

**The Effects of Corporate Governance Regulations
on the
Practices of Directors of Banks: A Philippine Experience**

A Research Paper for the Conference

Emerging Issues in Business and Economics: Governance and Innovation

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Chapter I

Introduction

A. Background of the Study

The Asian Development Bank (ADB) has recognized weaknesses in corporate governance as one of the major sources of vulnerabilities that led to the Asian financial crisis in 1997. The five worst affected countries, namely, Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand, all suffered, in varying degrees from over-capacity, poor quality of investments, excessive exposure to debt, especially unhedged short-term foreign debt. Casual observations suggest that ineffective boards of directors, weak internal controls, poor audits, lack of adequate disclosure and lax legal enforcement characterize corporate governance in many Asian countries. These weaknesses are believed to have contributed to the crisis by shielding banks, financial companies and non-financial corporations from market discipline, and by failing to terminate unprofitable projects, recognize bad loans, restructure or bankrupt poorly performing enterprises and discipline banks.¹

The joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC) described corporate governance in the Philippines as characterized by concentrated ownership by a limited number of family shareholders, within a bank-dominated financial market. It described the country as having a comprehensive set of corporate law and capital market regulations enforced by relatively weak institutions undergoing restructuring reforms. As in many East Asian countries, the need to strengthen corporate governance in the Philippines was highlighted during the financial crisis in the region, and relatively recent securities market scandals.²

In response to the perceived need for good corporate governance, the central monetary authority of the Philippines, the Bangko Sentral Ng Pilipinas (BSP), issued Circular No. 283 in May 2001 mandating the adoption of good corporate governance practices by members of the boards of directors of banks and non-bank financial institutions under its jurisdiction. This circular is also in line with the BSP's mission to provide proactive leadership in bringing about a strong financial system.

To ensure that good corporate governance practices are internalized, the BSP has taken the extra step of mandating the training of the bank directors by (training) institutions it (the BSP) has accredited. The deadline originally given to the directors to

¹ Asian Development Bank. Corporate Governance and Finance in East Asia. A Study of Indonesia, Republic of Korea, Malaysia, Philippines, and Thailand (Vol.1), 1. (2000)

² World Bank-IMF. Report on the Observance of Standards and Codes, Corporate Governance Country Assessment, Republic of the Philippines. (September 2001)

undergo the course on corporate governance was December 31, 2002. Earlier this year, this was extended to June 30, 2003. Directors failing to take and complete this seminar by the deadline will be temporarily disqualified and can only reassume their post upon completion of the course.

The two regulations of the BSP – the adoption of good corporate governance practices and undergoing training on the subject, are concrete steps in building a culture of good corporate governance in banks and non-bank financial institutions in the Philippines. The latter regulation, the mandatory training for bank directors, may also be a first in the Association of South East Asian Nations (ASEAN).

The De La Salle Professional Schools, Inc. Graduate School of Business (DLSU-PSI-GSB) is one of the few institutions accredited by the BSP to conduct this training on corporate governance. To date, the DLSU-PSI-GSB has trained some 2,000 directors and senior officers from roughly 400 banks.

There is presently no existing data, and no study yet conducted, on how corporate governance regulations (the adoption of corporate governance practices and training on the subject) have affected the practices of directors of banks in the Philippines.

There is likewise no known review and comparison, of the regulatory issuances by central monetary authorities in the ASEAN mandating the adoption of good corporate governance practices.

B. Review of Literature, Regulations, and Related Studies

Philip Phan believes that the corporate director is probably the least understood but most important person in a modern public corporation. This contradiction has resulted from a lack of knowledge among directors on what they should be doing in the boardroom and how they should fulfill their legal and moral responsibilities. Simply put, the buck stops with the directors and so they must understand their duties and the means to discharge them. The increasing pressures for corporate performance and shareholder value maximization mean that the days of the inactive board, dominated by the company's managers, are over.

All over the world, from the U.S. and Britain to France, Germany, and Japan, a sea of change is occurring in the boardrooms of the largest corporations: directors are

being called to account for their actions or lack of action on issues as diverse as economic performance to ethical violations.³

The Cadbury Report argues that a country's economy depends on the drive and efficiency of its companies. Thus the effectiveness with which their boards discharge their responsibilities determines the country's competitive position. They must be free to drive their companies forward, but exercise that freedom within a framework of effective accountability. This is the essence of any system of good corporate governance.⁴

The report emphasizes the importance of training directors. The weight of responsibility carried by all directors and the increasing commitment, which their duties require, emphasize the importance of the way in which they prepare themselves for their posts. Given the varying backgrounds, qualifications and experience of directors, it is highly desirable that they should all undertake some form of internal or external training. This is particularly important for directors, whether executive or non-executive, with no previous board experience. Newly appointed board members are also entitled to expect a proper process of induction into the company's affairs. It is then up to individual directors to keep abreast of their legislative and broader responsibilities. The training and development of directors is of importance to good governance.⁵

The Cadbury Report defines corporate governance as the system by which companies are directed and controlled. Boards of Directors are responsible for the governance of their companies.⁶

The Philippine Securities and Exchange Commission (SEC) defines corporate governance as a system whereby shareholders, creditors and other stakeholders of a corporation ensure that management enhances the value of the corporation as it competes in an increasingly global market place. The SEC Code of Corporate Governance was promulgated in pursuance of the Philippines' policy to actively promote corporate governance reforms aimed to raise investor confidence, develop the capital market, and help achieve a high-sustained growth for the corporate sector and the economy. The Code is applicable to corporations whose securities are registered or listed, corporation which are grantees of permits/licenses and secondary franchise from the SEC, and to public companies. The Code also applies to branches or subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed.⁷

³ Philip Phan. Taking Back The Boardroom. Singapore, 2000.

⁴ Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report), (December 1992).

⁵ Ibid.

⁶ Ibid.

⁷ Securities and Exchange Commission. Code of Corporate Governance. (April 2002)

The Code defines the specific duties and responsibilities of the board of directors as a body and as individual directors, accountability, audit function, stockholders' rights and protection of minority stockholders' interests, evaluation systems, disclosure and transparency requirements, and the required commitment to corporate governance.

BSP Circular No. 283 mandates the amendment of the Manual of Regulations for banks and non-bank financial institutions to incorporate good corporate governance practices. Specifically, it talks of the power and authority of the board of directors, its general responsibility, specific duties and responsibilities of the board of directors as a body and as individual directors.

BSP Circular No. 296 prescribes rules for the board, qualifications of directors and officers of banks and non-bank financial institutions along with disqualifications.

C. Research Problem

How have corporate governance regulations affected the practices of directors of banks in the Philippines?

Specifically, this research will try to answer the following:

1. Have the issuance of corporate governance regulations by the BSP and the required training been helpful to the board's governance as a body?
2. Have the corporate governance regulations and the training enabled the individual directors to learn more about their specific duties and responsibilities?
3. Has the training enhanced the capabilities of the individual directors in the functional areas of governance?
4. Have the regulations and training contributed to the board's fairness, accountability, transparency, and competence?
5. Do the directors believe that good corporate governance practices have contributed to enhancing shareholder value?

D. Research Objectives

The primary objective of this research study is to determine how the BSP corporate governance regulations (mandating the adoption of corporate governance practices and training on the subject) have affected the practices of the bank directors in the Philippines.

