Ravi Menon: Corporate governance – going beyond the rules

Opening address by Mr Ravi Menon, Managing Director of the Monetary Authority of Singapore, at the Securities Investors Association (Singapore) 4th Asian Investors' Corporate Governance Conference, Singapore, 1 October 2012.

* * *

Mr David Gerald, President & CEO, SIAS
Distinguished guests, ladies and gentlemen, good morning.

Evolution of corporate governance

1. The corporation, as we know it today, began in England as early as the 17th century. Ownership of companies typically vested in a few individuals who were also managers of the companies. There were no organised markets for the transfer of shares in the company. Shares were transferred only to friends or relatives.

2. Industrialisation in the 19th century led to large capital demands by companies. Markets for the transfer of shares began to sprout in New York and some European cities. During the 20th century, as corporations continued to grow, the descendants of the founding families gradually reduced their ownership shares. Control of corporations shifted increasingly into the hands of managers. A separation emerged between ownership and control.

3. The separation of ownership and control made economic sense. Businesses could tap the market for capital and executive talent separately and more efficiently. However, the separation of ownership from control presented an agency problem. Thus emerged modern corporate governance – a system to ensure accountability by those who run companies to those who invest in these companies.

4. But corporate governance rose to prominence only in the last two decades, starting with the UK's Cadbury Report in 1992. Since then, there has been a continuous stream of reforms in the UK to strengthen corporate governance, culminating in the UK Corporate Governance Code, which operates on a "comply or explain" principle. Corporate governance reforms in the US took a slightly different trajectory, leading to the Sarbanes-Oxley Act. Unlike the UK Code, Sarbanes-Oxley is enshrined in legislation and compliance is mandatory.

5. In Singapore, our corporate governance journey began in 2001, with the introduction of the Code of Corporate Governance. Since then, the Code has undergone two reviews to take into account changes in our corporate landscape as well as international developments. The most recent review was conducted by the private sector led Corporate Governance Council in 2010. MAS accepted all of the recommendations of the Council, with minor modifications, and issued a revised Code of Corporate Governance earlier this year. Key changes to the Code focused on strengthening Board independence, enhancing remuneration practices and disclosures, clarifying the Board's responsibility in risk governance, and providing further guidance on companies' engagement with shareholders.

Going beyond the rules

6. Rules on corporate governance – mandatory or otherwise – have been considerably enhanced in most major jurisdictions. Yet, rules alone cannot assure us of high standards of practice. The recent financial crisis has exposed significant shortcomings in the governance of companies. We have seen monumental failures in risk management, a spate of accounting scandals and outright fraud. Closer to home, SGX-listed companies have had their fair share of failures in corporate governance.

7. The answer does not lie in even more rules. We must now focus on changing behaviour and building capabilities, to make the recent reforms meaningful. Let me highlight three areas:

- one, strengthening market discipline
- two, building Board competencies
- three, instilling the right values

Strengthening market discipline

8. Let me begin with market discipline – the process by which stakeholders apply effective scrutiny on a company. The key enabler for market discipline is disclosure. We have put in place, in the SGX listing rules, the necessary requirements for disclosure to be ongoing, timely, and accessible. But for disclosure to enable effective market discipline, it must also be meaningful.

9. Meaningful disclosure is especially important given that our Code is non-mandatory. We have adopted a "comply or explain" approach so that we can pitch the expectations at the level of best practice while allowing companies the flexibility to deviate from these expectations if their particular circumstances warrant it. But companies must explain publicly the reasons for any such deviations so that the market can judge.

10. Unfortunately, disclosures being made by companies deviating from the Code are often uninformative. Let me give an example. A company that did not have independent directors making up at least one-third of the Board offered the following explanation: "The Board believes that there is an independent element on the Board and that it is able to exercise independent judgment on corporate affairs". The statement does not provide any evidence or information to shareholders on how the independent element is achieved in spite of the smaller number of independent directors.

11. Companies should provide meaningful explanations of their reasons for deviation, and not opt for "template" disclosures that shed no light on these reasons, or worse, obfuscate the issue. There is scope for standardising the format in which disclosures of compliance with key principles in the Code are made, to facilitate comparability across listed companies. MAS and SGX will be exploring this in the coming months.

12. In strengthening market discipline, disclosure is one side of the coin; the other side is the considered exercise of shareholder rights. Shareholders can play an important role in enhancing corporate governance by studying corporate statements, attending general meetings, and voting on key issues.

13. But the reality seems to be that companies have limited engagements with shareholders on governance issues, and most institutional investors do not vote or attend AGMs. The situation may be improving though, at least in Singapore. According to the CLSA Corporate Governance Watch 2010, institutional investors are becoming more active in voting their shares and engaging with companies in Singapore.

14. Shareholders are not the only people who can exercise market discipline. Third parties like the media and research analysts also have a role to play. They can shine the spotlight on exemplary companies as well as highlight questionable practices. Let me cite two commendable initiatives.

- The National University of Singapore and the Business Times have developed and publish regularly a Governance and Transparency Index, which assesses and ranks companies based on their corporate governance practices and the transparency of their financial results.

