Action Research on Funds Governance with Employee's Bank Trust's Unit Investment Trust Funds

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Abstract: The recent financial blow ups and buy outs has put much emphasis on good governance; the Organization for Economic Cooperation and Development (OECD) and Australian Securities Exchange (ASX) developed principles and guidelines for compliance to prevent fund blow-ups. These guidelines are geared toward international markets.

In the US and Europe, mutual funds dominate the investment market while in the Philippines, Unit Investment Trust Funds (UITFs) and mutual funds exist side by side with UITFs being more prevalent. This study focused on Employee's Bank Trust's team continuous effort in improving the governance framework of its Trust's Unit Trust and Investment Funds (UITFs) through the use of action research. The team believed that the creation of a governance framework would add on to the organization's competitiveness.

Data was collected through interviews, discussions, and documentation. The team, which included members from different units of Employee's Bank, found the framework recommended by Payne (2004) and applied it to the governance of Employee's Bank Trust collective investment schemes. Payne's framework highlighted five principles: code of ethics, law, regulations/regulators, independent directors, and lawsuits.

Using the framework, the team incorporated other principles believed to be necessary for a UITF governance framework through in-depth and regular consultations and meetings. The revised framework has allowed the team to improve fund governance. It was clear to the team involved in this endeavor that the framework had to be dynamic and open to modifications to incorporate improvements as time goes by. This study is significant due to the increasing popularity of collective investment schemes and the growing need to govern them accordingly.

Key Words: fund governance; compliance

1. INTRODUCTION

1.1 Purpose and Rationale

The past years saw the global market suffer and witnessed the US government buy-out financial institution after financial institution and since then, the public has clamored for more regulations and for a higher level of corporate governance. The numerous corporate scandals heightened the need for corporations to take notice and act with urgency.

Corporate governance, according to Lea (2006), usually refers to the fulfillment of responsibilities to shareholders or stakeholders and ensuring good housekeeping. The housekeeping aspect of governance refers to compliance to regulations, development of fair rules on how the corporation should be run, transparency, accountability, and a developed system of checks and balance (Aoki, 2001; Davis, 2005; Dnes, 2005; World Bank, 2005; Clarke, 2011). Employee's Bank, as with any other corporation, should adhere to a higher level of corporate governance; this proves to be a challenge though as current governance frameworks miss out on certain aspects unique to the Philippine setting.

The purpose of this study the creation of a framework on fund governance in the local setting that will ensure that all aspects specific to the local setting are taken into consideration and are fairly evaluated.

1.2 Context

The unsettling wake of recent blow-ups puts the spotlight on the importance of governance and compliance to regulations and standards. To appreciate the importance of governance requires an understanding of its nature. Arguably the most well-known definition of corporate governance is found in the Cadbury Report. It describes corporate governance as the system which companies are defined and controlled; it emphasizes how shareholders fulfill their role through the selection of directors and auditors of the firm. The responsibilities of the board are specified as providing leadership, direction and stewardship.
The report also emphasizes that the actions of the board are subject to laws, regulations and the shareholders (Cadbury et al, 1992). There is differentiation in the fulfillment of responsibilities to either shareholders or stakeholders. The stakeholder theory involves engaging in ethical behavior and ensuring that the interest of the public is looked after (Aoki, 2001).The profit maximization theory, on the other hand, states that the main responsibility of the board and the officers of the institution are to its shareholders and in maximizing business profits (O'Sullivan, 2001).

Another known definition of governance is the one devised by the Organization for Economic Cooperation and Development (OECD). The OECD defined corporate governance as a set of relationships amongst firm management, the board, shareholders and stakeholders. It also adds in its definition that governance provides the structure on how corporate objectives are set and how the attainment of these objectives is monitored. The OECD claims that an effective governance system results in lower cost of capital, thus better facilitating the use of resources which leads to growth (OECD, 2004).

The Philippine Securities and Exchange Commission (SEC) document was the first of many specific recommended readings of our examiner. She became a person I could seek feedback from time to time. The Philippine SEC (2009) defines Corporate Governance as the framework of rules, systems and processes in the corporation that governs the performance of the Board of Directors and Management in their respective duties and responsibilities to the stockholders. The definition connotes a change from the 2002 definition wherein "duties and responsibilities to stakeholders" has become narrowed down to stockholders. Teehankee (2010) pointed out that the impact of the local change in definition has yet to be seen, it is clear that corporate governance has no rigid agreed upon definition.

