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inCOMPLIANCE Asia

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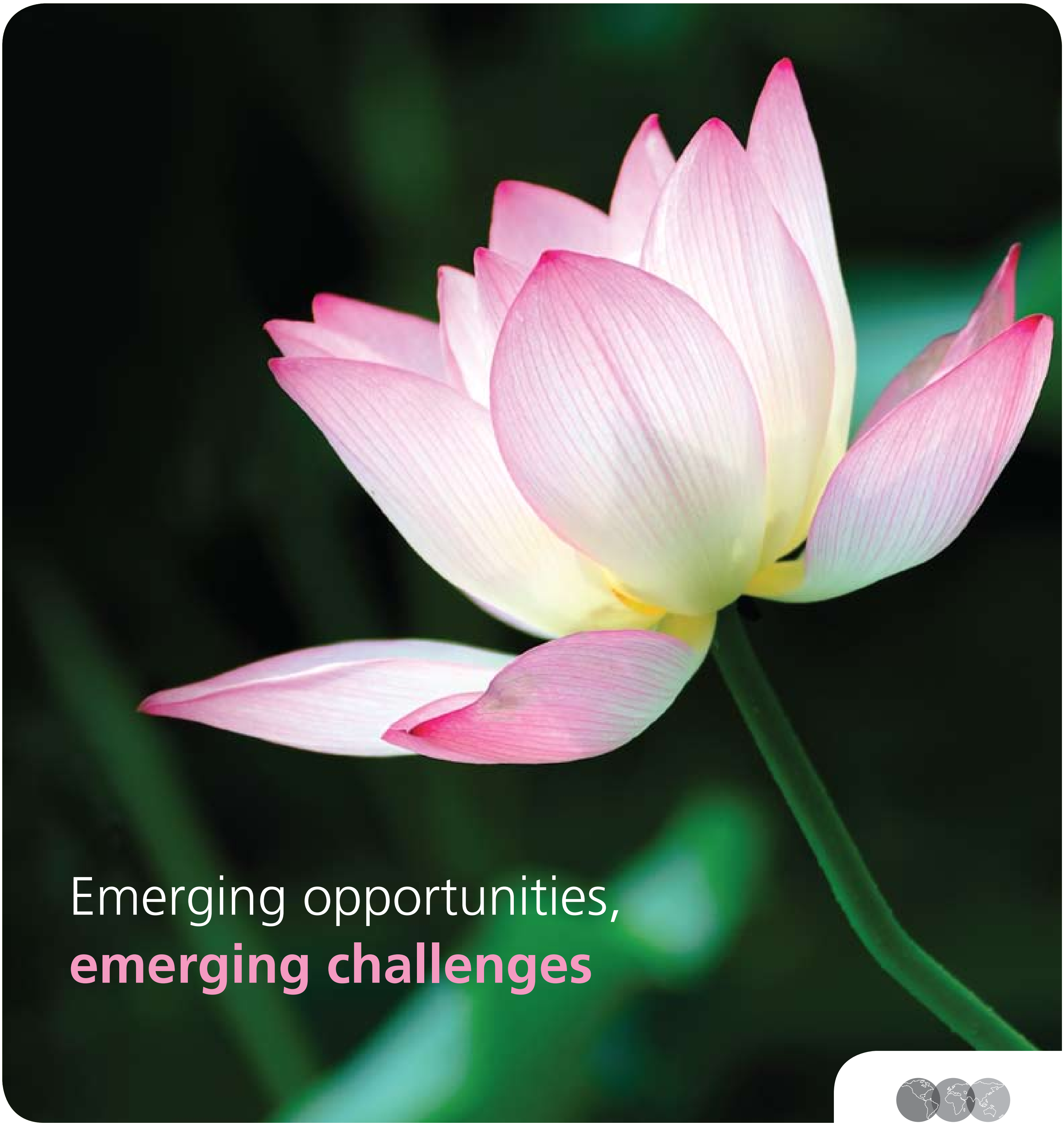

Emerging opportunities, **emerging challenges**

International Compliance Association
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ICA QUALIFICATIONS IN THE ASIA PACIFIC REGION

Australia

ICA in association with the Australian Financial Markets Association (AFMA) has created a new Diploma of Applied Anti Money Laundering and Counter Terrorist Financing. This will be the first qualification of its type that will be mapped to the Australian National Standards and be accredited through both state and national frameworks.

The course is due to commence in Sydney in mid 2011.

Malaysia

ICA has entered into an agreement with the Institute of Bankers Malaysia (IBBM) and the Asian Institute of Finance (AIF) to create a national training framework and a series of qualifications in anti money laundering.

The first programmes are expected to run from mid 2011.

Hong Kong

ICA has recently relaunched the International Diploma in Compliance in Hong Kong in partnership with Courses & Seminars. The International Diploma in Anti Money Laundering will also be launched for the first time in the region later in 2011.

For more information visit www.courses-seminars.com

Singapore

As the government appointed Lead Provider for training in compliance, ICA has already trained hundreds of AML and compliance professionals in the region. ICA offers Financial Industry Competency Standards (FICS) Accredited professional, specialist and graduate Diplomas suitable for all levels of experience.

