Asian Corporate Governance Association (ACGA)

“The State of Corporate Governance”

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Agenda

1. The regulatory context in Asia: Convergence and divergence in corporate governance reform

2. A new wave of reform in Asia

3. Ranking Asian markets on CG quality

4. The China dimension

Appendix: The role of ACGA

1. The Regulatory Context

Board independence before the Asian Financial Crisis of 1997-98

Country	CG Code on board governance?	Independent directors required?	Audit committees required?
China	No	No	No
Hong Kong	Minuscule	No	No
India	No	No	No
Indonesia	No	No	No
Japan	No	No	No
Korea	No	No	No
Malaysia	No	No	No
Philippines	No	No	No
Singapore	No	No	No
Taiwan	No	No	No
Thailand	No	No	No

After the Asian Financial Crisis:
A convergence in most markets towards international standards

Country	CG Code on board governance?	Independent board members required?	Audit committees required?
China	2002 / ?	Yes	Yes
Hong Kong	1993 / 2004 / 2012	Yes	Yes
India	1999	Yes	Yes
Indonesia	2001 / 2006 / ?	Yes	Yes
Japan	Imminent?	Optional. Abe proposing.	No. Very few.
Korea	1999 / 2003 / ?	Yes	Yes (large firms)
Malaysia	2000 / 2007 / 2012	Yes	Yes
Philippines	2002 / 2009	Yes	Yes
Singapore	2001 / 2005 / 2012	Yes	Yes
Taiwan	2002 / 2011	Yes. Still being phased in.	Yes (from 2014).
Thailand	2002 / 2006 / 2012	Yes	Yes

Asian Divergence

Legal variation in company law and board structure

	Historic basis of company law	Board structure	Minimum # of independents (INEDs)
China	German / mixed	Dual (two boards) + Party Committee	One-third
Hong Kong	English	Single	One-third
India	English	Single	33-50%*
Indonesia	Dutch	Dual (two boards)	30% (50% for banks)
Japan	German	Dual (two boards)	Choice: One INED or ISA[α]
Korea	German/ Japanese	Single or quasi dual	25-50%
Malaysia	English	Single	Majority*
Philippines	American	Single	Two or 20%
Singapore	English	Single	One third to majority*
Taiwan	German/ Japanese	Single or quasi dual	Two or 20%
Thailand	French / mixed	Single	Three/one-third

*Majority suggested only if the chairman is non-independent. Not a mandatory rule.

α "ISA" refers to an independent statutory auditor (kansayaku).

Source: ACGA research

Diverging tracks:
CG development in Asia has been moving on two tracks

1. International rules are dominant where common standards are accepted as necessary for trade/investment. For example:
   - Accounting and financial reporting standards
   - Organisation of shareholder meetings and vote counting
   - Regulation of external auditors

2. Local norms dominate where legacy issues and culture drive corporate behaviour, and vested interests prevail. For example:
   - Functioning of boards and board committees (as opposed to their formal structures, as seen earlier)
   - Dialogue with shareholders
   - Decisions on related-party transactions
   - Capital-raising exercises

In other words, convergence will remain limited and, in many areas, expressed more in form than substance.

2. New wave of CG reform in Asia

Reform goes in cycles and tends to follow crises. We are now in a new wave—at least the fourth since 1999. Highlights:

1. China: New CG Code / IPO rules / CG Guidelines for banks
2. Hong Kong: IPO due diligence / Price-sensitive information / Auditing
3. India: Landmark new Companies Act / SEBI listing-rule revamp
4. Indonesia: New single OJK regulator / CG Roadmap
5. Japan: Board independence / Stewardship Code / Pension system
6. Korea: Revised CG Code / Renewed focus on enforcement
7. Malaysia: Implementing CG Blueprint / Stewardship Code
8. Philippines: Renewed focus on financial statements and auditing
9. Singapore: Voting by poll / Restructuring listing regime
10. Taiwan: Independent directors / Audit committees / E-voting
11. Thailand: Regulation of auditors / Fight against corruption

What’s high on the agenda for companies?
(as seen by regulators and investors)

- Stability of banking system / adequacy of bank capital
- Transparent financial and non-financial reporting that can be trusted
- Fairness and clarity on related-party transactions
- Fair systems of capital raising (ie, no excessive dilution)
- Transparent shareholder meetings, including voting by poll
- Clarity on executive compensation policies
- A policy/strategy on sustainability and disclosure of material risks
- Board independence and effective committees
- Board diversity

What's high on the agenda for companies?
(as seen by companies)

- Succession planning in family firms
- Understanding their shareholder base / securing votes for AGMs in markets where quorums are high
- Shareholder communication

For more sophisticated companies:

- Board diversity, composition and evaluation
- Improving board committees
- Strengthening accounting and internal control systems
- Viewing CSR from a more "strategic" perspective

For more short-sighted companies

- Driving down audit fees!

