Tharman Shanmugaratnam: Corporate governance developments in Singapore and the region

Speech by Mr Tharman Shanmugaratnam, Deputy Chairman of the Monetary Authority of Singapore, Minister for Education and Second Minister for Finance, at The OECD Asian Corporate Governance Roundtable, Singapore, 27 June 2007.

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Introduction

Good morning and a very warm welcome to Singapore. It gives me great pleasure to be here at the OECD Asian Corporate Governance Roundtable. The last time the Roundtable was held in Singapore was in 2001, and we are happy to be able to host this important international gathering once again.

10 years after the 1997 Asian Financial Crisis, this year's Roundtable gives us a good opportunity to do a stock-take, to see where we are now and identify the areas where we must continue to move forward in the region.

Avoiding complacency in a benign economic environment

The macro picture amongst the Asian countries is vastly improved. The Asian economies are by and large showing strong growth, driven in large part by increased trade and investments both within Asia as well as with the rest of the world. Investor confidence is back. Capital inflows are back to the levels that existed before the Asian crisis. And strong inflows of portfolio capital and foreign direct investments have replaced bank lending as a dominant source of capital inflows. Last year, the ASEAN-5 countries, for example, attracted some US$50 billion of foreign direct investment, significantly greater than the US$28 billion seen in 1997. Institutional investors are allocating more funds to Asia, in search of higher yields and to benefit from the strong growth in the region. Improvements in corporate governance are part of this story.

But even in this positive climate, we must remain wary of risks. Terrorism and avian flu are not distant threats. The abundance of liquidity in global and Asian markets has also led to a narrowing of credit spreads that is unlikely to persist for long. The repricing of risk may be triggered by a variety of events, arising for example from a geopolitical disturbance, an unexpected setback in economic growth, or the failure of a major borrower in global financial markets. The repricing of risk, unwinding of spreads and contraction of liquidity in higher risk assets and markets may be sudden, and may not be orderly.

On the positive side, the innovations we have seen in global financial markets, including the extensive securitization of assets and growth of the derivatives market, has parceled out risks more widely and perhaps more evenly in the system. But it also makes the system less predictable in the event that things go wrong. We cannot predict how contagion will spread in global markets.

It is critical that the hard lessons on corporate governance learnt during the fall out from the Asian crisis are not lost during the current period of benign economic growth and relatively easy availability of funds. When the flight to safety and quality occurs, it will be those countries and companies with robust standards of corporate governance that will be better placed to keep the loyalties of investors.

Corporate governance developments in the region

We should therefore keep up the momentum of progress. Since the crisis, the Asian Roundtable countries have indeed made substantial progress in important areas of corporate governance reform. I will run through two key areas of progress very briefly.

Growth and strengthening of standard-setting bodies

Institutions matter. Several countries in Asia have established national committees on corporate governance since the crisis . The private sector has also strengthened its act. We have seen a number of institutes of directors set up in many countries, including China, Hong Kong, Indonesia, South Korea, Malaysia, Thailand and the Philippines. Minority shareholder watchdog groups are also now in place in countries such as Malaysia, South Korea and Taiwan. And Institutes of Directors, in particular, now play a key role in developing training programmes for both directors and management. In some countries – for example, Malaysia and Thailand, such training programmes have become a mandatory prerequisite for directors of listed companies. So we have seen a strengthening of both public and private bodies aimed at the common objective of scaling up standards of corporate governance.

Corporate governance regulations and best practices

We have seen considerable reform in the regulations and codes of corporate governance, as well as the actual practice of corporate governance in the Asian Roundtable economies. For instance, Pakistan, Chinese Taipei and Thailand all adopted new codes in 2002, while new or updated codes have been adopted in Bangladesh, Hong Kong, Indonesia and Korea since 2003. This has yielded visible benefits. There is greater clarity in many Asian economies regarding the fiduciary duties of the directors of listed companies. There has also been progress made in terms of more independent directors being introduced to the boards of listed companies in the Asian region .

Accounting rules have also been beefed up across the region. Some of the Asian Roundtable countries have made significant moves towards convergence with international standards and best practices on accounting. China, India, Indonesia and Philippines, have for example revised their accounting standards to bring them more in line with international standards.

Corporate governance in Singapore

Corporate governance in Singapore has similarly undergone evolution. I shall leave it to the speakers from the Singapore Institute of Directors and the Singapore Exchange to share on these more fully. I will talk briefly instead about our overall approach to corporate governance.

Regulatory framework – balance of mandatory rules and best practices

First, let me touch on the regulatory framework for corporate governance. In recent years, we have moved away from a merit-based approach towards a disclosure-based approach. The objective is to equip market participants with better information, let them take responsibility for making their own decisions and to judge the quality of the corporate governance of companies.

But a disclosure-based approach can only work well if it is backed up by a robust enforcement regime. This is key to maintaining the confidence of market participants in the disclosure-based regime. In recent years, our regulatory authorities have acted decisively in the face of breaches by market participants, such as in the cases of ACCS, Citiraya and China Aviation Oil.

Equally important for a disclosure-based regime is the raising of the bar on corporate governance standards themselves. Singapore’s approach here is a flexible one, recognising the need to cater to a range of companies of different sizes and resources. It comprises a balance of mandatory rules, captured in our legislation and listing rules, and best practice recommendations in the form of the Code of Corporate Governance. Listed companies are required to either adopt the best practice recommendations or to disclose instances where they have not done so and provide explanations for these – in other words companies must “comply or explain”.