For further details of upcoming courses in Singapore visit **www.int-comp.org/SNGProgrammes**

To be kept updated on further ICA developments visit www.int-comp.org

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Maintaining momentum

The financial crisis has been pivotal in further shifting the balance of global economic power from the West towards the East. The economies of Singapore, Hong Kong and Malaysia were last year ranked first, second and tenth most competitive in the world respectively according to the International Institute for Management Development, while the World Wealth Report found that the combined wealth of Asian millionaires overtook that of Europeans for the first time in 2010. Moreover, with the financial services sector in Asia-Pacific on an upward curve, there has been speculation that financial institutions in the UK, Europe and the US, disgruntled with the ongoing "banker bashing" in their home jurisdictions, may consider relocating eastward.

Against this background, there is a careful balancing act to be performed by regulators within the Asia-Pacific region – maintaining the attractiveness of their jurisdictions whilst ensuring robust regulation – which mirrors the pressure on compliance professionals to adhere to regulatory requirements without compromising the commercial success of their firms. Taking Hong Kong, for example, on the one hand the Securities and Futures Ordinance states that, in the performance of its functions, the Securities and Futures Commission (SFC) shall have regard to "the desirability of maintaining the status of Hong Kong as a competitive international financial centre" and "the desirability of facilitating innovation". On the other, the SFC's response to the "minibonds" saga in Hong Kong has been to overhaul the regulations surrounding structured products, with increased documentation and disclosure requirements and amendments to both the Products Handbook and the Code of Conduct heightening the compliance burden on firms.

With the growth of the financial services sector fuelling similar major regulatory initiatives across the region – from anti-money laundering developments in Hong Kong (see p9-11) to changes to the corporate governance framework in Singapore (see page 12-15) – the current climate presents both challenges and opportunities to those working in compliance.

James Thomas
Editor
inCOMPLIANCE

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inCOMPLIANCE New initiatives

Welcome to the first regional supplement edition of inCOMPLIANCE, focusing on the Asia Pacific Region. The ICA has worked extensively in Asia for a number of years. In 2007 the ICA was appointed the lead training provider in compliance by the Monetary Authority of Singapore (MAS), the Workforce Development Agency (WDA), and the Institute of Banking & Finance (IBF). To date over 700 students have taken courses leading to ICA Diploma qualifications in Singapore.

In Malaysia the ICA – working with the Institute of Bankers, Malaysia (IBBM) – will shortly launch a national AML/CTF training strategy that will incorporate courses at Certificate, Advanced Certificate, Diploma and Post-Graduate Diploma levels.

In Hong Kong students have been studying for ICA International Diplomas for over five years.

In Australia the ICA is working with the Australian Financial Markets Association (AFMA) to launch a Diploma of Applied Anti-Money Laundering and Counter-Terrorist Financing Management. This qualification will commence in June 2011.

Taking all these new and exciting initiatives into consideration, and bearing in mind the increasing importance firms are placing on the Asia-Pac region, we thought it would be both useful and timely to produce this special edition. Our lead article focuses on the unique opportunities and challenges facing the financial services sector in Malaysia which have accompanied the exceptional growth seen within the region post-crisis. We consider the demand that this has created for compliance expertise. The ICA's role in the creation of the AML framework is instrumental in this.

We also look at specific regulatory developments elsewhere in the region. We measure the anticipated impact of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill in Hong Kong; we assess the recently revised corporate governance regulations in Singapore; and we look at how Malaysia has positioned itself as an international centre for Islamic Finance.

Wherever you are based in the world, the activities and developments that are ongoing in the Asia-Pacific region are bound to be of interest to you and your firm. We hope that you find inCOMPLIANCE Asia to be a worthwhile source of information and reference for the future.

William B. Howarth.

Bill Howarth
Chief Executive
International Compliance Association

International Compliance Association

Excellence through Education

BECOME PART OF A GROWING GLOBAL ORGANISATION!

Due to our continued expansion in the Asia Pacific region, the ICA is looking for tutors and academics/facilitators to teach on ICA programmes throughout the region.

We are currently looking for experienced compliance and anti-money laundering professionals to assist with the delivery of courses, writing training manuals and student materials and assessment marking for a range of compliance and anti money laundering programmes offered in Australia, Hong Kong, Malaysia and Singapore.

The typical attributes required for the roles we are looking for include, but are not limited to:

- Approximately 10+ years experience in either Compliance, AML or a related field
- A track record of successful engagement in or liaison with the financial services industry
- Excellent communication skills, both written and oral
- A proven track record of facilitating workshops for large groups of individuals with diverse work and educational backgrounds
- Ability to focus on education with an outcomes based approach
- Experience of writing educational materials or publications of educational content
- A personal commitment to widening participation and a passion for the development of Compliance/AML as a profession
- Self-motivated, autonomous and innovative with the ability to work within tight deadlines

To ensure the continued high standard of all aspects of our programmes, we wish to speak with those who fulfil the above criteria and would be interested in assisting us with these on a full time, part time or contract basis.

If you have strong industry experience and the above attributes, and would be interested in speaking with us about current opportunities, please submit your CV to **Sam Gibbins**, Business Development Executive, at **sgibbins@int-comp.org** or call **+65 6500 0010** to discuss further.