In line with the research problems, the specific research objectives are:

1. To determine whether the issuance of corporate governance regulations by the BSP and the required training have been helpful to the board's governance as a body.
2. To determine whether the corporate governance regulations and the training have enabled the individual directors to learn more about their specific duties and responsibilities.
3. To find out whether the training has enhanced the capability/capabilities of the individual directors in the functional areas of governance.
4. To determine whether the regulations and training have contributed to the board's fairness, accountability, transparency, and competence.
5. To find out whether or not the directors believe that good corporate governance practices have contributed to enhancing shareholder value.

To enhance the study, the following objective is added:

6. To compare the corporate governance regulations issued by the BSP with corporate governance regulations issued by the selected Association of South East Asian Nation (ASEAN) monetary authorities.

E. Conceptual Framework

This research study will be conducted within our conceptual framework of corporate governance for banks and quasi banks (Figure A), and the link of the BSP regulations and the required training to shareholder value and economic growth (Figure B).

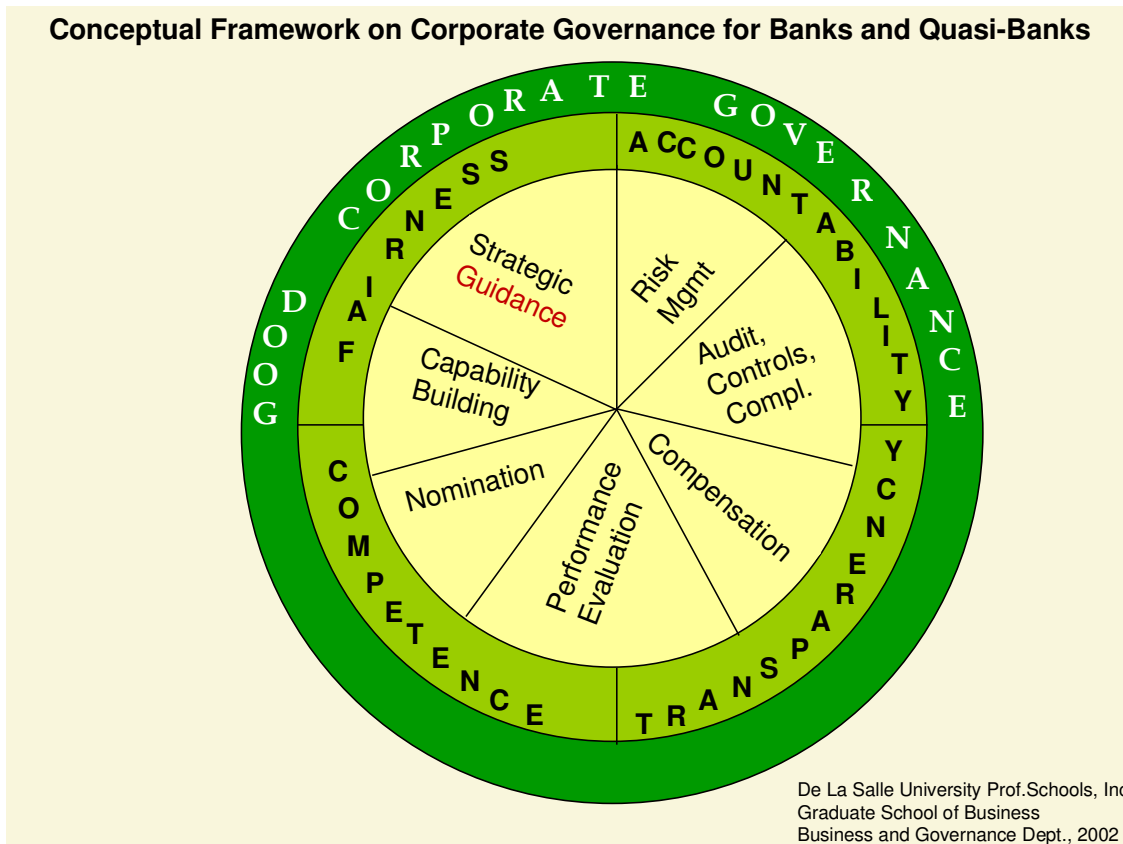


Figure A

Our model for corporate governance identifies seven functions of the Board of Directors. These are the functions of strategic guidance; risk management (of particular importance for banks); audit, controls, and compliance; compensation; performance evaluation; nomination; and capability building.

The Board must carry out these functions and ensure fairness, accountability, transparency, and competence in its actions.

Our model of corporate governance differs from other models primarily in its stress on risk management and capability building as explicit functions of the Board. Furthermore, our model emphasizes, aside from the fairness, accountability, and transparency required both from the Board as a body and from individual directors, the element of “competence.”

This study was likewise made within our conceptual framework which links the BSP regulations and the required training to shareholder value and economic growth (Figure B).

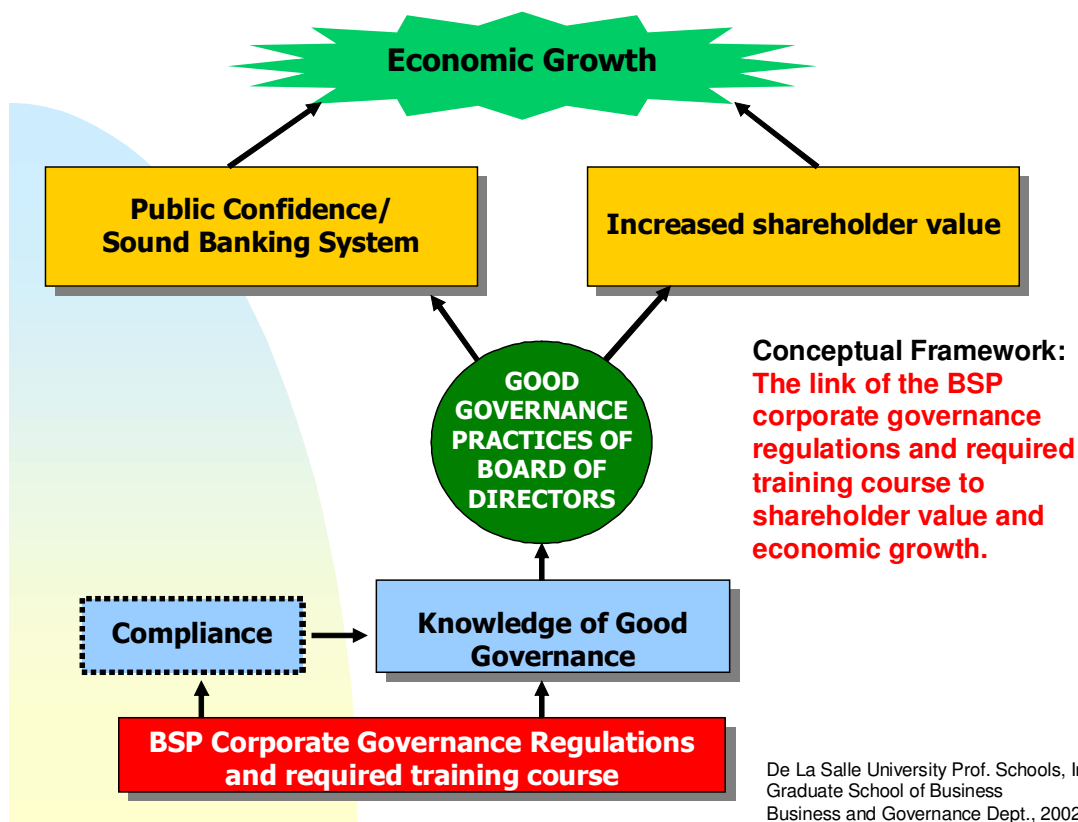


Figure B

This framework suggests that the BSP corporate governance regulations and required training course leads not only to compliance with regulations but more importantly, gives the bank directors knowledge of good governance practices. The actualization of these practices should theoretically lead to increased shareholder value. It should also result in public confidence and a sound banking system. The increased shareholder value, public confidence, and a sound banking system in turn contribute to the country's economic growth.

