

Amando M Tetangco, Jr: Strengthening the foundation for effective governance

Speech by Mr Amando M Tetangco, Jr, Governor of the Central Bank of the Philippines (Bangko Sentral ng Pilipinas), at the Induction of Officers and Annual General Membership Meeting of the Bankers Institute of the Philippines (BAIPHIL), Makati City, 24 July 2007.

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The newly elected officers and directors of BAIIPHIL led by its President and BSP Assistant Governor Ms. Ma. Dolores B. Yuvienco, my colleagues at the MB (MBM Valdepeñas, Boncan, Villafuerte, Antonio) Prime Minister Virata, Gov. Laya, Gov. Cuisia, SEC Chairman Barin, members of the Institute, bank chairman, vice-chairman, presidents, other distinguished guests, fellow BSPers, ladies and gentlemen.

First of all, let me thank you for inviting me to be your inducting officer and guest speaker in this year's general membership meeting. It is an honor to be here.

I am very pleased to be here today for your annual general membership meeting for several reasons. First, we at the Bangko Sentral ng Pilipinas look at the Bankers Institute of the Philippines more popularly known as BAIIPHIL as our partner in strengthening our banking system through research, information exchange and education.

In fact, BAIIPHIL is one of only seven institutions accredited by the Bangko Sentral to conduct mandatory corporate governance seminars for bank directors.

Second, the theme chosen by BAIIPHIL's new set of officers and directors for the fiscal year 2007 to 2008 echoes our own focus at the Bangko Sentral, which is: "Enhancing Internal Governance a Continuing Journey."

Indeed, good corporate governance is a must for banking institutions, whether they are private or government. You can say that we at the Bangko Sentral walk the governance talk. While I will be the first to say that we are not perfect, it is not for lack of trying. In fact, it is a continuing topic in our planning sessions. Like BAIIPHIL, we at the Bangko Sentral believe that for as long as the environment where we operate remains dynamic, there will always be room to enhance governance; it is a continuing journey with no finish line.

We at the Bangko Sentral ng Pilipinas are also pleased that Assistant Governor Dolly Yuvienco has been elected President of BAIIPHIL at a time when the banking sector made the crucial transition to Basel II.

But before I go into the details of our ongoing corporate governance reforms, I will give an overview of the performance of the banking system before and after the Bangko Sentral institutionalized the corporate governance framework, to put things in proper perspective.

Philippine banking system: an assessment

Prior to the institutionalization of corporate governance reforms, the growth rates of key balance sheet accounts of the banking system were minimal at single-digit levels of about 5 per cent. Bank earnings and returns to shareholders were also moderate.

In 2002, the Bangko Sentral institutionalized corporate governance within the banking system, beginning with the Mandatory Seminar on Corporate Governance and the issuance of the Bangko Sentral Handbook on Corporate Governance.

Since then, the practice of good corporate governance at individual banks has played a major part in strengthening the foundations for growth and stability of the Philippine banking system.

As of May 2007, key performance indicators of the banking system reflected overall soundness: double-digit growth rates in assets, deposit liabilities and capital accounts. Likewise, asset quality has significantly improved with preliminary NPL/NPA ratios of 5.8 percent and 6.6 percent, respectively, moving closer to their pre-crisis levels of 4 percent. If you recall, we had double-digit NPL/NPA ratios of 17 percent and 15 percent, respectively, in 2001. It is also worth noting that unlike our neighboring countries, the asset cleanup of our banking system did not require huge government bailouts. What we had were incentives to remove some friction costs.

Meanwhile, banks remain well-capitalized with capital adequacy ratio of 18.1 percent (vs. 14.2 percent in 2001), on a consolidated basis, still above the BSP regulatory requirement of 10 percent and the international standard of 8 percent.

Banks also sustained their profitability as annualized consolidated net income after tax stood at P17.3 billion. Higher bank profits likewise resulted in bigger returns for banks' shareholders as annualized Return on Equity stood at 10.4 percent, versus 5.8 percent in 2001.

In other words, the Philippine banking system remained resilient and in a much stronger position on sustained implementation of financial sector reforms.

With our banks on a sound footing, the bigger challenge lies in the sustainability of its growth momentum. In this area, corporate governance continues to play a crucial role and we, at the BSP, remain committed in working with industry players, industry associations such as BAIPHIL, and other financial regulators to further strengthen the foundation of corporate governance for our supervised financial institutions.

Rationale for corporate governance reforms

On a global level, adherence to good corporate governance also plays a key role in sustaining the overall health of the financial system and ensuring its ability to withstand crises.

To recall, fundamental weaknesses in corporate governance have been identified as among the factors that triggered the 1997 Asian crisis and other financial catastrophes in recent years. In the case of the Asian crisis, financial systems in the region became vulnerable to external shocks arising from excessive concentration of risk, poor credit policies, and inadequate risk management systems.

The international response, which emerged as a consensus was to move toward best practices particularly on corporate governance. On our part, we at the Bangko Sentral rationalized the regulatory framework to closely align prudential standards with practices that promote the good governance tenets of transparency, accountability and fairness. Let me now highlight these initiatives.

BSP's corporate governance initiatives

Bangko Sentral's corporate governance agenda is anchored on the practice of effective corporate directorship, sound audit and compliance systems, and enhanced disclosure in financial reporting. In this regard, we have issued several regulations intended to reinforce these critical elements of good governance. At the core of these regulatory initiatives is the leading role to be played by the board of directors in the overall corporate governance agenda.