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Emerging opportunities, **emerging challenges**

The process of financial liberalisation and expansion presents challenges to the compliance profession within Malaysia. **James Thomas** speaks with **V. Maslamani**

IN Brief

- Financial liberalisation in Malaysia has increased financial sector growth
- Malaysia's regulators have actively developed the rulebook post-crisis
- There is a shortfall of compliance expertise to meet the above conditions, and programmes are underway to implement and develop standards and qualifications

While many economies in the West remain mired in a state of low growth and high unemployment, emerging markets have weathered the past three years more successfully. Those in Asia-Pacific in particular have experienced positive growth through the financial crisis, with competitive interest rates and increasing local wealth attracting improved capital flows into the region. At the same time, however, governments and regulators have been presented with the complex task of developing and maintaining regulatory frameworks which are flexible enough to keep pace with developments in the financial sector, supporting growth and innovation whilst still providing the necessary safeguards for all market participants. Accordingly, firms have been presented with a rapidly changing and expanding regulatory landscape and demand for compliance expertise has increased.

Opening the doors

Malaysia is a prime example of a jurisdiction which is looking to respond to the twin challenges of maximizing emerging opportunities while managing the attendant risks. The country has undergone a steady process of liberalisation within its financial services sector over the past five years as part of a drive towards its target of securing "developed nation" status by 2020. This process has accelerated since Prime Minister Datuk Seri Najib Tun Razak assumed office on 3 April 2009.

For example, whereas historically Malaysia has had firm restrictions on the admission of foreign players into its financial sector, its push to open up its economy has resulted in an increase in new licences being granted to foreign banking groups seeking to establish a base in Malaysia for the first time, with firms such as Goldman Sachs and Citigroup being granted permits to operate in the country. Moreover, during a recent visit to Australia, Prime Minister Najib suggested that the current 30% limit on foreign shareholdings in Malaysian banks could be relaxed, specifically paving the way for Australian bank ANZ to potentially double its 24% holding in the Malaysian-domiciled AmBank Group. Elsewhere, the country has also made bold steps to expand its Islamic finance industry and to position itself as an international centre for Islamic finance (see p16-18).

Such reforms have seen Malaysia named the 10th most competitive economy in the world (and fifth within Asia-Pac) in the International Institute for Management Development's 2010 rankings[1], up from 18th in 2009, while it was also the only emerging market within the top 20 of the World Economic Forum's financial development index in 2010[2], jumping from 22nd place in 2009 to 17th. Having achieved 7.2% growth last year, and with unemployment at around 3%, the country is proving increasingly attractive both to foreign investors and financial services firms looking to set up business there.

Meeting a shortfall

The liberalisation within the financial services sector brings with it new challenges for compliance professionals as regulators have responded to the perceived risks resulting from market expansion. Indeed, as Bank Negara Malaysia (BNM) Deputy Governor, Dato' Muhammad bin Ibrahim, suggested in a speech late last year: *"The influx of capital inflows have led to a rapid expansion of liquidity translating into rising prices, leading to concerns of asset bubbles and the possibility of overheating in the economy… in the current global economic environment, uncertainties loom large and we have to be mindful of the challenges ahead, either as an investor or a policymaker."*

Such concerns have translated into an increase in regulatory output post-crisis. As V. Maslamani, Head of the Compliance Division at RHB Banking Group, explains: "Although Asia-Pac fared well through the economic crisis, the crisis actually resulted in considerable regulatory change within the region, with regulators increasingly focusing on corporate governance issues and risk management, preparing Malaysia to move up the scale to be on par with international best practice. The resulting compliance challenge is enormous as there has been a continuous wave of new rules being developed by both BNM and the Securities Commission Malaysia."

Malaysia is also preparing itself for the mutual evaluation exercise to be undertaken by the Asia/Pacific Group on Money Laundering possibly in 2012. In 2007 Malaysia fared well against the Financial Action Task Force's 40+9 recommendations. "While Malaysia performed reasonably well in the last mutual evaluation exercise, it has prompted a considerable effort by the regulator, the enforcement agencies, and the private sector in working towards eliminating corruption and criminal activities," explains Mr V. Maslamani. "This has resulted, for example, in an increase in the number of charges brought by the enforcement agencies, while the regulators are also increasingly focusing on how they can bring in more reporting agencies to be on par with the banks." With such developments, the cost of compliance for Malaysian firms has steadily >>

> *"Although Asia-Pac fared well through the economic crisis, the crisis actually resulted in considerable regulatory change within the region, with regulators increasingly focusing on corporate governance issues"*
> V. Maslamani

increased in order to meet the ever changing regulatory standards. However, with Malaysia ranking 56th out of the 178 countries in Transparency International's 2010 Corruption Perception Index[3], there is still progress to be made in the area of countering corruption and the demand for expertise in this field is likely to remain high.

The second main regulatory challenge facing Malaysia results from the fact that, despite the fast pace of recent regulatory change, nevertheless current market developments are moving quicker still. "Banks and other financial service providers are taking steps towards becoming conglomerates and operating as universal banks, meaning that many of the rules that exist today for banks and capital markets probably will be revised in time to come to meet the market demands," Mr V. Maslamani continues. "The expansion in Malaysia's financial sector has resulted in the regulators being busy focusing on developing new rules in emerging areas such as corporate governance, investor protection, market conduct, customer information disclosure, whistleblowing requirements and so forth."

This wealth of regulatory activity leads to a further challenge, namely the need to meet the increasing demand for compliance professionals with the appropriate skills to respond to these constant regulatory developments. "Malaysia is short of skilled people," Mr V. Maslamani explains, adding that the shortage of experienced and qualified compliance experts has resulted in a process of "musical chairs", with talented individuals choosing to move frequently between a select few organisations in search of higher salaries. The influx of new players into the market is likely to exacerbate this problem as the existing pool of skilled professionals will be spread yet more thinly, and is likely in the short term to result in an increase in the potential for skilled compliance staff to be headhunted by competitors, meaning that firms will need to fight to retain key personnel. As a scarce and in demand resource, compliance professionals may see their remuneration increase, but of course, more fundamentally, the overall lack of compliance resource within the industry could inevitably lead to firms running a greater risk of regulatory breach.