The conceptual framework for this study will be:

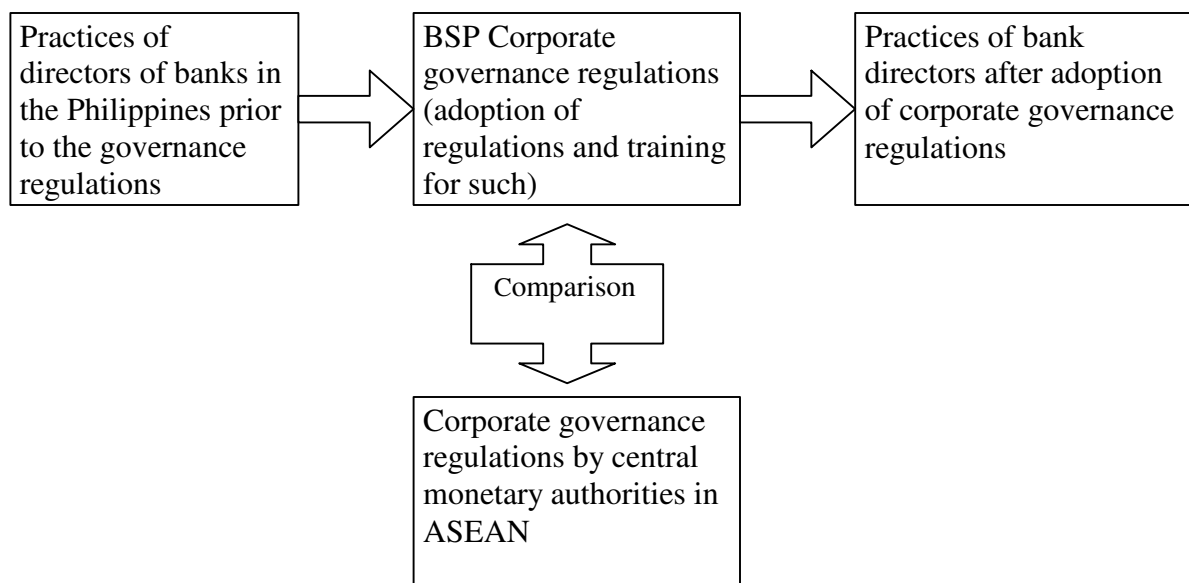


Figure C

In this framework, the practices of directors of banks in the Philippines prior to the governance regulations is a given. The study then seeks to determine how the imposition of BSP corporate governance regulations and the required training have affected the said practices of bank directors on governance.

The study also compares the BSP corporate governance regulations with the corporate governance regulations by central monetary authorities of selected countries in the ASEAN.

F. Significance of the Study

The BSP's Circular No. 283 issued in May 2001, is the very first corporate governance regulation issued by a Philippine government agency. The subsequent regulation mandating training is also the first move of its kind. It preceded the Philippine SEC's Code of Corporate Governance that was issued in April 2002.

This research study is important for policy makers in the Philippines since the results will say whether corporate governance regulations (the adoption of such and training on the subject) can indeed improve the governance practices of bank directors.

The lessons learned from this study can be used by other regulatory agencies to build a culture of good corporate governance in firms under their jurisdiction.

The Philippine experience on the effects of corporate governance regulations on the practices of bank directors can also serve as a guide for central monetary authorities in the ASEAN and other similarly situated nations.

G. Scope and Limitations of the Study

This study is the first phase in a multi-phase program which seeks to look into the effects of corporate governance regulations on the practices of directors of banks in the Philippines. The research limited itself to directors of rural banks in the Metro Manila area and the provinces of Batangas and Cavite.

Metro Manila is the center of business and government in the Philippines. It sets the trend in banking and finance, education and training, and practically all aspects of business and development. The nearby provinces such as Batangas and Cavite tend to pattern their business, banking and commercial activities on trends obtaining in Metro Manila. Many directors and officers of rural banks in these areas are in fact based in Metro Manila.

It was therefore felt that the study should first be delimited to focus on how corporate governance regulations affected the practices of directors of banks in these areas. Further research can later be conducted to determine the effects of corporate governance regulations among directors of banks in other areas.

The study relies principally on the perceptions and reports of the directors themselves. Social desirability effects may affect responses and the conclusions will have to be taken in light of this limitation.

The comparison of the corporate governance regulations with those issued by the central monetary authorities of ASEAN countries was limited to the following member states and their central banks: Brunei Darussalam – Ministry of Finance; Indonesia – Bank Indonesia; Malaysia – Bank Negara Malaysia; Singapore – Monetary Authority of Singapore; Thailand – Bank of Thailand.

Data for this study are of May 7, 2003. Any developments after this date are not included.

H. Definitions of Terms

The terms of continuing relevance and applicability throughout the study are:

1. ASEAN – the Association of South East Asian Nations. Member nations are the Philippines, Indonesia, Thailand, Singapore, Malaysia, Brunei Darussalam, Cambodia, Laos, Myanmar, and Vietnam.
2. Bangko Sentral Ng Pilipinas (BSP) – the central monetary authority of the Philippines. It provides policy direction in the areas of money and credit. It has supervision over the operations of banks and exercises regulatory powers as provided in Republic Act No. 7653 and other pertinent laws over the operations of finance companies, quasi-banks, and institutions performing similar functions.⁸
3. Banks - entities engaged in the lending of funds obtained in the form of deposits.⁹
4. Corporate governance – is the system used to direct and manage the affairs of the company to enhance shareholder value and promote corporate fairness, accountability, and transparency.
5. Corporate governance regulations – the corporate governance regulations referred to in this study are those issued by the BSP, specifically Circular No 283 (May 2001) and 296 (September 2001). The emphasis is more on BSP Circular No. 283.
6. Practices of bank directors – actual use of the good corporate governance principles stated in BSP Circular No. 283; compliance with the stated duties and responsibilities of the Board of Directors as a body, and of individual directors, as mandated in BSP Circular No. 283.
7. Rural Banks – banks as defined in Republic Act No. 7353.¹⁰ The rural banks compose the majority of banks in the Philippines in terms of number but not in terms of assets, equity, or profits.

Within the context of the banking system, the rural bank exists to operate in the provinces essentially to serve the financial needs of the rural folk.¹¹

⁸ Republic Act No. 7653, The New Central Bank Act

⁹ Republic Act No. 8791, The General Banking Law of 2000.

