

PRELIMINARY **SCORECARD** ON
CORPORATE GOVERNANCE REFORM
IN THE **BANKING SECTOR**

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Introduction

Introduction

East Asian Bank CG initiative is under PECC auspices:

- *Focus on the bank scorecard*
- *Of serious concern, particularly in East Asia.*

Introduction

In virtually all of East Asia,

capital markets still play a SMALLER role
vis-a-vis the **banks**

in sourcing external finance.

Introduction

In the US and UK, CG reforms are introduced via the capital markets.

Within East Asia, more in and through the banks.

Introduction

Many banking reforms undertaken in response to the

- East Asian financial crisis, or
- the BIS agreements,

have opened opportunities to introduce CG reforms in and through the banks.

A Scorecard for CG Reform in the Banking Sector

- In promoting CG reforms,

each economy uses available LEVERS to
initiate and eventually force the pace of
reforms.

Understandably, each economy

- *follows a pathway open to it;*
- *will have varying pathways.*

However, after a few years of experimenting
in several economies in East Asia

*a pattern of the more promising steps is
emerging.*

There is active and positive conversation on at least

***FIVE steps** that have advanced the cause of CG reforms in the banking sector.*

- The *first step*,

is the **REGULATORY** push towards directors' training on CG.

An essential component of the "fit and proper" test.

The seminar is based on the

- *OECD core principles of corporate governance*
- *local laws and regulations that stress the duties and responsibilities of bank directors.*

“Fit and proper” test ensured compliance by almost all bank directors in several East Asian economies of this requirement.

A Scorecard for CG Reform in the Banking Sector

- But ATTENDANCE at an Orientation Seminar **does not** necessarily lead a director to any specific immediate action to reform his or her board.

A Scorecard for CG Reform in the Banking Sector

A second step

Mandate from regulators for the setting up of **Board Committees***, with **“independent directors”** constituting majority membership.

**Audit, Risk Oversight, and Governance ++
(to include director nomination, continuing education,
performance evaluation, and remuneration).*

Bank directors who serve in these Committees must

- *learn to focus;*
- *put in more time;*
- *do much more work;*
- *get some specialized training.*

Moreover, particularly in the case of
“independent directors”,

*they become acutely aware that their
professional reputation is on the line by being a
bank director.*

- But how do bank directors know that they are performing their functions accordingly?

The *third step*

maintaining a corporate governance
scorecard.

a tool that allows for

an occasional but regular comparison between current practices and selected best practice guidelines, either in the

- *Board itself or*
- *Board Committees*

a tool that allows for

monitoring of the narrowing or widening of GAPS?

Need for an honest-to-goodness CG Improvement Program (CGIP) for their bank which is action-specific and time-bound.

A Scorecard for CG Reform in the Banking Sector

- The *fourth step*

A program that demands an increasing level of professionalization in the practice of bank directorship.

Beyond conformance, **performance roles** have to be emphasized as well.

This includes

- *policy and strategy formulation*
- *fostering a bank culture of ethics and*
- *social responsibility.*

Institutes of Directors have been set up which offer

a Professional Directors Program.

- Broadening the CG regime

by shaping the norms and actual practices that several

- **“reputational agents”**
- *bank regulators*
- *other regulators*

observe.

It is also shaped by the standards and codes observed in the economy which includes the

- *administrative,*
- *judicial, and*
- *political sectors as well.*

A Scorecard for CG Reform in the Banking Sector

The *fifth* step

*Playing an active role in corporate governance
reform advocacy.*

- The dialogue continues on the emerging pattern on the 5 steps.
- As the dialogue firms up, the bank scorecard can be piloted in participating East Asian economies.

As the new BIS agreements come into force

a similar scorecard can be devised for major bank borrowers with a potential for having a systemic effect on an economy.

- *Such a scorecard should be made on a regular basis.*
- *After some time (say 3 years), it can be expanded to include CG reforms in an economy as pursued through the banking sector.*

A Possible Framework for a Bank CG Scorecard

- In East Asia,

*we already have a common set of guidelines
for proper practices of corporate governance.*

A Possible Framework for a Bank CG Scorecard

- They were adopted in Shanghai during the Ministerial meetings of 2001; and

endorsed during the succeeding Economic Leaders' meeting (also in Shanghai).

It provided a useful head start.

- The Shanghai Guidelines considered the following “umbrella” areas:
 - *The Board as a whole*
 - *The Chairman*
 - *The Members of the Board*
 - *Board Meetings*
 - *Board Committees and Issues*

- Each of these broad “umbrella” areas covers specific points taken from the Shanghai Guidelines.

- Devising a bank CG scorecard for participating economies in East Asia:
 - *A need to review the Shanghai Guidelines;*
 - *A determination of the relative importance (i.e. weights) to each point within an area, and then to each of the five umbrella areas.*

Where only one economy is involved, weights may be determined by the

- *bank regulator, or*
- *bankers' association, or*
- *local institute of directors, or*
- *consortium of all three.*

A Possible Framework for a Bank CG Scorecard

But where several economies are involved, e.g. in East Asia,

it is necessary to FORGE A CONSENSUS on the relative importance to give to

- *each point and to*
- *each of the five umbrella areas.*

A Possible Framework for a Bank CG Scorecard

- Step 2 – beyond the Shanghai Guidelines,

it includes proper practices for a few Board Committees, such as

- *Audit,*
- *Risk Oversight, and*
- *Governance (nomination, continuing education, performance evaluation, and remuneration).*

A Possible Framework for a Bank CG Scorecard

- Step 3 brings in still more areas that shape a culture of:
 - *compliance,*
 - *performance,*
 - *ethics, and*
 - *social responsibility.*

- Expanded Guidelines: **also need some consensus to be forged** on their formulation as well as possible use as a common reference for banks in the area.

An agreed set of weights would make the resulting scorecards comparable between

- *banks,*
- *banking sectors.*

- Once such a framework has been agreed upon, it's a matter of having the WILL to use it.
- *The challenge becomes one of going from mere "possibility" to actuality.*

POSSIBLE REINFORCEMENTS

- a Professional Directors Program
- The Bankers' Association
- Bank regulatory authority

- The INFLUENCES that can be brought to bear on banks to push forward with this initiative would help shape how the framework for the bank CG scorecard can be used to come up with actual scores.

- a) Where individual banks participate largely on a voluntary basis, self-rating is observed.

With the assistance of an independent institute of directors, the self-rating scores can be put together and monitored.

A Possible Framework for a Bank CG Scorecard

- b) Where the bankers' association is involved,
cross-checks can be provided by peer rating.

(But the involvement of an independent IOD should be much stronger to ensure the proper selection of peers.)

A Possible Framework for a Bank CG Scorecard

- c) Where the regulatory authority is involved

the bank examiners' observations and judgments can help enrich those made earlier by the concerned bank directors.

A Possible Framework for a Bank CG Scorecard

- Ideally, the results of
 - *self-rating,*
 - *rating by peers, and*
 - *examiners rating*

can be put together, following a pre-agreed process (*with possible assistance from an independent IOD*).

A Possible Framework for a Bank CG Scorecard

- The frequency for issuing results involving several parties can only be annual.
- Sustained over a few years, it can be a tool for tracking progress in improving actual CG practices in bank boardrooms.

- With a CG scorecard across economies made comparable

---both between banks and eventually
between borrower corporations ---

the interest of the international investment
community in CG reforms, particularly in East
Asia, would be much better served.