Developing standards

As such, there is a pressing need for an adequately skilled workforce to meet the increased regulatory requirements and a concurrent drive is underway in Malaysia towards the development of standards and qualifications in compliance.

The Compliance Officers Networking Group (CONG), which Mr V. Maslamani chaired for two years on rotational basis before stepping down this February, has been instrumental in driving this process. "CONG was created as a means of trying to raise the professional standards of the compliance function within the country," he explains. "Since being established, the group has undertaken several initiatives, it has been key in improving the networking between enforcement agencies and the regulators and has forged a successful public-private sector partnership through working with regulators."

A particular area of focus for CONG has been the development of an accreditation programme for the entire compliance domain. The anti-money laundering (AML) component is currently being developed, and the programme will then be extended to cover compliance officers within commercial and investment banking, and finally universal banking compliance officers. The ICA is one of the partners involved in developing the programme, producing professional qualifications at three levels in AML.

"CONG is also engaging with BNM to devise a standard compliance framework for Malaysia covering banks, capital markets and insurance companies," Mr V. Maslamani continues. "Our hope is that BNM will develop a broad framework outlining the compliance requirements for institutions, because currently compliance structures and arrangements show huge variation in each and every commercial bank depending on each entity's business needs." It is hoped that this process will add impetus to the efforts underway to enhance the compliance function in commercial banks, which are often seen as the "big brother" in a financial conglomerate operating as a universal bank. Such a framework can draw on the details found in Malaysia's banking industry competency framework (which Mr. V. Maslamani helped to develop, acting as a Subject Matter Expert) which was a high level model aimed at identifying, for example, the necessary scope of work and skill set of individuals working in compliance. The hope is to achieve a similarly high level model on how the compliance structure should be organised within regulated firms.

Growing opportunities

With such initiatives underway, compliance is clearly an exciting field to be operating in within Malaysia. While the fast changing regulatory environment is certainly challenging, the opportunities for compliance professionals are emerging just as rapidly.

IN Detail

1. http://www.imd.org/research/publications/wcy/World-Competitiveness-Yearbook-Results/#/wcy-2010-rankings/
2. http://www.weforum.org/issues/financial-development/
3. http://www.transparency.org/policy_research/surveys_indices/cpi/2010

Levelling the **playing field**

While the draft AML legislation due to come into force in 2012 is broadly welcome, the Government must ensure that it won't put Hong Kong's financial institutions at a disadvantage on the global stage, writes **Vincent Li**

Although the Hong Kong Monetary Authority (HKMA) has had robust and effective anti-money laundering (AML) guidelines in place since 2000, an assessment of Hong Kong's AML framework by the Financial Action Task Force's (FATF) evaluation team in 2007 concluded that, in order to meet FATF standards, such guidelines must be "legally enforceable". As such, the Hong Kong Government set a target to put legislation in place by April 2012 governing the entire AML framework, codifying AML requirements, and imposing civil and criminal liabilities in the event of breaches.

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Bill, currently in draft form, is the Hong Kong administration's response to FATF's requirements. Banks in Hong Kong strongly support the Bill and recognise it as an important regulatory development and an essential step for Hong Kong to meet its obligations as a member of FATF. The proposed consolidation of existing rules will maximise consistency across all types of financial institutions, while the new statutory framework for money changers and remittance agents will also strengthen the reputation of Hong Kong's financial services industry as a whole.

Current concerns

The prime concern for financial institutions in Hong Kong is whether the proposed Bill will weaken their ability to compete in the international market. With that in mind we believe that some refinements are necessary to the Bill, not to lower standards but simply to ensure a level playing field with other jurisdictions. Moreover, we believe that it is important that any law introduced takes account of the material difference between the current situation, involving compliance with a set of guidelines (the breach of which might result in, say, a negative finding from HKMA), and adherence to a legislative framework (the breach of which could result in criminal or civil prosecution against individuals or institutions).

We recently presented these views to the administration, which agrees that going beyond international standards could adversely affect the competitiveness of Hong Kong as an international financial centre. Fruitful discussions are continuing in order to establish a consensus view on how to revise the requirements in a manner which would be acceptable by the FATF.

IN Brief

- There are concerns that proposed AML legislation could impact Hong Kong's future competitiveness
- The draft Bill should be amended to mirror international standards
- This should include the requirement for a risk-based approach to AML

A risk-based approach

One key area of concern is the importance of ensuring that the Bill recognises that the prevention of money laundering should be conducted on a risk sensitive basis, acknowledging the fact

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that each bank's business is unique. Under the HKMA guidelines it was possible for a bank to take a risk-based approach to AML, but there is currently no equivalent provision in the draft Bill, meaning that when HKMA is crafting guidelines in future it will not have the authority to offer banks the kind of flexibility that has existed hitherto.

Customer bases of each bank vary – from local individuals to complex trust arrangements – and different banks operate in different jurisdictions, with their own distinct product and service offerings. Therefore, a bank that only provides basic banking services to individuals in Hong Kong will have very different risk management needs to a bank that offers a range of services to various customer segments in multiple jurisdictions. The circumstances of each customer relationship and transaction also present unique risks, because of the compounding effect of all the relevant facts of the case. For example, we need to take extra due diligence steps if a customer is opening an account without face-to-face contact with our bank, but we need to take a more stringent approach if that person is also a politically exposed person.