¹⁰ Ibid.

¹¹ Rural Bankers Association of the Philippines, www.rbap.org

Chapter II

Research Methodology

A. Type of Study

The study is descriptive and uses the survey method to generate the basic data. There are no existing secondary data available, thus, the need for primary data. It is also exploratory as it merely attempts to describe current conditions in a particular sector of the banking industry – rural banks -- and how the BSP's corporate governance regulations have affected the practices of these banks and their bank directors.

Participant Observation

The author is taking an insider view of the subject being studied, being currently the Chairman of a rural bank, and having worked and interacted with members of the board of rural banks for roughly 30 years.

B. Method of Gathering the Data

A survey was conducted with a probability sample of rural banks in selected areas with the members of the boards of directors as respondents. The study decided to focus on rural banks for this initial study. It is felt that this first attempt to investigate the impact of corporate governance regulations can be more useful by focusing on banks that are privately held and generally family owned. Future research should complement this study by covering universal, commercial, thrift, and government banks. Details of the survey are given in the succeeding section.

C. Sampling Design

Sample Size

The study set the sample size to 130 respondents. Given an effect size for this sample, the results of the study are true 92% of the time using the same population with a margin of error of plus or minus 5%. The derived power is shown as Figure D.

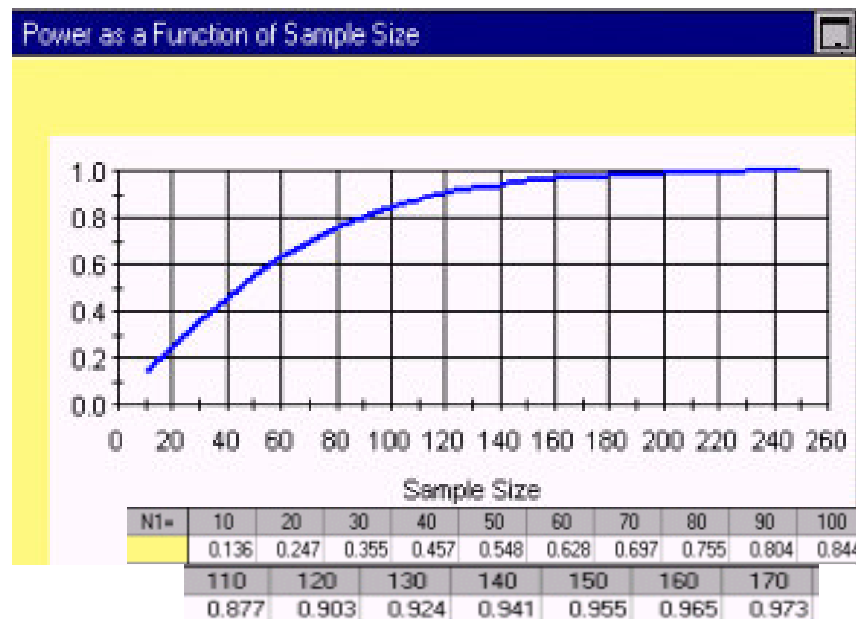


Figure D

Respondents

Respondents are members of the board of directors of rural banks in Metro Manila and nearby provinces, namely: Batangas and Cavite. There are some 97 rural banks in these areas or roughly 12.5% of total rural banks in the Philippines.

Sampling

The study used a multi-stage probability sampling covering all rural banks in Metro Manila, Batangas, Cavite. In the first stage, the researcher listed all rural banks in the target areas. In the second stage, 10 banks were selected by convenience from each area. In the third stage, directors of these selected banks were listed and targeted for interview.

As a contingency measure, five additional banks were identified as possible replacements for the banks in the original list, to cover for banks or bank directors who refuse to be interviewed.

All bank directors of target banks who were available at the time of the study were interviewed.

Data Gathering

Well-trained and experienced interviewers using a highly structured questionnaire conducted personal interviews. The questionnaire is shown in Appendix A. The

interviewers followed the standard routine for conducting executive interviews, as follows:

- Letter was sent to the Chairman of the Board.
- An interviewer confirmed receipt of such letter through telephone
- On confirmation, copies of questionnaires for all Board members were sent through fax or delivered by the interviewer in person.
- An interviewer confirmed receipt of the questionnaires via telephone. Where possible, the interviewer who hand-delivered the questionnaire conducted the interview if the bank director was available and willing to be interviewed.
- For those contacted through fax, an appointment was set for the interview.

The study set a maximum of three call backs, after which the target respondent was dropped from the list.

D. Survey Instrument

The study made use of a four-page highly structured questionnaire. It was printed in a table format and on both sides for ease of use. It was designed in such a way that it could be self-administered.

Every side of the form represents a section. The first part of the questionnaire is an introduction and another two parts comprise the survey proper. The last part covers the demographic classification of the respondents.

E. Analytical Techniques

The study used both the descriptive and causal methods of analysis. Where practical, nominations by respondents were transformed to numerical values or scaled using standard techniques for data transformation. The following were the techniques used for analysis.

Descriptive Analysis

Summary statistics using totals were used for qualitative information while measures of central location and dispersion were used in describing data with continuous scale.

Test of Proportion

The Binomial Test procedure compares the observed frequencies of the two categories of a dichotomous variable to the frequencies expected under a binomial distribution with a specified probability parameter. By default, the probability parameter for both groups is 0.5. To change the probabilities, a test of proportion for the first group is attempted. The probability for the second group will be 1 minus the specified probability for the first group .

T-Test

The Paired-Samples T Test procedure compares the means of two variables for a single group. It computes the differences between values of the two variables for each case and tests whether the average differs from 0.

Bivariate Correlation

The Bivariate Correlations procedure computes Pearson's correlation coefficient, Spearman's rho, and Kendall's tau-b with their significance levels. Correlations measure how variables or rank orders are related.

Linear Regression

Linear Regression estimates the coefficients of the linear equation, involving one or more independent variables that best predict the value of the dependent variable. It is used in exploratory analysis and descriptive in nature.

F. Respondent Profile

A total of 130 bank directors from 27 rural banks were interviewed, an average of five respondents per bank. On the average, these directors are affiliated with banks that have been in operation for 35 years with two branches, has seven board members, and around 28 employees.

