Heng Swee Keat: Corporate governance developments in Singapore

Keynote address by Mr Heng Swee Keat, Managing Director of the Monetary Authority of Singapore, at the 2009 Asian Investors' Corporate Governance Conference, Singapore, 19 November 2009.

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Mr. Tan Chok Kian, Chairman, Securities Investors Association (Singapore)
Mr. David Gerald, President & CEO, Securities Investors Association (Singapore)
Distinguished guests
Ladies and gentlemen

Introduction

Good morning. I am very happy to join you today at this inaugural Asian Investors' Corporate Governance Conference. Thank you for inviting me to speak at this event.

I congratulate SIAS and your partners on bringing together such a wide range of investors and corporate governance practitioners from across Asia. I applaud your commitment to hold this event annually, as it is necessary for practitioners to stay abreast of the latest corporate governance developments and to reflect on how we can do better.

Corporate governance as an on-going concern

Good corporate governance is a key pillar underpinning Singapore's reputation as a trusted financial and business hub. Over the years, we have sought to continually improve corporate governance in Singapore. This includes a review of the Code of Corporate Governance in 2005 by the former Council for Corporate Disclosure and Governance ["CCDG"], chaired by Mr. JY Pillay.

In the last two years, following the transfer of oversight of corporate governance of listed companies to MAS and the Singapore Exchange, we have focused on strengthening the practices of corporate governance in Singapore. In 2007, Professor Mak Yuen Teen of the National University of Singapore was commissioned by MAS to undertake a study aimed at assessing the current state of corporate governance practices in Singapore, identifying gaps and proposing measures for improvement.

Professor Mak highlighted, among others, the need to enhance the effectiveness of Audit Committees through training, practical guidance and sharing of experience among Audit Committee members.

Arising from this, the MAS, the Accounting and Corporate Regulatory Authority ["ACRA"] and the Singapore Exchange established a private sector committee to develop practical guidance to assist Audit Committees to better appreciate their responsibilities and enhance their effectiveness in performing their role. The Committee, led by Mr. Bobby Chin, worked intensely over 9 months and completed its work in October 2008. The Committee's output, "Guidebook for Audit Committees in Singapore", has become a practical and valuable reference for directors who serve on the Audit Committees.

We have also been supportive of efforts by the Singapore Institute of Directors to review its structure and strengthen the delivery of its director training program, so that it may better meet the increased demands placed on directors in this current environment.

The continual efforts by industry practitioners, investors and regulators to improve corporate governance have enabled Singapore to stay ahead of the field. The World Economic Forum's

Global Competitiveness Report 2009, for instance, ranked Singapore first in corporate governance standards in Asia.

Lessons from the crisis

In the aftermath of crises, corporate governance standards and practices often come under scrutiny. For instance, after the Enron/Worldcom failures, critics pointed to the lack of independence of auditors and Audit Committees, and to deficiencies in accounting standards. After the bursting of the dot.com bubble, attention was drawn to the severe conflicts of interest by brokers and analysts.

The recent financial crisis has been no different. Indeed, reviews by international bodies and national agencies have found that weak corporate governance played a role in this crisis. For instance, the OECD report on "The Corporate Governance Lessons from the Financial Crisis"[1] noted that "the financial crisis can be, to an important extent, attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies."

While many of the corporate governance failures that have been uncovered so far affected financial companies, many of the structural weaknesses may also be common to large and complex listed firms. It is therefore relevant for Boards of other companies to reflect on these findings. Let me briefly highlight a few common themes.

The first relates to the quality and composition of Boards. Research shows that although having a good balance of directors with a range of skills and experience that are relevant to the business of the firm is an essential foundation for good corporate governance, this was also often the most neglected.

A number of reports[2] also found weaknesses in the implementation of effective risk management. In many cases, risk was not managed on an enterprise-wide basis and Boards were not fully apprised of the level of risk facing the company. Overseas regulators are now reviewing the role of Boards in providing guidance on the alignment of corporate strategy with risk-appetite, as well as on appropriate internal structures in risk management.

Not surprisingly, remuneration practices have attracted the most public attention. The alignment of executive and Board remuneration with the longer term interests of the company and its shareholders is a widely accepted corporate governance principle. Nonetheless, compensation practices that rewarded staff handsomely for short-term gains, without any corresponding penalties for longer-term losses, have been blamed for encouraging excessive risk taking in some institutions. A number of jurisdictions, such as Australia and the US, are considering legislation that will address this by empowering shareholders to have a more direct role in setting remuneration.

Creation of the Corporate Governance Council

Financial institutions in Singapore have generally been prudent in their business, and have weathered the crisis well. Listed companies in Singapore that have maintained high standards of governance have similarly withstood the crisis. Nevertheless, we must not be

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[1] Kirkpatrick, Grant (February 2009), "The Corporate Governance Lessons from the Financial Crisis", OECD.

[2] Walker, David (July 2009), "A Review of Corporate Governance in UK Banks and Other Financial Industry Entities", Her Majesty's Treasury; G20 Working Group 1 (March 2009), "Enhancing Sound Regulation and Strengthening Transparency", G20; OECD Steering Group on Corporate Governance (May 2009), "Corporate Governance and the Financial Crisis - Key Findings and Main Messages", OECD.

complacent. We must not let up in our efforts to improve our regulations and codes, as well as in the actual practices and governance culture.

As part of this effort, I am pleased to announce that we will be establishing a Corporate Governance Council, comprising members from the private and public sectors.

