proposed to push the corporate governance envelope further in the East Asian segment of the Asia Pacific region, due consideration has been given to the weakness of the institutional and regulatory regime in many economies. Ten steps were included in the package (the summary of the ten steps is attached).
- Of those ten steps, two present themselves as noteworthy since they offer immediate prospects for regional cooperation. Indeed, IDEA.net has picked up these two---the Professional Directors Program (and a more focused training of professional directors with the independence of mind and other qualifications to contribute independently to the board process) and the CG Scorecard (at both the macro and micro levels)---as the steps they can take in mutual support of each other.
- It is these two initiatives, already chosen by IDEA.net, that are well worth considering as the two most important practical steps forward in improving actual CG practices in the Asia Pacific region.

Manila, October 25, 2005

