

Amando M Tetangco, Jr: Of ironies and synergy

Speech by Mr Amando M Tetangco, Jr, Governor of Bangko Sentral ng Pilipinas (BSP, the central bank of the Philippines), at the First ASEAN Corporate Governance Conference and Awards “Governance Transformation in ASEAN: Reform and Priorities”, Manila, 14 November 2015.

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Can self-interest lead to the greater good? Prior to Adam Smith¹ it was counter-intuitive to say, “Yes.” Human nature, in its narrowest sense, if you must, is anathema to the proposition that individuals naturally uphold the common good. But proceeding from Smith’s theory, we tap individuals’ natural inclination to pursue their own interests. We motivate them to see that good governance works to their benefit. Self-interest therefore is channelled to nationally desirable ends. Another “irony” results - supervised entities are now competing to adopt good governance principles! In doing so, there is cooperation with regulated entities. Competition toward cooperation.

This provokes another thought: Can the regulator partner with the regulated? I believe so. When standards are merely imposed from the top-down, results can be unsustainable. To have sustainability, interests of the regulator and the regulated must converge.

Can more granular measurement lead to unlimited possibilities? In the ASEAN Capital Markets Forum (ACMF), I believe the answer is “yes”. Since its initiation four years ago under the ACMF Implementation Plan, the ASEAN Corporate Governance Scorecard (ACGS) has raised awareness for tangible benefits of good governance practices among publicly listed companies. The Scorecard has become increasingly more than a compliance metric or tick-box. Rather, it is now a tool to achieve organizational alignment and focus.²

OECD studies show that investors have greater confidence in firms whose governance standards are measured and clearly understood, consequently allowing better access to equity and debt finance³, leading to reduced cost of capital⁴, and thus translating to improved share value⁵. These are goals both regulators and the regulated desire. Since the initiative began in 2011, regulators have championed good governance principles. It is for “your own good,” we say. And, we have not been off-the-mark in our pronouncement.

Our advocacy has been heard. McKinsey has found that boards of directors of corporations are increasingly “more confident in their knowledge of the companies they serve and more strategic in their approach.” And we know that strategy formulation is the first step to good governance.⁶ Also, as shown in an ADB study⁷, PLCs have begun to voluntarily adopt best practices. There is greater appreciation that a balanced scorecard can generate firm-level

¹ Paraphrasing an idea in Adam Smith’s *The Theory of Moral Sentiments* (1759).

² “Robert S. Kaplan and David P. Norton, *The Strategy Focused Organization: How a Balanced Scorecard Companies Thrive in the New Business Environment*.” 2001 Harvard Business School Publishing Corporation, p. 8.

³ <http://www.oecd.org/daf/ca/corporategovernanceprinciples/43654500.pdf>. The Tangible Benefits of Good Governance. Last accessed 11 November 2015. OECD.

⁴ Ibid.

⁵ Ibid.

⁶ *Improving Board Governance: McKinsey Global Survey results*. August 2013. Available at http://www.mckinsey.com/insights/strategy/improving_board_governance_mckinsey_global_survey_results last accessed 12 November 2015.

⁷ Asian Development Bank, *ASEAN Corporate Governance Scorecard, Country Reports and Assessments, 2013–2014*.

governance improvements⁸ and attract foreign investments. Ultimately, these enhance the region's visibility, integrity and "branding" as an asset class.

The impact of good corporate governance is not just on the micro. It is also on the macro. There is evidence that improvements in corporate governance of firms positively affect aggregate economic activities at the country, and in our case, regional levels. Studies show this is especially so when firms improve transparency. When firms are better governed, interests of the firm and of stakeholders are more closely aligned. This gives firms stronger incentives to achieve high productivity and efficiency, thereby raising "economy-wide" productivity growth.⁹ Success inspires more success and good governance results in the whole being greater than the sum of its parts.

In terms of corporate governance, ASEAN has certainly come a long way since the 1997 financial crisis. OECD reports that many key financial and corporate institutional reforms here have translated to "stronger regulation, better resourced regulators, new institutions and an increasingly involved shareholder base." A key facet of this positive development is corporate governance reform.¹⁰

Moreover, as the ACMF effort has reached its fourth year, we have a better understanding of corporate governance standards across the region. As regulators, we now have a common diagnostic tool to help us improve corporate governance standards. Each country in the region is expected to build on these standards to create their own corporate governance framework, which should clearly articulate expectations on (among others) the fitness and propriety of the board, checks and balances, and transparency.

The fundamental principle is that the tone of good governance should be set and come from the top. It should remain the highest priority as it emphasizes the importance of having "fit and proper" standards for individual board members. These standards, we believe, should put as much weight on integrity, as on knowledge, expertise and competence.

Fitness and propriety are also displayed in the exercise of independent and objective judgment. The "state" of independence is defined by parameters on term limits, a cap on the number of concurrent independent directorships and the challenge of a seemingly limited number of qualified independent directors. Systems of checks and balances should likewise be deeply embedded across all levels in the company.

Unquestionably, an environment that fosters transparency should be the new norm. A system for cooperation and collaboration among government bodies, regulators, and supervisors should be in place to ensure reasonableness of disclosure requirements. We must display the will and capacity to implement standards and take enforcement actions, if needed.