In the area of risk management, one size does not fit all. Flexibility is essential in order to achieve high standards and meaningful outcomes. For these reasons, we believe that the Bill should express the overarching FATF principle of a "risk-based approach". This principle recognises that AML/CTF is not merely a "tick-box" exercise, but that every factual scenario presents different challenges and risks and that a contextual approach needs be taken to prevent money laundering and terrorist financing. It will also ensure that new risks and challenges can be addressed quickly, while supporting guidance can also be provided by regulatory authorities to ensure consistency across and within sectors.

International standards

Our second concern is that Hong Kong should apply an international standard to the prevention of money laundering and terrorist financing. This was the original reason behind the introduction of the proposals in the Bill, following the issue of FATF's mutual evaluation report in June 2008. We suggest that it should continue as the guiding factor. >>

“One key area of concern is the importance of ensuring that the Bill recognises that the prevention of money laundering should be conducted on a risk sensitive basis”

Hong Kong operates in a global and interactive financial market. Our ability to compete with other jurisdictions and provide a superior service for our customers relies upon two key factors: first, our reputation for having a robust legal framework and second, the ease of doing business here. This requires a balance to be struck between regulation and addressing the needs of our customers. It also means that Hong Kong should impose customer due diligence standards that are equivalent to, but not more onerous than, international standards.

Where possible, the best litmus test of an international standard is the FATF framework itself. However, we recognise that, in some cases, FATF has not provided enough detail. In such cases, we suggest looking at how other FATF member countries have implemented that framework, to ensure that Hong Kong continues to offer an internationally competitive service standard.

One example that we have raised in our submission is the due diligence requirement for a company or another type of entity, such as a trust or partnership. As currently drafted, the Bill requires banks to undertake due diligence on all persons who own or control 10% of such an entity – a threshold carried over from the current HKMA guidelines. FATF does not provide a specific test of ownership. However, the approach taken in the jurisdictions we have examined – for example the UK and US – only requires due diligence of persons who own or control 25% of the entity. The consequence of Hong Kong maintaining a 10% threshold is that the onboarding process will slow down and become more onerous for customers – even the most co-operative customer needs time.

Other jurisdictions recognise that determining ownership and control is a complex matter and that the relevant threshold should be greater than 10%. Imposing substantially more onerous documentation requirements on customers in Hong Kong increases the likelihood that customers will choose another major financial centre for their business if they can.

Again, our focus here is on maintaining the strength and competitiveness of Hong Kong’s financial services industry, and striking a proportionate – and internationally-aligned – balance in regulation.

Although HKMA and the government might argue that the 10% threshold has been used for years in Hong Kong, through the AML guidelines which have been place since 2000, I believe that it is also important to recognise in this regard the significantly greater flexibility that currently exists under those guidelines, and the substantially lower penalties that could be enforced under them compared with the new legal framework being proposed.

Implementation

Finally, we believe that the current timetable for the new framework is challenging and that the scheduled implementation date of 1 April 2012, as set out in section 1 of the Bill, may not offer enough time for financial institutions to roll out the practical guidance and public education which is critical to the success of the Bill’s implementation. Instead, we suggest that the law should be passed as planned in April 2012, but that it should not be enforced until one year after the guidelines are issued (i.e. it would therefore come into effect in April 2013). This is not a unique suggestion, but is well-supported by international practice. For example, the UK Bribery Act was passed in April 2010, and was not due to come into force until April 2011. We believe that the extra time is essential to allow many financial institutions to implement the policies and procedures, and deploy the resources necessary to comply with the Bill.

Time is short

The dialogue between the industry association, the policy bureau and the regulators is still ongoing. The fact is, however, that the government is running out of time. According to the schedule the government wants to pass the Bill before the close of this legislative year, i.e. before September 2011. This means that an agreement with industry will be required as soon as possible, so that the Bill can pass the second and third reading debate. We remain hopeful that, in the short time remaining, a consensus position can be found which protects Hong Kong’s best interests and preserves its competitiveness on the global stage.

Vincent Li is Head of Financial Crime Risk at Standard Chartered Bank (Hong Kong). He was the chairman of the AML Committee formed under the Hong Kong Association of Banks (HKAB) in 2010 and was the convenor of the Industry Working Group on Suspicious Transaction Monitoring formed under the chairmanship of the Hong Kong Monetary Authority (HKMA) between 2006 and 2009. In the meantime, he is a standing member taking part in the Working Group on Suspicious Transaction Reporting formed by the Joint Financial Intelligence Unit (“JFIU”), Hong Kong Police.

Countering **complacency**

What impact will Singapore's recently-revised regulations have on the corporate governance landscape?

James Thomas speaks with **Professor Mak Yuen Teen**

“Balancing the interests of issuers who are seeking capital and the investors who are providing it is a perennial problem, and perhaps we think too much about the issuers’ interests and not enough about those of the investors”

Professor Mak Yuen Teen

Singapore is currently leading the way in corporate governance practice within Asia, having overtaken Hong Kong in the most recent ACGA / CLSA corporate governance survey[1]. Recent years have brought improvements to the regulatory enforcement regime in Singapore – in particular around fraud, corruption and insider trading – which is strong relative to much of the region. The country also enjoys a robust regulatory framework, sound listing rules and a solid system of securities law. Moreover, it is aligned with international accounting standards and follows the US model of regulatory oversight of auditors, which includes auditor registration, practice monitoring and so forth.