- The Securities Investors Association (Singapore) will introduce a new corporate governance page on its website to provide investors with more information on the corporate governance practices of the top 100 companies selected through the use of a corporate governance scorecard.

15. It is also encouraging to see an increase in local media coverage of corporate governance issues. But there is one area where I believe the media can do better. Media reports following a company's AGM tend to focus excessively on the remuneration of the CEO and the directors, with precious little commentary on the company's performance, business strategies, or risk management. I am not suggesting that remuneration issues are not appropriate areas for scrutiny – they very much are – but we need a more holistic assessment of our companies, and the media plays an important educational role in this regard, especially for retail investors.

Building board competencies

16. A second area where we need to go beyond the rules is in raising the competency levels of our Boards. Corporate governance reforms the world over have focused on addressing the principal-agent problem chiefly through strengthening the independence of Boards. This is necessary but not sufficient. A good director must not only be independent in form, but must be competent so that he can also be independent in substance. Directors must be able and willing to devote time to their roles and have the relevant experience to question management and form independent views on strategy, risk, and performance.

17. This is particularly relevant in the area of risk management. Boards have an important role to play in determining the company's risk tolerance and risk policies. They must oversee management in designing, implementing, and monitoring the company's systems for managing risk.

18. But risk is fundamentally about uncertainty and is therefore inherently subjective. This is why a diverse Board – with both executive and independent directors as well as a variety of backgrounds and expertise – is key. Given the complexity of the environment we operate in, only through robust debate and rigorous consideration of the range of possibilities can Boards make sound decisions on risk and strategy.

19. Putting together diverse Boards with competent directors, and at the same time meeting the tighter requirements for independence, is a real challenge – especially for a small country like Singapore with a limited talent pool. The solution does not lie in lowering our standards for either independence or competence. Companies must take a more proactive approach in identifying and making available training to their directors. One possible way to increase the pool of directors would be for more Singapore companies to be open to having their senior staff sit on the Boards of other companies, as a way to further develop their promising executives.

20. There are some promising initiatives underway. The Singapore Institute of Directors (SID) and the Stewardship and Corporate Governance Centre (SCGC) have been working to help increase the pool of directors through a variety of training programmes. For example:

- The SID-SMU Directorship Programme provides basic, broad-based knowledge essential for performing as Board directors.
- SCGC, set up by Temasek, is developing a training programme designed specifically for potential and newly appointed directors.

21. But more work needs to be done in the area of competency building. Let me offer one possibility. There may be scope to build a cadre of full-time professional directors in Singapore. The concept of a professional director – as a person "who spends all his time in

the discharge of his responsibilities as a director of various publicly held corporations"[1] – is not new. In some jurisdictions, professional associations have introduced accreditation frameworks for directors, such as the "chartered director" in UK and the "accredited director" in New Zealand. This could be worth considering.

Instilling the right values

22. Finally, corporate governance must be about instilling a culture that places values above profits. Publicly listed companies are increasingly at risk of becoming slaves to the pressures of quarterly earnings. In a brutally competitive environment, this short-termism promotes not only excessive risk-taking but a variety of sharp practices, exploitative sales, and even fraudulent transactions. Little wonder that public trust in corporations has diminished in many jurisdictions.

23. Boards and senior management have a critical role in promoting a culture rooted in strong ethical frameworks. They must make clear that serving the customer's interest, dealing fairly with suppliers and counterparties, following the laws of the land, and not placing the larger society at risk are essential for maximising long-term shareholder value.

24. Directors and senior managers set the tone for what is acceptable behaviour and what is not. The questions they ask – as well as the questions they do not – send strong signals throughout the corporation. Let us ask ourselves:

If a particular division in a company is making huge profits, what does the Board and senior management do? Congratulate them and raise the targets? Or ask probing questions about how much risk is being taken, whether there has been fair dealing, and whether all stakeholders have been served?

25. Restoring ethical conduct is particularly relevant for the financial industry. Following the crisis, the industry has fallen into disrepute, especially in the West. Recent revelations arising from the Libor scandal – and this is not unique to London – suggest that the lessons have not been learnt. If we allow this culture of cynical greed to take root, it will undermine the public trust that is so critical to not just the growth but the viability of financial institutions. The leadership of financial institutions – Boards and senior management – owe a special duty of care to ensure that finance is trustworthy, socially redeeming, and economically purposeful. They must send a clear, unadulterated message, down to the last person in their organisation: "If it is not right, don't do it. If it is not true, don't say it."

26. This is an area that MAS intends to engage the Boards and senior management of financial institutions on.

Conclusion

27. We are making good progress in our corporate governance journey. We are now entering a new phase, and must go beyond rule reforms to create the conditions for good governance to flourish – developing a conducive ecosystem for market discipline, building up the competencies of our Board directors, and instilling a culture of ethical conduct and values.

28. I wish you all success in this important new phase of our corporate governance journey.

---

[1] Joseph Barr, "From the Boardroom: The Role of the Professional Director", Harvard Business Review, May-June 1976. 5.