Although diverse, the main tenets of the different definitions include the role of the board as the ones who set the strategic objectives of the company and the board's accountability, stewardship, and responsibility to the shareholders.

The principles of the OECD highlight the responsibilities of the board in setting strategic direction through adequate disclosures, transparency, and the protection of shareholders and stakeholders. The OECD emphasizes the need to protect even minor and foreign shareholders while enlarging the scope of governance through the inclusion of stakeholders. The OECD limits the stakeholders to those partners who have formal agreements with the firm (established through law or mutual agreements). It is unclear if stakeholders with non-formal agreements with the firm are included.

The Australian Securities Exchange (ASX) developed their own corporate governance framework which highlights eight principles: solid foundation for management and oversight, structure the board to add value, promote ethical and responsible decision-making, safeguard integrity in financial reporting, make timely and balanced disclosure, respect the rights of shareholders, recognize and manage risk, and remunerate fairly and responsibly.

The ASX and OECD definitions have common ground, the ASX expands the principles through the inclusion of the importance of structuring the board to add value, the creation of a corporate of code of ethics, the need to recognize and manage risk and finally the importance of fair remuneration to its board and employees while being clear about its relationship to performance.

According to Buck (2008), "the guidelines are built on the belief that one size does not fit all organizations in the Australian market and that there is little value in a checklist approach to corporate governance that does not focus on the particular needs, strengths, and weaknesses of the organizations." This study is focused developing a governance framework that addresses the particular needs, strengths, and weaknesses of the Philippine investment market are incorporated in the framework.

Furthermore, the need for a tailored governance framework on UITFs is a concern not only for Employee's Bank Trust but also for most, if not all, Trust groups in the Philippines. The BSP highlights the need for an appropriate governance framework and emphasizes this by continuously updating its rules and regulations with regards to the management of the UITFs. To ensure that Employee's Bank Trust retains its compliance and competitiveness in the market, it needed to be one step ahead in the formulation of its governance framework.

2. METHODOLOGY

Action research, according to Coghlan (2001) is suitable for organizational concerns such as systems improvement, organizational learning, and the management of change. Furthermore, because these are real events which must be managed in real time; these provide opportunities for both effective action and learning; and that they can contribute to the development of theory of what really goes on in organizations (p.2).

The author, together with his research collaborators, followed the action research cycle in identifying and constructing the underlying issue and the necessary actions that Employee's Bank needed to address and implement to avoid following in the path of destruction that many financial institutions have fallen into.

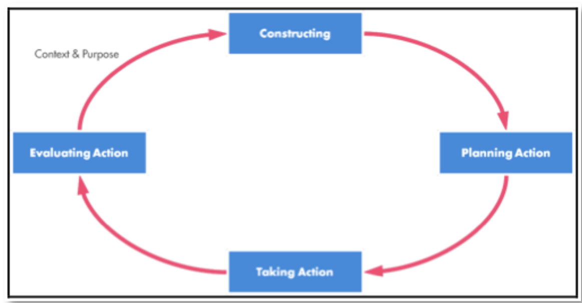

Figure 1. Action Research Cycle (Coghlan & Brannick, 2014)

Data and information were primarily generated through interviews and discussion with various shareholders and triangulated with archival records and other documents.

In order to effectively enact the change process, the author had to manage his role duality, and address organizational politics. Concepts of Bandura's (1977) Social Learning Theory and Lewin's Force Field Analysis were also applied.

This study follows the fund governance framework of Payne (2004). His model highlights five principles necessary for fund governance: (a) a code of ethics, which is supposed to lay out the conduct that is acceptable or unacceptable; (b) law, the ultimate sledgehammer in safeguarding the interests of the investor; (c) regulations/regulators which are to be interpreted for individual situations; (d) independent directors, the supplement to the regulation of funds with the use of independent directors makes the oversight function more efficient and effective; and (e) lawsuits, the ultimate form of protecting investors' rights comes in the form of lawsuits. All of which echoed the principles stated of OECD and ASX, and the CFA Institute's Asset Manager Code of Conduct (2010).