Clearly, Board oversight is key to effective bank governance and ultimately, to achieving overall stability within the organization. Toward this end, we have emphasized the collective responsibility of the banks' board of directors and senior management to ensure the soundness and stability of their respective banks. One way to instill such accountability to the board of directors is through director education.

Since 2002, the BSP has been requiring bank directors and trustees of non-stock savings and loans associations (NSSLAs) to undergo the mandatory seminar on corporate governance to familiarize them with their duties and responsibilities as corporate decision makers. As of end-March 2007, a total of 6,856 directors and trustees or 84.7 percent of the 8,094 directors/trustees of banks, quasi-banks and NSSLAs have attended corporate governance courses. Let me take this opportunity to remind those who have yet to take the governance course to get their schedule as soon as possible. This is mandatory.

We have also enforced and strengthened our fit and proper standards for directors and officers of financial institutions. In this regard, we also support continuing director education and training particularly on qualification/disqualification standards (Circular No. 513 dated 10 February 2006).

Similarly, we have highlighted the role of independent directors in protecting the broader public interest and the creation and empowerment of critical board-level committees on corporate governance, risk oversight and audit.

To promote fairness and transparency further, we have enforced stronger safeguards against connected party transactions. Another related issuance of the BSP is the revision of the prompt corrective action or PCA framework following the issuance of Circular No. 523 dated 23 March 2006. This was done to compel banks to take pre-emptive action against what may constitute as threats to financial stability and thereby, ensure that they continue to operate in a safe and sound manner. As part of the PCA framework, banks are encouraged to align capital with actual risk exposures, implement business improvement measures, and institute corporate governance reforms.

And in the interest of accountability, we have required banks to establish a sound compliance system. The aim is to ensure a bank's identification of relevant laws and regulations, analysis of risks of non-compliance, and prioritization of compliance risks.

The Bangko Sentral also recognizes the critical role that external auditors play in providing an independent and objective assessment of financial institutions' condition and performance. In connection with this, we have further rationalized the guidelines governing the selection, appointment and the reporting requirements for external auditors of banks.

As a further measure, we have issued new guidelines on internal audit function. The standards define the status and scope of the internal audit, prescribe the minimum qualifications for bank internal auditors, and highlight the importance of the audit committee in establishing appropriate mechanisms for reporting financial improprieties or malpractices.

Shift to international accounting standards

The BSP also spearheaded the full adoption by the banking system of prescribed international financial reporting standards (IFRS) and international accounting standards (IAS) for enhanced risk disclosure and better market discipline.

The implementation of the Philippine Financial Reporting Standards (PFRS) and the Philippine Accounting Standards (PAS) is expected to improve the quality of financial information to be disclosed to market participants.

In relation to this, we have issued the new financial reporting package (FRP), in accordance with the provisions of PFRS/PAS. The new FRP will facilitate an enhanced off-site surveillance by Bangko Sentral of its supervised entities.

Corporate governance and Basel II

Moreover, improved governance in banks and other financial institutions remains an integral aspect of our continuing agenda to promote a sound and stable banking system. This will be highlighted further as we begin to fully implement the revised risk-based capital adequacy framework under Basel II this year.

The new Basel II-based framework will not only focus on the computation of the appropriate level of capital given a certain level of exposure, but will also underscore the need for more market disclosures by banks on their risk exposures and risk management practices. The required disclosures to the public of bank capital structure and risk exposures are aimed at promoting greater market discipline in line with the so-called Pillar 3 of the Basel II recommendations.

These reform initiatives should go a long way in establishing a sound governance regime at the institution level for a more effective and stronger financial intermediation. Ultimately, this will help preserve overall integrity and stability of the banking system.

In fact, there are already a number of success stories on governance at the institution level. Let me briefly highlight some of them.

One universal bank was able to exit from its 5-year rehabilitation program, partly due to improvements in corporate governance and oversight. This generated positive results, highlighted by a reduction in the Bank's NPA ratio, strengthening of its capital position and improvement in the Bank's profitability and liquidity.

Another bank was able to achieve progress in building up its capital. The bank successfully raised its capital through issuance of tier 1 capital (common shares, preferred and hybrid tier 1 capital), thereby increasing its CAR from 14 percent as of end-September 2005 to 27 percent as of end-March 2007!

Still another universal bank launched a major bank-wide initiative designed to restructure its whole credit delivery process and resolve the increasing volume of its non-performing loans. This program, embedded under the Bank's credit excellence thrust, includes technical infrastructure and system enhancements, policy reviews and credit organization alignment. Coupled with good governance principles, the Bank was able to achieve a significant decrease in its NPL ratio from 8.68 percent to 3.99 percent in March 2007. Its risk management system also significantly improved, enabling the Bank to allocate capital among the various businesses more appropriately and building its capabilities to engage in derivatives activities.

The examples set by these banks demonstrate the crucial beneficial role of good corporate governance in ensuring and sustaining a strong foundation for growth and profitability. I hope their stories will inspire other banks to take the path of good governance in word and in deed.

In closing, I would like to thank BAIPHIL for its steadfast support for BSP's reform initiatives, particularly, in championing corporate governance.

Congratulations to the newly elected officers, directors and committee chairpersons! I am confident that you will lead BAIPHIL in a professional manner and exemplify the very ideals of good governance.

Thank you all. Mabuhay ang BAIPHIL! Mabuhay ang Philippine banking sector!