3. Ranking Asian markets on CG Quality

"CG Watch" total market scores: 2007 to 2012

(%)	2007	2010	2012	Change 2012 vs 2010 (ppt)	Trend of CG reform
1. Singapore	65	67	**69**	(+2)	Improving, but culture needs to open more
2. Hong Kong	67	65	**66**	(+1)	Static, but reinvigorated regulator positive
3. Thailand	47	55	**58**	(+3)	Improving, but corruption a major issue
4. = Japan	52	57	**55**	(-2)	Government stalling, companies opening
4. = Malaysia	49	52	**55**	(+3)	Culture at last showing signs of openness
6. Taiwan	54	55	**53**	(-2)	Rules improving, but still behind the curve
7. India	56	48	**51**	(+3)	Enforcement up, Delhi an obstacle
8. Korea	49	45	**49**	(+4)	Government more open, companies less so
9. China	45	49	**45**	(-4)	Rules improve, but culture still weak
10. Philippines	41	37	**41**	(+4)	Improving, but will it be sustained?
11. Indonesia	37	40	**37**	(-3)	Regressing, but new regulator may help

New survey in Sept 2014

Source: "CG Watch" surveys, Asian Corporate Governance Association & CLSA Asia-Pacific Markets

Total market scores based on five categories

"CG Watch" market category scores

(%)	Total	CG Rules & Practices	Enforcement	Political & Regulatory	IGAAP	CG Culture
1. Singapore	**69**	68	64	73	87	54
2. Hong Kong	**66**	62	68	71	75	53
3. Thailand	**58**	62	44	54	80	50
4. = Japan	**55**	45	57	52	70	53
4. = Malaysia	**55**	52	39	63	80	38
6. Taiwan	**53**	50	35	56	77	46
7. India	**51**	49	42	56	63	43
8. Korea	**49**	43	39	56	75	34
9. China	**45**	43	33	46	70	30
10. Philippines	**41**	35	25	44	73	29
11. Indonesia	**37**	35	22	33	62	33

Source: Asian Corporate Governance Association

4. The China Dimension

CG reform started in China in earnest in the early 2000s. Some highlights:

- **2001:** Guidelines on independent directors (CSRC).
  Set one third as the standard; ahead of Hong Kong at the time.
- **2002:** National Code of Corporate Governance (CSRC).
- **2003:** Directive on quarterly reporting (CSRC).
- **2005:** Guidelines on governance of banks (CBRC).
- **2007:** Convergence of accounting and auditing standards with IFRS and ISA. (Not complete adoption, however.)
- **2007:** CSRC to strengthen listed company governance—use of funds, operation of board, internal controls.
- **2008:** SSE launches a Corporate Governance Index.
- **2013:** CBRC launches its new CG Guidelines for commercial banks.
- **2013/4:** CSRC revising IPO rules. Considering revised CG Code. Strengthening enforcement.

A key point: The GFC significantly undermined China's belief in international norms of corporate governance. Much greater self-belief today.

ACGA

Critique of China: "CG Watch 2012"

- China Securities Regulatory Commission (CSRC) continues to amend regulations (eg, IPO valuations), but some core **CG rules and standards** not keeping pace with regional or global best practices.
- Much **enforcement** still involves fines and warnings for disclosure breaches. Some progress against insider trading (but limited disclosure).
- Several **government agencies** working to improve CG, but question of coordination. Tight control on the flow of information.
- Quality of audits and **audit regulation** hard to assess. MOF a strict regulator and CSRC active on listed company audits. But audit industry still relatively young and many CPA firms have grown rapidly. Questions over capacity of CPA firms.
- Communication with shareholders seems to be improving, but disclosure of **CG practices** remains heavily formulaic and, at worst, misleading. Details on implications of state ownership lacking. Private sector CG not good. A few domestic institutional investors starting to stir.

"CG with Chinese characteristics"

Board structure: The Company Law requires a "board of directors" (EDs, NEDS, INEDs) and a "supervisory board". Inspired by both the German and English models, but very different. Attempts to create a single-tier system in mid-2000s failed.

Role of CPC: Political system and Company Law require/facilitate the formation of "party committees" in companies. CPC Organisation Department makes major appointments to SOE leadership positions.