The objective of the Council will be to promote a high standard of corporate governance in companies listed in Singapore so as to maintain and enhance investors' confidence. In turn, this will enhance Singapore's reputation as a leading and trusted financial centre, and benefit all players involved.

In conceptualising the Corporate Governance Council, the CCDG serves as a useful reference. Unlike the CCDG, which also had responsibility for promulgating accounting standards and improving disclosure practices, the Corporate Governance Council's focus will be squarely on corporate governance matters.

Among the Council's roles will be the identification of opportunities for continuing professional development of directors and the development of practical guidance for Board committees. By taking into account perspectives of relevant stakeholders, the Council can develop initiatives that are robust and balanced, and achieve broad support and alignment of all parties.

MAS will announce members of the Corporate Governance Council, and its terms of reference, early next year.

Review of the Code of Corporate Governance ("the Code")

An important and immediate task for the Council once it is set up will be to conduct a review of Singapore's Code of Corporate Governance.

The Code was last reviewed in 2005 and took effect for all AGMs held on or after 1 January 2007. The Code has served us well. However, this financial crisis has thrown up valuable lessons on corporate governance. Members of our media, academia and the corporate and financial sector have also been suggesting possible improvements, and several overseas jurisdictions have also completed or are in the process of updating their own Codes. It is therefore timely for us to embark on another review. In determining the scope of the review, the Council could consider the suggestions for improvements from stakeholders, and developments in other jurisdictions, taking into account the local context where relevant.

Higher standards for banks & insurance companies

This financial crisis has shown that the failures of financial institutions with significant operations can destabilise the entire financial system, and severely disrupt economic activities. MAS' approach has been to require high regulatory and prudential standards for locally incorporated banks and life insurance companies as well as standards of corporate governance that are more stringent than what they have to observe as listed companies. Locally incorporated banks and significant life insurers are required to comply with the Corporate Governance Regulations which are mandatory as opposed to the Code which is applied on a "comply or explain" basis. The Corporate Governance Regulations also impose more stringent requirements regarding the composition of Boards and Board committees.

MAS is in the midst of reviewing the Corporate Governance Framework for locally incorporated banks and insurers. The review will focus on the effectiveness of risk management at the Board level, including the role played by Boards in safeguarding the safety and soundness of their institutions and in addressing market conduct risks. This would include a review of the Board's role in setting remuneration policies to manage risks effectively and the need for the Board to comprise members with relevant expertise and experience in the technical, financial and operational aspects of risk management of the various lines of business of the financial institution.

MAS will also review the need to further tighten the definition of independence by requiring the Nominating Committee to consider the length of service on the Board as an additional criterion in determining the independence of a director.

With regards to remuneration practices, MAS has done an initial assessment of the practices of our local banks against the Principles for Sound Compensation Practices issued by the Financial Stability Board. We support the idea of aligning compensation with appropriate risk-taking. As the core issue is the holistic management of risks across the institution, MAS will, in our implementation of these Principles, incorporate these into the Corporate Governance Framework. That way, the various governance elements pertaining to risk management can function in a balanced and coherent manner.

Role of advocacy bodies

So far I have spoken mainly on the role of regulators in setting out good corporate governance Codes and practices. However, the quality of corporate governance depends critically on people and values.

Industry groups such as SIAS have an important role in formulating and implementing higher standards of corporate governance practices. I would like to take this opportunity to applaud SIAS for being a tireless advocate of investor rights. Mr. David Gerald, in particular, has contributed significantly in this area. SIAS has played its part in empowering securities investors through education and information, most recently with regard to structured products. It has also played a role as a "corporate integrity watchdog" by actively engaging corporations that have fallen short of good corporate governance practices.

The effort to promote good corporate governance practices and to cultivate ethical corporate culture and behaviour is also supported by advocates in the media, academia and professional associations.

Our local media have highlighted good and bad practices. Several journalists have written thoughtful pieces. It is useful to have discerning commentary that points to deficiencies in specific firms without over-generalising.

The National University of Singapore Corporate Governance and Financial Reporting Centre, as well as the Singapore Management University Sim Kee Boon Institute for Financial Economics both publish useful indices that assess the standards of corporate governance in Singapore.

Professional associations such as ICPAS, IIA, SAICSA and SID have also been playing their roles in this area.

Conclusion

In closing, let me reiterate the point that good corporate governance pays – if not in immediate share prices, at least in the resilience of the firm in a crisis. Indeed, one key conclusion from the study by the Senior Supervisors Group[3][3] is that financial firms that best rode out the recent crisis were ones with good corporate governance standards, demonstrating "a comprehensive approach to viewing firm-wide exposures and risk, sharing

[3] William Rutledge et al. (March 2008), "Observations on Risk Management Practices during the Recent Market Turbulence", Senior Supervisors Group.

quantitative and qualitative information more effectively across the firm and engaging in more effective dialogue across the management team."

Better governance per se does not guarantee that there will never be a crisis, but it can minimise its probability and its impact if it does occur. Singapore has made good progress over the years in our corporate governance practices, but we must press on with continual improvements. As regulators, professional bodies, investors, academics and the media, we each have a role – let us work closely together in this journey.

Finally, while my comments have focused mainly on Singapore, it is heartening that we have such a deep and diverse group of investors and practitioners from around the region. I am sure there will be much that we can learn from each other, and I hope that deep and frequent interactions like this catalyse new ideas and spur us all to do better. I wish you a fruitful conference. Thank you.