We will keep both our legislation and best practice codes up to date through regular refinement, so that they stay relevant to a changing environment. We will also keep close watch on developments internationally, to see if they might be relevant to the Singapore environment. For example, the UK has enacted a new Companies Act 2006 in which the duties of directors have been codified.

Recently, there have been discussions between the Institute of Certified Public Accountants of Singapore, or ICPAS, and the Singapore Institute of Directors, or SID, regarding directors’ responsibilities for the internal controls and accounting policies and estimates that are relevant to companies’ financial statements, and how these responsibilities of directors should be reflected in auditors’ reports. This recent issue illustrates the importance for clarity on directors’ duties amongst all stakeholders. The Accounting & Corporate Regulatory Authority, or ACRA, will lead a study on the duties of directors, taking into account of standards observed internationally as well as the corporate environment in Singapore. ACRA will work with the Singapore Institute of Directors, ICPAS, the MAS and SGX, and other stakeholders in this study.

Corporate governance – enhancing performance

A sound and responsive regulatory framework is critical to corporate governance. But it is worth reminding ourselves that corporate governance is not merely about compliance with the rules. Corporate governance is in the wider sense about how the business and affairs of a company are directed and managed in order to enhance corporate performance and long-term shareholder value. Good corporate governance is ultimately about performance and accountability to shareholders.

This relates to the effective functioning of the board – how it draws on different skill-sets amongst directors, how it sets strategies, and how it interacts with senior management to build knowledge and make decisions in the interests of shareholders.

Well-functioning boards aimed at sustained performance are in truth work-in-progress in Singapore and elsewhere in Asia – we probably have more distance to cover in this regard than in compliance with rules. Many companies do not have a good mix of experience and skills amongst their directors. While some of the bigger companies may have the necessary resources and can seek outside help, there are a large number of companies that require help along this journey. We should therefore focus our energies not just on formulating sound rules and best practice codes, but on encouraging and helping companies to address practical issues in making their boards effective and high-performing.

Corporate governance study commissioned by MAS and SGX

This is one of the reasons why MAS and SGX jointly commissioned a study on improving the implementation of corporate governance practices in Singapore. This study was carried out by Associate Professor Mak Yuen Teen of the National University of Singapore's Business School and the Corporate Governance and Financial Reporting Centre. The study focused on assessing the current state of corporate governance practices in Singapore and proposing practical measures to improve board effectiveness and governance.

Details of the study can be found in the report, which MAS and SGX will be publishing on their websites later today. For now, let me highlight two particular areas of the study's recommendations that we have started working on.

Professional development and training of directors

One area of improvement is in the training of directors. Having committed and skilled directors is a key component in the effective functioning of the board. Director training is particularly relevant for new or first-time directors, to assist them in understanding their roles and responsibilities, and to equip them with the necessary skills. Even experienced directors need to continually upgrade their skills, to oversee and steer companies in today's rapidly changing and globalised landscape.

MAS has been in discussion with the Singapore Institute of Directors on how we can build on its very useful work to date, and develop a comprehensive and sustained approach to training and development of directors in Singapore. MAS will help to fund a study that will help to operationalise this comprehensive approach to training. The study will cover a few areas. First, it will look into benchmarking directors' training and development against best practices in other leading jurisdictions. A number of jurisdictions have in the last few years developed extensive structured training programs for directors. Secondly, it will examine possible collaborative arrangements between a range of organisations and training providers. Thirdly, it will also focus on how best such training initiatives should be financed.

This is an important initiative to ensure our companies have skilled directors on their boards, who can help them to grow and expand in the region, and be recognized leaders in both performance and governance.

Developing practical guides for listed companies and directors

A second issue arising from the study has to do with developing practical guides for listed companies and directors. This is in line with helping companies help themselves on the path to better corporate governance, MAS will work with industry and professional bodies on practical guides on areas of interest to companies.

The importance of an effective audit committee in particular was highlighted in the corporate governance study by Professor Mak. It noted that almost all corporate scandals involved some form of financial impropriety, with the audit committee often seen to be part of the governance failure.

Some guidance on the roles, functions and skills required by an audit committee would be useful. We need to encourage well-qualified directors to take on the critical responsibility of being a member of an audit committee. Such practical guidance notes could be useful in helping directors on audit committees to understand their roles relative to that of senior management. It could also provide better focus on how they can add value by enabling the important interaction between strategy and financial and accounting controls. I note that the UK has issued similar guidance on Audit Committees – otherwise known as the Smith Guidance – to assist companies.

Conclusion

Let me conclude. The Asian Financial Crisis has served to highlight the importance of corporate governance. It is a key component that contributes to the strength of our markets and to the performance of our companies. While corporate governance practices across Asia have improved significantly, we cannot lower our guard. When times are good, we should press ahead and gain momentum in our efforts to improve corporate governance.

But good corporate governance, as we all know, goes beyond box-ticking. It must be focused on both the spirit and substance behind corporate governance rules and guidelines. It is important that we convince companies of the inherent benefits of good corporate governance, as a tool for sustained corporate performance.

Platforms like today's OECD Asian Corporate Governance Roundtable are invaluable as we go forward. This is how we can share our experience, learn from each other, and perhaps do a bit of nudging.

I wish you fruitful and insightful discussions. Thank you.