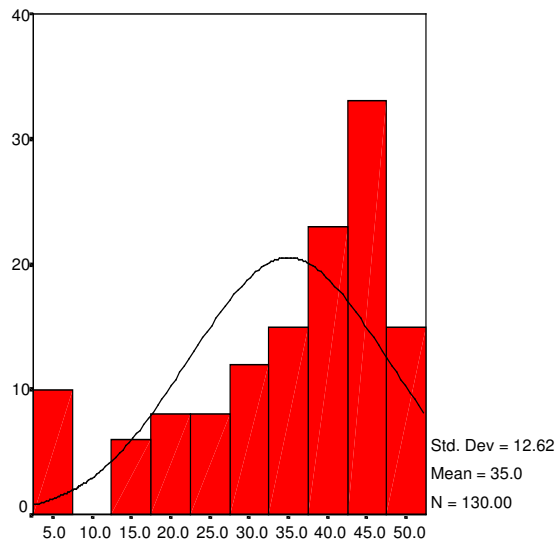


Figure E. Years Respondent Banks Have Been in Operation

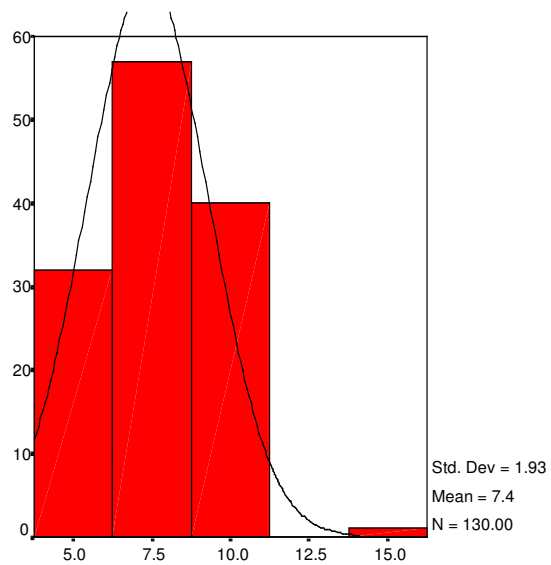


Figure F. Number of Directors of Respondent Banks

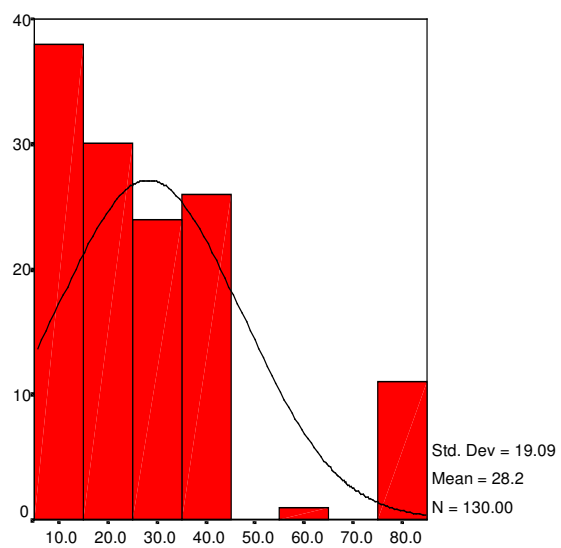


Figure G. Number of Employees of Respondent Banks

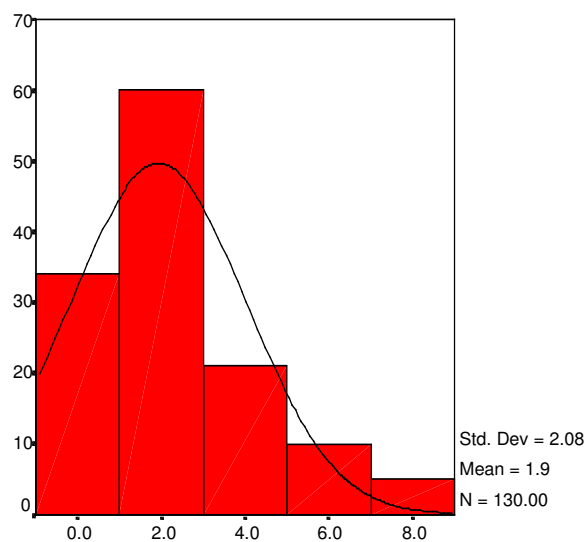


Figure H. Number of Branches of Respondent Banks

G. Research Methodology for the Comparison of BSP Corporate Governance Regulations with those issued by ASEAN Central Monetary Authorities

The sourcing of corporate governance regulations issued by ASEAN Central Monetary Authorities of Singapore, Thailand, Malaysia, Indonesia, and Brunei Darussalam was made through an internet search and coordination with the Bangko Sentral Ng Pilipinas, and the South East Asian Central Banks (SEACEN) Research and Training Centre.

Chapter III Analysis of Findings

A. Overall Impact

Overall

To define the overall impact, nominations of compliance by respondent-directors for the 22 specific duties and responsibilities listed in BSP Circular 283 Series of 2001 before the implementation of this Circular were cross-analyzed with their nominations of compliance after the implementation.

On the average (based on 22 duties and responsibilities of the Board and individual Directors), 65% of respondent-directors say that they and their banks were implementing the specific duties and responsibilities listed in BSP Circular 283 prior to its issuance. The proportion increased to 84% after the BSP issued Circular 283, or an average increase of 19 percentage points

The level of compliance before and after the implementation of BSP Circular 283 is significantly different (at null hypothesis prior and after = 0 and $\alpha = 0.05$, with $p\text{-value} < 0.000$). This suggests that overall, the BSP's corporate governance regulations have had a significant impact on the practices of banks and bank directors.

To explore what demographic variables could be influential in overall compliance, the following four variables were tested for statistical significance:

- Number of years the bank has been in operation,
- Number of the bank's branches,
- Number of the bank's directors
- Number of regular employees

Based on the correlation and its corresponding test of significance, at $\alpha=0.05$, the change in the overall compliance was significantly related with the number of years the bank has been in operation, the number of the bank's branches, and the number of regular employees (all with $p\text{-values}$ significant even at $\alpha = 0.01$). The number of board of directors however, is not correlated with the change in overall compliance as shown on the next page:

Correlation of Demographic Factors to Perceived Impact of Corporate Governance Regulations

| Demographic Factor(s) | | CHANGE |
|-------------------------------------|---------------------|--------|
| Years Bank Has Been in Operation | Pearson Correlation | .301** |
| | Sig. (2-tailed) | .000 |
| | N | 130 |
| Number of Bank Branches | Pearson Correlation | .355** |
| | Sig. (2-tailed) | .000 |
| | N | 130 |
| Number of Directors in Bank's Board | Pearson Correlation | -.008 |
| | Sig. (2-tailed) | .928 |
| | N | 130 |
| Number of Regular Employees | Pearson Correlation | .346** |
| | Sig. (2-tailed) | .000 |
| | N | 130 |

** Correlation is significant at the 0.01 level (2-tailed).

For descriptive purposes, the relation of the overall change with the demographic variables was tested further using regression. Based on the results, the model using the bank's years of operation and number of branches as predictor have the most desirable results (with F-value being the highest at similar significant R^2 at 66.9%). That is, the longer the bank has been operating and the bigger its branch network, the more significant the compliance.

Model Summary

| Model | R | R^{2a} | Adjusted R^2 | Std. Error of the Estimate | Change Statistics | | | | |
|-------|------------------|----------|----------------|----------------------------|-------------------|----------|-----|-----|---------------|
| | | | | | R^2 Change | F Change | df1 | df2 | Sig. F Change |
| 1 | .82 ^b | .67 | .66 | 3.16 | .67 | 129.23 | 2 | 128 | .000 |

^a For regression through the origin (the no-intercept model), R Square measures the proportion of the variability in the dependent variable about the origin explained by regression. This CANNOT be compared to R Square for models, which include an intercept.

^b Predictors: Years Bank Has Been in Operation, Number of Bank Branches

Duties of the Board of Directors as a body

BSP Circular 283 listed 15 duties and responsibilities of the Board of Directors as a body. To define the overall impact, nominations of compliance by respondent-directors for the 15 specific duties and responsibilities of the Board before the implementation of this Circular were cross-analyzed with their nominations of compliance after the implementation.