However, despite being a leader within the region, there are areas in which Singapore’s corporate governance practice could be improved, and, according to Mak Yuen Teen, Associate Professor at the National University of Singapore: “The latest challenge for Singapore is avoiding complacency.” As the ACGA / CLSA report states: “Even the best Asian markets – Singapore and Hong Kong – have a long way to go before they can claim to be truly international” – there is therefore some work to be done in raising standards across the region to a level at which it can be considered world leading.

Balancing interests

Much of the difficulty of achieving such change within Singapore lies in managing the tension which exists between the desire to encourage companies to list on the local exchange and the need to ensure the protection of investors through a robust regulatory framework. For example, the exchange itself is a listed company with a regulatory role and therefore there is an inherent conflict between its regulatory and commercial objectives. “Balancing the interests of issuers who are seeking capital and the investors who are providing it is a perennial problem,” explains Prof. Mak, “and perhaps we think too much about the issuers’ interests and not enough about those of the investors. We want companies to list here, without considering whether regulators are able to enforce rules or investors are able to enforce their rights if anything goes wrong. More could be done in terms of investor protection; for example, through better screening of companies.”

He cites as evidence of this trend the example of the many Chinese companies which have chosen to list in Singapore, and questions whether such decisions are motivated by a perceived leniency in the corporate governance requirements on the island. “The determining factors for any company in choosing to list within a jurisdiction are usually liquidity, proximity to >>

operations, and proximity to customers," he explains. "However, many Chinese companies currently listing in Singapore would probably find better liquidity in Hong Kong or some of the major markets, and they are certainly not bringing themselves closer to customers or operations through listing here as most of their operations are in China anyway. The concern, then, is whether we are attracting the lower quality companies."

Part of the attraction for such companies, historically, has been Singapore's relatively modest requirements around the composition of companies' Boards of Directors. The persistence of the "old boys' network" has resulted in some Directors sitting on many – sometimes up to 13 or 14 – boards, and the independence of boards and the commitment of Directors to the companies is therefore sometimes open to question. There are related concerns over whether some independent Directors who are serving on boards have the relevant expertise and experience. For boards of financial services firms there is also the question of whether there is adequate financial industry experience, risk management expertise and executive compensation expertise amongst the independent Directors in light of the heightened expectations following the financial crisis. This situation has been perpetuated by low levels of Director accountability, with Directors rarely being charged for breaches of duties let alone prevented from sitting on too many boards.

Shareholder in-activism

A further weakness in Singapore's corporate governance regime is the fact that it is difficult for shareholders to exert any corrective influence on company behaviours, and therefore shareholders very rarely take action. As Prof. Mak continues: "In recent years, there have been numerous cases of companies, often based in China but listed in Singapore, in which fraud has occurred. Because these companies are based in China, regulators in Singapore are unable to take action because, even though strictly speaking they are breaking Singapore law, we don't have extradition treaties with China and therefore can't bring the individuals responsible over here to charge them. Needless to say, it will be even more futile for shareholders to take action to enforce their rights, especially given the legal costs involved." With roughly 45% of the companies listed in Singapore being based overseas – and about half of that number being from China – it is routine to find that, when things go awry with such companies, neither regulators nor shareholders are able to achieve a suitable outcome.

The legal system in Singapore creates further restrictions on shareholder activism. "Here shareholders rarely take action because there is no class action of the kind that you see in the US," explains Prof. Mak. "The contingency fee system of litigation in the US, in which if you sue and you lose you are not required to pay the legal fee, means that people are very willing to take action. By contrast, a shareholder who decides to sue here will face very high legal costs and may not recover all of those fees even if they are successful. Compounding this, the likelihood of punitive damages is also very small."

Changing requirements

To counter concerns over standards of corporate governance in the Singapore financial services sector, the Monetary Authority of Singapore (MAS) has recently introduced revised regulations on corporate governance, which are mandatory for banks, financial holding companies and direct life insurers incorporated in Singapore with assets over $5bn, while additional guidelines apply on a "comply or explain" basis for those with assets under $5bn. The regulations place particular focus on the areas of board composition and Director accountability.

For example, MAS has tightened the definition of "independence" of Directors, meaning that after nine years as a Director one can no longer be considered "independent". Moreover, firms are now required to have a Chief Risk Officer, and a risk management committee. In common with developments in jurisdictions such as the UK, MAS is also placing greater scrutiny on remuneration throughout financial institutions, with closer attention being given to how key officers who perform controlled functions are paid, rather than simply focusing on senior management and Directors' remuneration.

The requirements also place new demands on financial services firms around the appointment of Directors, and aim to ensure that Directors have the appropriate level of expertise. When appointing Directors, financial institutions should target individuals with financial industry experience, risk management experience and compensation experience, in light of what is expected of a risk management committee and remuneration committee. This approach is broadly consistent with the recommendations of the Basel Committee and the UK Walker Review. However, these requirements are not without their problems. For example, filling boards with such individuals could prove a challenge in the short term, believes Prof. Mak. "Taking the requirement for financial experience," he argues, "most financial institutions in Singapore have individuals on the board who have worked in a financial institution before, but it is very different working in a bank, say, just 10 years ago than it is today. You've got to ask how relevant their experience is to today's market." >>

Mak Yuen Teen is Associate Professor of Accounting and former Vice Dean (Finance and Administration) at the NUS Business School, National University of Singapore. He was also the Co-Director of the Corporate Governance and Financial Reporting Centre at the NUS Business School which he founded in January 2003, until December 2009. He continues to be actively involved in this area.