A business model that often draws discussion and one that is almost always associated with our region – is related party interest. While we recognize that such a corporate structure has inherent risks, we must also be mindful that synergies can lead to success of individual companies. It would therefore be beneficial to set higher oversight and control standards. This, to address conflict of interest concerns and propriety of related transactions.

Our own efforts at the Bangko Sentral ng Pilipinas with respect to our supervised entities follow the global thrust closely, while at the same time being mindful of emerging domestic industry concerns and unique situations in our legal and regulatory environments. However, regulation

⁸ Chris Razook, Corporate Governance Challenges Facing Southeast Asia, The Ethical Boardroom, Spring 2015. In www.ifc.org last accessed 11 November 2015.

⁹ Gianni De Nicolò, Luc Laeven, and Kenichi Ueda, Corporate Governance Quality: Trends and Real Effects IMF Working Paper Series WP/06/293. December 2006.

¹⁰ OECD, Reform Priorities in Corporate Governance in Asia: Taking Corporate Governance to a Higher Level (2011), <http://www.oecd.org/corporate/ca/49801431.pdf> last accessed 11 November 2015.

alone is not enough. A culture that induces appropriate/proper behavior, even when nobody is watching, is needed.

Ladies and gentlemen, the scope of governance must be broad. Our initiatives must not begin and end with PLCs only. The financial environment where PLCs operate is made up of many moving parts. Efforts must extend to financial market segments as well. In particular, we must promote orderly financial markets that feature real price discovery and enforce responsible market conduct.

From the perspective of a central bank, we view good corporate governance as the foundation of safe and sound banking operations. It embodies principles of fairness, accountability and transparency. The Basel Committee on Banking Supervision emphasizes that since banks have an important financial intermediation role in the economy, the public and the market must be highly sensitive to any difficulties potentially arising from any corporate governance shortcomings in banks.¹¹ Clearly, the financial industry thrives on public trust to sustain resiliency. But I believe these principles are true not just for the banking sector but for all commercial endeavors as well.

We should also recognize that SMEs make significant contributions to regional growth. Thus, they should be included in our continuing transformation process. This transformation should also not leave consumer protection behind. Ladies and gentlemen, governance must be inclusive.

For certain, we give credit to ACMF for identifying good corporate governance as a prerequisite for economic and financial integration. In doing so, ACMF strategically built a strong foundation for our single market of ten separate economies. Good corporate governance as a bedrock is essential for an economy whose combined GDP is expected to grow 4 times to US \$10 trillion by 2030¹² and is projected to become the 4th largest in the world by 2050.¹³ With this forecast, we are therefore beginning strong with that trajectory in mind.

Diversity in ASEAN is a good thing. It suggests availability of niche markets that can be tapped. Different needs can be explored and met. Pockets of expertise can be harnessed.¹⁴ Each nation has a comparative advantage that will benefit the others. Regardless of our differences, we should work together to continually make the Scorecard reflect internationally recognized good practices in a manner that remains relevant and applicable to ASEAN. This can be done through systematic collaboration, to ensure cohesion and promote synergy. As each nation is here represented, I am confident we are off to an auspicious and productive start.

But can there be constancy amidst change? The answer, I would say, is “yes.” This year, the Philippine SEC celebrates its 79th Founding Anniversary. Its core functions endure, yet it also makes history by launching the Philippine Corporate Governance Blueprint. In crafting the plan, I understand that the SEC convened a multi-sectoral consultative working group, which considered past, present and changing requirements of corporate governance, while remaining sensitive to nuances of the domestic market. For this endeavor, we congratulate the Philippine SEC and its proactive and tireless Chairperson, my friend and colleague, Honorable Teresita Herbosa. We look forward to the Blueprint’s introduction.

¹¹ Basel Committee on Banking Supervision, Consultative Document. Principles for Enhancing Corporate Governance. Published in October 2010. <http://www.bis.org/publ/bcbs176.htm> last accessed 12 November 2015.

¹² Institute of Corporate Directors. ASEAN CG Scorecard and Best Practices.

¹³ “Understanding ASEAN: Seven things you need to know”. McKinsey&Company. May 2014.

¹⁴ Amando M. Tetangco, Jr. Prospects for and Developments in the Philippine Banking System, Philippine International Banking Convention 2015, 2 October 2015, Shangri-La Makati.

My final thoughts for this morning. For sustainability of the corporate governance initiative, achieving synergy among seeming ironies is the challenge. Self-interest toward the greater good, Competition toward cooperation, Partnerships between regulators and the regulated, Unity in diversity, Consistency amidst change.

In addressing these seeming ironies, balance is key. Balance in choosing a firm regulatory stance, while respecting and giving a wide berth to what motivates PLCs and individual firms. I believe we are on the right track.

As we fulfill our mandate as the country's central monetary authority, and as member of the Philippine Financial Sector Forum – comprised of financial regulators, we stand one with you in the vision to make ASEAN an “asset class” of its own.

On behalf of the Monetary Board and the officers and staff of the BSP and the Financial Sector Forum, I congratulate the ACMF, and the fifty PLCs of the region, inaugural award recipients of the ASEAN Corporate Governance Award. For being exemplar in your way of governance, and being the elite first of many batches that will bring more investments and growth into our region, we warmly applaud you.

As we say in the vernacular, maraming salamat and mabuhay po tayong lahat.