On the average, 60% of respondent-directors say that their bank's Board of

Directors was implementing the specific duties and responsibilities listed in the BSP Circular 283 prior to its issuance. The proportion increased to 87% after the BSP issued Circular 283 or an increase of 27 percentage points.

The level of compliance before and after the implementation of BSP Circular 283 is significantly different (at null hypothesis prior and after = 0 and $\alpha = 0.05$, with $p\text{-value} < 0.000$). This suggests that the BSP's corporate governance regulations have had an impact on the practices of these banks' Board of Directors as a body.

If the demographic variables were correlated with the overall change in compliance for the duties and responsibilities as a body, the significance test for the correlation coefficient indicated that the number of regular employees, the number of the bank's branches and the years that the bank has been in operation are significantly related with the former (with $p\text{-values}$ all less than 0.01).

Duties of the Individual Members of the Board of Directors

BSP Circular 283 listed seven duties and responsibilities of the individual members of the bank's Board. To define the overall impact, nominations of compliance by respondent-directors for the seven specific duties and responsibilities of the Board of Directors before the implementation of this Circular were cross-analyzed with their nominations of compliance after the implementation.

On the average (based on seven duties and responsibilities of the individual members of the Board), 75% of respondent-directors say that they were carrying out the specific duties and responsibilities listed in BSP Circular 283 prior to its issuance. The proportion increased to 76% after the BSP issued Circular 283, or an increase of one percentage point.

The level of compliance before and after the implementation of BSP Circular 283 is not significantly different (at null hypothesis prior and after = 0 and $\alpha = 0.05$, with $p\text{-value} < 0.325$). This suggests that the BSP's corporate governance regulations have had practically no real effect on the practices of individual bank directors.

In the case of the individual directors, the analysis correlating compliance with the different sample groups is not tenable because the change in the overall compliance was barely minimal.

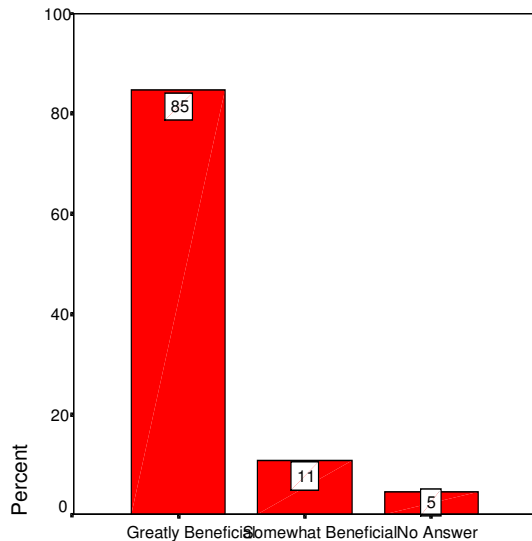
Overall Benefit to the Banking Industry

Respondent-directors were asked, using a three-point scale, as to whether corporate governance regulations have been generally beneficial to the Philippine banking industry.

The vast majority of these respondents say that the BSP's corporate governance regulations had been beneficial to the Philippine banking industry. More than two-thirds

of respondents (85%) say that the regulations had been greatly beneficial to the industry, while 11% say that the regulations had been somewhat beneficial. The rest do not have any specific opinion on this subject.

Figure I. Overall Benefit to the Banking Industry



Note: Due to rounding off, the sum of the percentage exceeds 100.

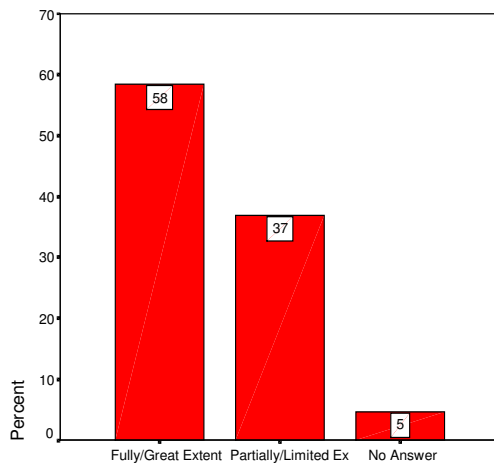
General Compliance

Respondents-directors were asked, using a three-point scale, about their perception as to the extent banks in general comply with or implement the BSP's corporate governance regulations.

The question asked was: "After the issuance of the corporate governance regulations, to what extent do you think, banks in general, comply with or implement them?"

The majority of these respondents (58%) say that banks, in general, comply with the regulations to a full extent. The other 37% of respondent-directors say that banks, in general, comply with the regulations partially or to a limited extent only.

Figure J. Extent of Compliance

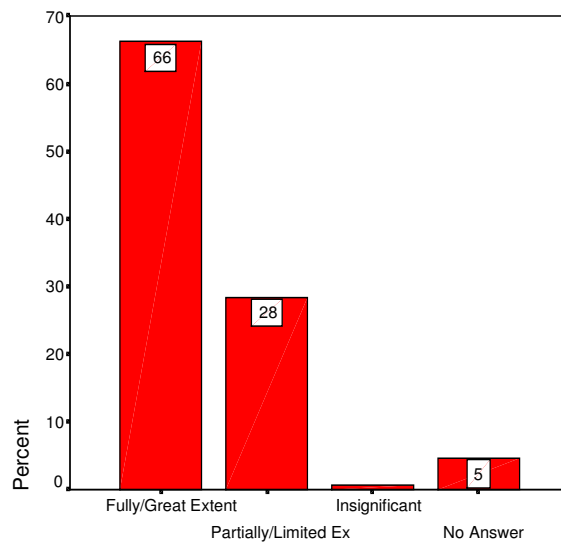


Note: Due to rounding off, the sum of the percentage exceeds 100.

Impact on Shareholder Value

Respondent-directors were asked, using a three-point scale, as to whether the corporate governance regulations have improved their bank's shareholder value.

Figure K. Impact on Shareholder Value



More than half considered the BSP Circular 283 as a reason for improvement in their bank's shareholder value. Overwhelmingly, the directors believed that it has had a positive impact in enhancing shareholder wealth (95% cumulative).

B. Specific Impact

To define the specific impact of the BSP corporate governance regulations on the practices of directors of bank, nominations of compliance by respondent-directors for each of the 22 specific duties and responsibilities listed in BSP Circular 283 before the implementation of this directive were cross-analyzed with their nominations of compliance after the implementation.

Of this total, 15 are specific duties and responsibilities for the Board of the Directors as a body and seven are specific duties and responsibilities of the individual members of the Board.

Specific Duties of the Board of Directors as a body

Out of the 15 specific duties and responsibilities of the Board as a body, the duty to “Adopt/maintain adequate risk management” had the highest increase in compliance. From a proportion of 35% before the implementation of BSP Circular 283, the proportion of “compliers” went up to 95% after the implementation, an increase of 60 percentage points, as shown in Table 1.