The requirement for risk management expertise is equally problematic, he suggests. MAS has left it to the financial institutions themselves to determine what kind of risk management expertise is required on the board, but some guidance and clarity would be welcome. "In requiring risk management expertise, does MAS mean that we must have 'quant-types' on boards, i.e. those who are very good at financial risk management?" asks Prof. Mak. "If so, you have to wonder whether such types would have the wider skills to make good Directors, and the worry is that companies will simply end up appointing individuals who have recently been employed in a risk management capacity." MAS has also not imposed requirements for independent Directors on the risk management committee, preferring to focus on risk management expertise. Both independence and expertise are important.

Meanwhile, compensation expertise also throws up some problems, not least because, traditionally, very few board members have come from a human capital background, and the pool of such individuals may not be large enough to satisfy demand.

Taken in sum, these requirements for additional expertise also introduce the potential for boards to grow to an unwieldy size due to the difficulty of finding individuals who possess more than one of these skills. However, with only three listed banks and a handful of large insurance companies, the hope is that identifying such individuals will not prove a challenge too far.

Effectiveness

Instead, perhaps a more pressing question is how these regulations will apply in practice and whether they will have the desired effects of improving board composition and behaviour, and promoting good corporate governance, or whether they simply address the physical form of boards rather than the substance of how they act.

On the face of it, the regulations do appear to be addressing substance rather than form. "I always feel that MAS is very serious about raising standards," says Prof. Mak, "and if you look carefully at the regulations, MAS is definitely trying to put more pressure on nominating committees to appoint the right kind of people." Significantly, the regulations require firms to document the entire nomination process as well as their assessment of whether Directors are independent. MAS, being a supervisor, will be able to inspect those minutes and Prof. Mak believes that this ability will ensure that standards of behaviour are raised.

Much, then, will depend on the willingness of MAS to actually enforce the regulations, through conducting thorough governance reviews of financial institutions and scrutinizing the records of discussions that take place at committee meetings. Prof. Mak believes that, having required firms to document such discussions, it seems likely that the regulator will, in due course, demand access to them.

On a less positive note, while there is much in the regulations aimed at correcting board composition and behaviour, there is little focus on promoting increased shareholder activism, and indeed Prof. Mak believes that, in not extending the mandatory requirements further, the shortcomings resulting from an inactive shareholder base could persist. "The 'comply or explain' approach has been applied in many jurisdictions, but I feel it has not worked in Singapore, in part because we don't have the level of institutional shareholder activism that you see for example in the UK," he explains.

It remains to be seen whether these regulations have the desired effect of elevating Singapore's corporate governance regime on the global league tables, but it is nevertheless hugely positive that – despite leading the way within the region – Singapore is continuing to push towards higher standards.

IN Detail

1. "CG Watch 2010", Credit Lyonnais Securities Asia in collaboration with the Asian Corporate Governance Association

Leading by **example**

James Thomas reports on how Malaysia has nurtured its Islamic finance industry, and considers how current and future regulatory developments within the sector are increasing demand for financial services and Shari'ah compliance expertise

Malaysia's Islamic finance sector has experienced massive expansion over the past decade – according to Dato' Muhammad bin Ibrahim, Deputy Governor of Bank Negara Malaysia (BNM), the country's Islamic banking assets grew 20% annually between 2001 and 2010, reaching 20.9% as a share of total banking sector assets as at June 2010, compared with 6.9% a decade ago. Malaysia is also the world's largest sukuk market, with over 60% of global sukuk issuances.

Several factors have contributed towards this exponential growth. Firstly, there is an increasing awareness and understanding of Shari'ah-compliant funds and products amongst both the general public – and in particular within the Muslim community – and institutional investors. Moreover, this interest has itself been driven by the fact that Islamic finance institutions weathered the global financial crisis with much greater success than providers of "conventional" financial services, due to inherent socio-economic features of the Shari'ah principles underlying Islamic finance.

The social dimension

Indeed, while the fallout from the global financial crisis has brought the concepts of good governance, rigorous oversight, transparency, and due diligence to the forefront of the regulatory debate surrounding conventional financial services, such principles have been hardwired into Islamic finance from the outset. This offers Islamic finance the advantage of not only having avoided the excesses associated with conventional financial activities, but also provides it with a head start within the current regulatory environment, in which the issues of culture, ethics and "outcomes" within financial transactions have become increasingly important considerations for financial regulators.

As Associate Professor Dr Asyraf Wajdi, Head of Research Affairs at the International Shari'ah Research Academy, explains: "The Shari'ah principle embedded within Islamic finance disallows providers from engaging with or entering into any form of ambiguous or fictitious transaction, for example derivative instruments or transactions which are not clear in terms of their underlying value. This restricted Islamic finance providers from entering into transactions which were eventually found to be the cause of the whole financial crisis – Shari'ah became a kind of shield to them."

In other words, the socio-economic dimension inherent to Islamic finance means that there is a natural governance requirement >>

within all Islamic finance transactions. Indeed, Islamic finance institutions are required to have an in house Shari'ah committee, which plays a fundamental role in ensuring that the transactions such institutions enter into operate within certain ethical parameters outlined by Shari'ah principles. "For a bank to enter into any transaction it needs to receive endorsement from its Shari'ah Committee, which will look into the transaction and consider whether it involves any fictitious or ambiguous elements inconsistent with Shari'ah principles," explains Dr Asyraf Wajdi. "The whole operation of Islamic finance therefore requires close monitoring to ensure that not only is there a commercial objective, but that the commercial objective in question is – in layman's terms – positive to society as a whole."