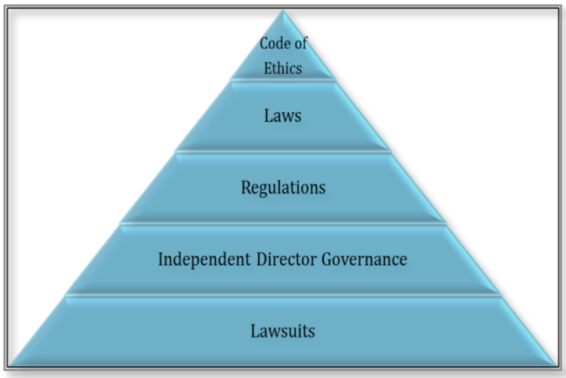

Figure 2. Payne's Fund Governance Framework

3. RESULTS AND DISCUSSION

This study was conducted from May 2012 to December 2015, on two action research cycles that resulted in the Governance and Compliance Model shown in Figure 3.

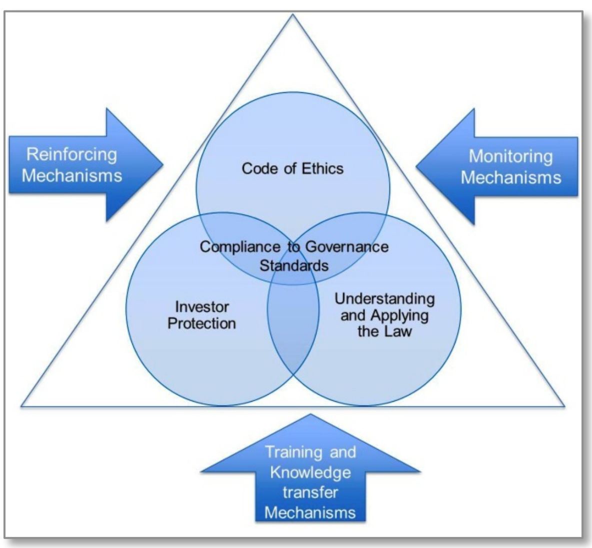

Figure 3. Governance and Compliance Model

The model is dynamic with the principle components interacting with one another. There are also three mechanisms that affect the ability to govern and comply adequately. The first component of the model is the establishment of the code of ethics. This is consistent with Payne's framework and the definition of this code is the same. The author and his team recommends that a code for UITF compliance should specify that fund managers should act with independence, objectivity, skill, competence and diligence (CFA Asset Manager Code of Conduct, 2010).

The second component of the framework is Investor Protection; that the needs of the investors are the priority. This is consistent with the OECD (2004) and ASX (2007) documents that emphasize the need to respect shareholders rights and that they should be given equitable treatment as does the CFA Asset Manager Code (2010) which states that fund managers should act professionally at all times and act for the benefit of the client.

The third and final principle in the framework is Understanding and Applying the Law and Regulations. To ensure compliance, mere understanding of laws and regulation is not enough. The CFA Standard of Professional Conduct (2010) that states members and candidates must understand all applicable laws, rules and regulations of any government, regulatory organization, licensing agency or professional association governing professional activities. This was a very interesting addition to the framework since banking laws come out frequently and there are times when they are subject to several interpretations.

To ensure compliance to governance standards, several mechanisms are put in place, adequate monitoring mechanisms, reinforcement mechanisms, and training and knowledge transfer mechanisms. Monitoring mechanisms are the fruits of policies and procedures created by the team. These may be as simple as process checks are these may also include the utilization of a system. Reinforcing mechanisms come in the form of reward and punishment. Compliant behavior, or any activities that espouse ethical activities that protect the investors within the confines of the law and regulations, will be rewarded. While non-compliant, unethical activities will be punished. These reward mechanisms are consistent with Lewin's three-step change process (Dias, 2014). These allow members of the Trust group to unfreeze undesirable behavior and reward the desired behavior. These mechanisms are proposed to be incorporated in annual ratings. The final mechanism in the framework is one where training and knowledge transfers are facilitated.

4. CONCLUSIONS

Due to the increasing popularity of collective investment schemes and the growing need to govern them accordingly, the framework needed to be dynamic and easily modifiable for improvements, which is what the governance and compliance model shown in Figure 3 is.

One of the benefits of this research is that the team was able to generate historical information on what was and was not done well over the course of this study. This information will prove valuable in the creation of future policies and procedures to be compliant to governance practices. It would also be useful for the other members of the industry to engage in similar action research cycles, to understand their current situations. The policies and procedures that would need to be created by these Trust groups would be different across the industry members but the basic tenets of: protecting investors, creating a code of ethics, and knowing and understanding the law will be components that can cut across industry players and be applied consistently in their organizations.

Future researchers on fund governance may focus on the spiritual dimension of legal and ethical compliance. A research on how spirituality impacts compliance may also be a worthwhile angle to look into.

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