Table 1

| Base: Total Respondents | Percent to Total Respondents | | | | |
|--|------------------------------|-------|------------|------------|---------------|
| | Before | After | Net Change | To Be Done | Not Important |
| Select/appoint officers qualified to effectively administer bank/quasi-bank | 82.3 | 93.1 | 10.8 | 6.9 | 3.8 |
| Establish appropriate compensation package for all personnel that is consistent with stockholders' interest | 73.1 | 88.5 | 15.4 | 11.5 | 10.8 |
| Establish objectives/draw up a business strategy, and ensure that performance vs. plan is regularly reviewed | 40.0 | 90.8 | 50.8 | 9.2 | 9.2 |
| Prescribe corporate values, codes of conduct and standards of appropriate behavior | 52.3 | 86.9 | 34.6 | 13.1 | 10.0 |
| Establish compliance via sound written policies | 49.2 | 90.8 | 41.5 | 9.2 | 3.1 |
| Prescribe clear assignment of responsibilities and decision-making authorities to directors | 48.5 | 96.2 | 47.7 | 3.8 | 4.6 |
| Supervise bank/quasi-bank/trust entity affairs and provide adequate checks/balances | 50.8 | 79.2 | 28.5 | 20.8 | 3.8 |
| Monitor, assess, control performance of management | 66.9 | 88.5 | 21.5 | 11.5 | 6.2 |
| Adopt/maintain adequate risk management | 35.4 | 94.6 | 59.2 | 5.4 | 3.8 |
| Constitute audit committee composed of members with accounting/finance background | 39.2 | 79.2 | 40.0 | 20.8 | 20.0 |
| Meet regularly with all meetings documented | 76.2 | 95.4 | 19.2 | 4.6 | 3.8 |
| Keep individual members and shareholders informed about the bank's performance | 70.0 | 95.4 | 25.4 | 4.6 | 3.1 |
| Ensure that the bank provides only those services/facilities supportive of the economy | 65.4 | 80.0 | 14.6 | 20.0 | 7.7 |
| Assess at least annually its performance and effectiveness as a body | 67.7 | 68.5 | 0.8 | 31.5 | 6.2 |
| Keep authority within the powers of the institution as stated in the articles of incorporation | 80.8 | 81.5 | 0.8 | 18.5 | 1.5 |
| Average proportion of directors | 59.8 | 87.2 | 27.4 | 12.8 | 6.5 |

Specific Duties of Individual Members of the Board of Directors

The BSP's corporate governance regulations had little impact on the specific duties and responsibilities of individual directors, even on those duties whose compliance ratio before the implementation had been relatively low. However, the compliance ratio for most of the duties and responsibilities had been high in the first place as shown in Table 2 below:

Table 2

| Base: Total Respondents | Percent to Total Respondents | | | | |
|---|------------------------------|-------|------------|------------|---------------|
| | Before | After | Net Change | To Be Done | Not Important |
| Conduct fair business transactions and ensure that personal interest does not bias board decisions | 83.8 | 84.6 | 0.8 | 20 | 3 |
| Act honestly/in good faith, with loyalty and in the best interest of the institution, and stakeholders | 83.8 | 84.6 | 0.8 | 20 | 3 |
| Devote time and attention necessary to properly discharge duties and responsibilities | 74.6 | 74.6 | 0 | 25.4 | 7.7 |
| Act judiciously on matters brought before the board | 76.9 | 77.7 | 0.8 | 29 | 2 |
| Exercise independent judgment, taking a position when necessary and supporting plans when beneficial to the institution | 68.5 | 70.0 | 1.5 | 39 | 6 |
| Have working knowledge of statutory & regulatory requirements affecting the institution | 61.5 | 61.5 | 0.0 | 50 | 11 |
| Observe confidentiality | 75.4 | 75.4 | 0.0 | 32 | 9 |
| #b – Average # of respondents who comply per dimension | 74.9 | 75.5 | 0.5 | 31.9 | 6.3 |

However, it should be noted that non-compliers have indicated their intention to carry out those specific duties and responsibilities they are not currently doing. Only a few consider any of the duties and responsibilities as not being important.

Areas of Governance

Respondent-directors were asked to nominate the areas which have been enhanced with the implementation of corporate governance regulations. The results are as follows:

| | | |
|-----------------|---|-------|
| Fairness | - | 80.0% |
| Accountability- | | 79.2% |
| Competence | - | 79.2% |
| Transparency | - | 76.9% |

To validate the above findings, tests of proportion must be performed.

Table 3

| | Group | N | Observed Proportion | Asymptotic Sig. (2-tailed) |
|----------------|--------------|----|---------------------|----------------------------|
| Fairness | Group 1: yes | 23 | 0.70 | 0.000 ^a |
| | Group 2: no | 10 | 0.30 | |
| | Total | 33 | 1.00 | |
| Accountability | Group 1: yes | 28 | 0.85 | 0.000 ^a |
| | Group 2: no | 5 | 0.15 | |
| | Total | 33 | 1.00 | |
| Transparency | Group 1: yes | 27 | 0.82 | 0.000 ^a |
| | Group 2: no | 6 | 0.18 | |
| | Total | 33 | 1.00 | |
| Competence | Group 1: yes | 29 | 0.88 | 0.000 ^a |
| | Group 2: no | 4 | 0.12 | |
| | Total | 33 | 1.00 | |

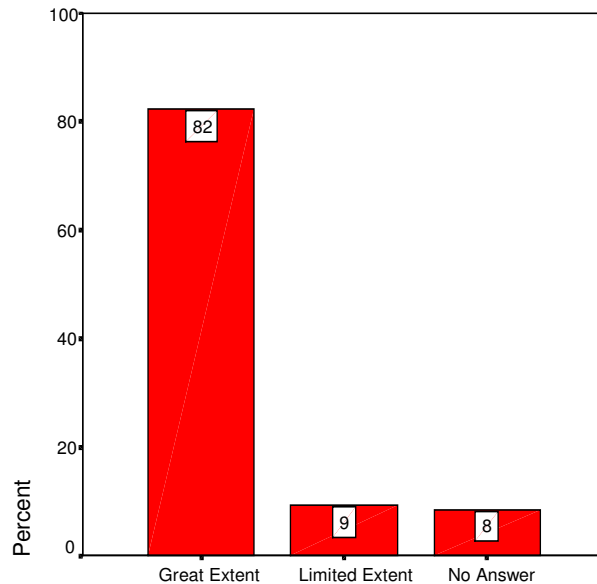
^aBased on Z Approximation

Based on the test, the proportion of those who perceived that they have benefited from corporate governance regulations in terms of fairness, accountability, transparency and competence vis-à-vis those who did not, is significant.

Training

Among those who attended the training on corporate governance, 82% say that their knowledge on corporate governance regulations has improved to a great extent. Only 9% say that the effect was limited as shown in the succeeding chart:

Figure L. Extent (of) Improvement of Knowledge on Corporate Governance Regulations Due to Training or/Participation in Seminars



Note: Due to rounding off, the total percentage displayed is not equal to 100.

To describe the relation of the improvement on the knowledge of corporate governance regulations to the change in the overall compliance, their correlation was tested for significance. Majority of the directors perceived that the training had improved their knowledge of Corporate Governance Regulations and change in Overall Compliance. The corresponding correlation between the two was also significant (p -value = 0.027). This suggests that training has had a positive effect on compliance.