Incentives for growth

Aside from the current attractiveness of this intrinsic moral component, the growth of Islamic finance in Malaysia also owes much to the significant steps which the government has taken to position the country as an international Islamic finance hub, aggressively promoting the country's Islamic finance sector on the world stage. The government has also worked hard to improve the ease with which Islamic finance providers can operate within Malaysia, through the introduction of regulatory and taxation concessions and incentives aimed at providing a level playing field between conventional and Islamic finance products, thereby encouraging growth in the industry.

The government has been very proactive, for example, in providing tax neutrality for Islamic finance institutions to circumvent the prohibitively expensive stamp duty charges that would otherwise be incurred for the majority of Shari'ah transactions. As Dr Asyraf Wajdi explains: "Executing a loan, for example, in a conventional finance context incurs a single, one off stamp duty cost, although achieving the same economic effect in an Islamic finance context requires several contracts to be executed, with each contract invoking stamp duty. In the absence of tax neutrality these costs would be passed to the consumer. Instead, the waiver ensures that Islamic finance institutions receive equal tax treatment to conventional providers in this regard."

Meeting demand

The expansion of Islamic finance in Malaysia – and the proactive stance adopted by the government – is not without consequences for the regulation of Islamic finance institutions, which, taken together with the increasing presence of Islamic finance both nationally and internationally, is contributing towards a growing demand for qualified Shari'ah compliance professionals.

For example, the new governance framework issued by BNM for Islamic finance institutions is one current driver for this demand. Aimed at strengthening existing Shariah governance processes, decision making, accountability and independence, the framework impliedly necessitates that Islamic

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finance institutions increase the number of Shari'ah experts they employ. For example, it requires that the Shari'ah Board of banks be increased from three members to five, while an individual may only sit on the board of a single bank. Moreover, the framework also imposes a requirement for the creation of new units or departments to be set up within Islamic finance institutions, including a Shari'ah audit unit, a Shari'ah research unit, and a Shari'ah risk management unit, all of which will naturally need to be made up of individuals with both Shari'ah and financial expertise.

Indeed, according to HRH Raja Nazrin Shah, Financial Ambassador of the Malaysian International Islamic Financial Centre, speaking at the Islamic finance Forum 2010: "For Islamic finance to reach its full potential, it is necessary for the industry to be well-supported by a pool of capable professionals who are well versed in conventional and Islamic finance, and in the Shari'ah… [and] it is timely for industry participants to take greater responsibility for human capital development."

Dr Asyraf Wajdi agrees that there is currently a shortfall in the number of active Shari'ah experts versed in both Islamic and conventional finance. "This is something that the industry needs to further address in terms of education and training," he suggests. "There are more than enough individuals with a Shari'ah background but the question is how to ensure that such people also have the experience, understanding and technical expertise in financial instruments and in finance in general." While Malaysia has always enjoyed a surplus of Shari'ah graduates, career ambitions for such individuals have traditionally focused exclusively on the religious institutions. The development of the Islamic finance industry has created a new platform and a new opportunity for students of Shari'ah to branch out, although a "paradigm shift" is required in order to tap into this pool of skilled potential Islamic finance practicioners. And while Dr Asyraf Wajdi does suggest that it is generally easier to train individuals versed in Shari'ah about conventional finance than it is to train people who are from a banking or finance background in Shari'ah, the huge demand for Islamic finance professionals makes an equally strong case for either approach.

International dimension

Demand for Shari'ah expertise is also being driven at an international level, as the growing significance of Islamic finance in the international financial system has created considerable debate around the interface between Islamic and conventional finance.

The internationalisation of Islamic finance has gathered momentum through the creation of the Task Force on Islamic finance and Global Financial Stability by the Islamic Development Bank and Islamic Financial Services Board (IFSB), which reported last year on the issue of global financial stability, and the role of Islamic finance within the new financial world order. The report recommended the establishment of an Islamic Financial Stability Forum (IFSF) to promote financial stability within the Islamic financial system, a move which could further increase the demand for risk and compliance expertise within the Islamic finance sector.

Moreover, the increasingly international nature of Islamic finance has also created a demand for harmonisation of financial reporting standards due to the growing need for cross-border comparability in Islamic financial transactions. As BNM Governor Dr Zeti Akhtar Aziz explained at her keynote address to the World Congress of Accountants (WCOA) in November of last year: "The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) has made contributions towards improving the measurement approaches for Islamic transactions and the overall quality of financial statements. There has also been greater cooperation at the regional level through the recently formed Asian-Oceanian Standard-setters Group (OSG) to examine the technical issues in the financial reporting of Islamic finance. The efforts by AAOIFI and OSG represent important contributions to current efforts to evolve an accounting framework that is appropriate and that will support further the global development of Islamic finance. It is important that the standards setting bodies such as the International Accounting Standards Board are engaged in this process to complement, and to leverage on the current global efforts to converge international accounting frameworks."

Malaysia's vibrant Islamic finance industry has been a rare success story amidst the global financial turmoil of the past three years. However, as Islamic finance takes an ever larger role on the global stage, demand for risk and compliance expertise must be met in order to ensure the continued growth and success of the industry.

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