C. Comparison of BSP Corporate Governance Regulations with those promulgated by other central monetary authorities in the ASEAN

An internet search on the websites of the Bank of Thailand, Monetary Authority of Singapore, Bank Negara (Central Bank of Malaysia), and the Ministry of Finance of Brunei Darussalam show no evidence of any corporate governance regulation issued by these central monetary authorities. No information was also available at the SEACEN Centre.

The Bank Indonesia has a few corporate governance provisions incorporated in its “Bank Indonesia Regulation Concerning Commercial Banks, Number 2/27/2000.”

The Question and Answer portion on its website regarding “On-site permanent supervisory presence” states the following:

It must be aware that the ultimate responsibility for a bank’s soundness and safety lies with the Board of Directors. A bank Board of Directors must be strong, independent, and attentive to the bank’s soundness and safety. Accountability of the bank Board of Directors is not only to the bank shareholders, but also to its depositors, to Bank Indonesia as bank supervisor (in the future also to the deposit insurance institution), and to the communities served. Bank Indonesia’s responsibilities as a supervisor, are to identify structural problems or emerging problems, as well as to ensure that the Board of Directors settles the problems appropriately.¹²

¹² www.bankindonesia

Chapter IV

Conclusions and Recommendations

A. Conclusions

The study was conducted to answer the research problem “how have corporate governance regulations affected the practices of directors of banks in the Philippines?”

Based on the findings of the study, the respondent-directors believe that the BSP’s corporate governance regulations, as contained in Circular 283, Series of 2001, have had overall, a significant and positive effect on the practices of banks and bank directors. The effect has a definitive level of statistical significance.

The change in overall compliance is significantly related with the number of years a bank has been operating, the number of the bank’s branches and the number of regular employees. Further analysis shows that the longer the bank has been operating and the bigger the branch network, the more significant the effect.

Respondent-directors consider the regulations as having:

1. considerably improved the Board’s exercise of its duties and responsibilities;
2. been beneficial to the Philippine banking industry;
3. generated a high degree of compliance; and
4. improved the bank’s shareholder value.

The study sought to answer five specific research questions, and had six research objectives. The specific research problems and the results of the study relative to each problem are as follows:

Research Problem No. 1: Have the issuance of corporate governance regulations by the BSP and the required training been helpful to the board’s governance as a body?

Findings: On the average, 60% of respondent-directors say that their bank’s Board of Directors, as a body, was implementing the specific duties and responsibilities listed in the BSP Circular 283 prior to its issuance. The proportion increased to 87% after the BSP issued Circular 283.

Specific duties and responsibilities wherein the impact has been the greatest for the Board of Directors are as follows (in the order of significance):

1. Adopt/maintain adequate risk management (59%).

2. Establish objectives/draw up a business strategy, and ensure that performance vs. plan is regularly reviewed (51%).

3. Prescribe clear assignment of responsibilities and decision-making authorities to directors (48%).

4. Establish compliance via sound written policies (42%)

5. Constitute audit committee composed of members with accounting/finance background (40%).

However, all the directors that are not yet complying and implementing the above duties and responsibilities say that they will be complying.

This makes us conclude that, as perceived by the respondents, the issuance of corporate governance regulations by the BSP has been helpful to the Board's governance as a body.

Research Problem No. 2: Have the corporate governance regulations and the training enabled the individual directors to learn more about their specific duties and responsibilities?

Findings: On the average (based on seven duties and responsibilities of the individual members of the Board), 75% of respondent-directors say that they were carrying out the specific duties and responsibilities listed in BSP Circular 283 prior to its issuance. The proportion increased to 76% after the BSP issued Circular 283, or an increase of 1.0 percentage point.

There had been no significant effect on the individual directors of the Board, mainly because the proportion of compliance had been relatively high in the first place prior to the issuance of BSP Circular 283, Series of 2001.

However, in two areas, the ratios of compliance had been less than the others. These are:

1. Exercise independent judgment, taking a position when necessary and supporting plans when beneficial to the institution (68% compliance).
2. Have working knowledge of statutory & regulatory requirements affecting the institution (62% compliance).

All the directors that are not yet complying with the corporate governance regulations say that they will be complying.

This makes us conclude that, as perceived by the respondents, the issuance of corporate governance regulations by the BSP has not been that significant for

individual board members.

Research Problem No. 3: Has the training enhanced the capabilities of the individual directors in the functional areas of governance?

Findings: Among those who attended the training on corporate governance, 82% say that their knowledge on corporate governance regulations has improved to a great extent. Only 9% say that the effect was limited.

Further analysis shows that the correlation between improvement and knowledge due to training and overall compliance is significant. This shows that training has had a positive effect on compliance.

We can therefore conclude that, as perceived by the respondents, the training has improved the individual directors' knowledge of corporate governance regulations and has thus enhanced their capabilities in the functional areas of governance.

Research Problem No. 4: Have the regulations and training contributed to the board's fairness, accountability, transparency, and competence?

Findings: Respondent-directors were asked whether the corporate governance regulations have contributed to the board's/bank's fairness, accountability, transparency, and competence. The affirmative answers are as follows:

| | | |
|-----------------|---|-------|
| Fairness | - | 80.0% |
| Competence | - | 79.2% |
| Accountability- | | 79.2% |
| Transparency | - | 76.9% |

This makes us conclude that, as perceived by the respondents, the corporate governance regulations have contributed to the board's fairness, accountability, transparency, and competence.

Research Problem No. 5: Do the directors believe that good corporate governance practices have contributed to enhancing shareholder value?

Findings: More than half of the respondents considered the corporate governance regulations as a reason for improvement in their bank's shareholder value. Overwhelmingly, the directors believed that it has a positive impact on their shareholder wealth.

We can therefore conclude that the directors believe that good corporate governance practices have contributed to enhancing shareholder value.

For the additional Research Objective No. 6: To compare the corporate governance regulations issued by the BSP with corporate governance regulations issued by the central monetary authorities of the other ASEAN countries identified in this study.

Findings: It appears, based on the facts gathered, that the no central monetary authority in the ASEAN (specifically from Thailand, Singapore, Malaysia, Indonesia, Brunei Darusallam) has issued a comprehensive code of corporate governance as the BSP did through its Circular 283.

However, more definitive proof and further research is desirable before a firm conclusion can be given on this matter.

B. Recommendations

Given the results, the following are recommended:

1. That further study be carried out to determine why the respondents perceive that the issuance of corporate governance regulations has been helpful to the Board's governance as a body (increase of 27 percentage points); but why on the other hand, they perceive that it has not been that significant for individual board members (increase of 1 percentage point).
2. That the BSP continuously monitor compliance with the corporate governance regulations.
3. That the BSP continuously stress the importance of good corporate governance practices and its link to increased shareholder value.
4. That the BSP on one hand push, and that the rural banks on the other hand by themselves initiate, capability building for the Board of Directors, senior management, and other company personnel. Furthermore, it would be to the advantage of the rural bankers to foster a culture of continuous improvement in corporate governance practices.
5. That this multi-phase research be continued to cover rural banks in the other regions, along with universal, commercial, thrift, and government banks.
6. That further research be conducted to compare the corporate governance regulations issued by the BSP with corporate governance regulations issued by the central monetary authorities of the ASEAN countries covered in this study.

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