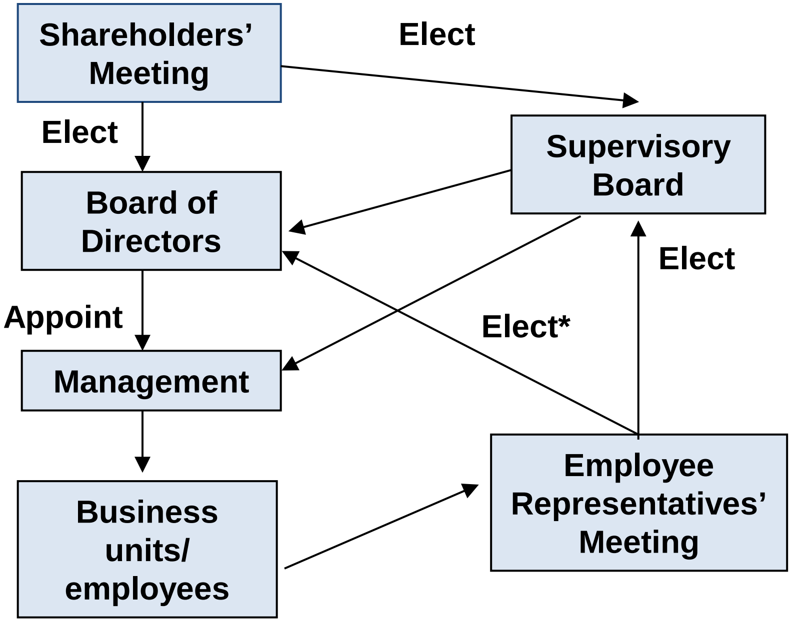
Role of SASAC: Close supervision of around 117 central SOEs (CSOEs) under its direct ownership/management. Selection of directors, remuneration policies, training. Set up a pilot board programme for CSOEs in 2005. Baosteel the first. Covers more than 50 CSOEs.

Role of CBRC: Exerts tight supervision over commercial banks, including appointment of senior management and directors. Actively vets and tests new directors.

Role of CSRC: Market development <u>and</u> investor protection. Fundamentally concerned about retail interests.

Board structure: Law vs practice

Governance structure: Company Law



**If the company was established by two or more SOEs. Not mandatory for "companies limited by shares" (public companies).*

What is missing from this picture?

1. The role of the CPC in the selection and appointment of senior SOE management / directors.
2. The role of SASAC in the selection and appointment of directors.
3. The role of the Party Committee in companies—and its relationship to the Board of Directors.
4. The fact that listed SOEs are part of a group, with a parent company (CSOE) and numerous subsidiaries. Need to look at governance in the group context, esp. role of parent.
5. A sense of what the Supervisory Board does. Is it superior in reality to the Board of Directors?

Source: ACGA research

State-owned Assets Supervision and Administration Commission (SASAC)

Current issues / areas of focus

1. **Role of SASAC:** Following the 3rd Plenum (November 2013), a plan to move towards "capital management" with less "administrative control" of enterprises. The right balance is still being debated. Will China adopt the Singapore (Temasek) model? Not entirely. Administrative control unlikely to disappear completely.
2. **Going abroad:** Preparing CSOEs to expand overseas through M&A and direct investment.
3. **Directors:** Need more qualified directors, especially outside directors with know-how and specialist experience. "Competition is getting tougher" for SOEs; "CG will be in serious trouble" without good outside directors.
4. **Duties of chairman vs. general manager/CEO:** Lack of clear division of responsibility can lead to friction.
5. **Parent-subsidiary relationship:** Tension between the two, especially where the latter own more assets. "Sometimes the listco owns 70% of the assets of the Group, so how can parents control the group?"

Impact of New Leadership

Although still early days, some patterns are emerging:

1. Financial reform a major priority (eg, interest rates; capital convertibility; QFII and RQFII; Shanghai Free Trade Zone; Shanghai-Hong Kong Stock Connect). This does not address CG directly, but should bring indirect benefits (eg, a more competitive environment for state banks; greater liquidity into the securities market, hence growth of institutional investors).
2. Financial regulators keen to rebalance the market from heavy retail influence to a more stable institutional base.
3. Renewed focus on SOE reform, especially the concept of “mixed ownership”: putting selected assets into new (unlisted) companies with a more diversified ownership base, hence a more balanced board and better corporate governance as the aim. See recent announcements from Sinopec and Cofco.
4. Challenges / areas of slow reform: rule of law/independent judiciary; media freedom; government corruption.

Appendix: The Role of ACGA

- An independent, non-profit membership association dedicated to encouraging and facilitating improvements in corporate governance in Asia. We are a practical research organisation.

- We promote a constructive dialogue between and among key groups, including institutional investors, companies, regulators and intermediaries.

- We provide original information and analysis for members and instigate positive improvements around the region through targetted advocacy initiatives.

Advocacy Achievement – Korea

Our advocacy and engagement initiatives focus on systemic governance issues

Issue

Unaudited accounts presented for shareholder approval prior to Korean AGMs

ACGA Initiatives

- Met Samsung Electronics in Seoul in 2013 to initiate engagement.
- Subsequent meeting with Samsung in Hong Kong in early 2014 when the firm promised audited accounts would be presented at its AGM.
- Wrote to 26 Korean companies, with the letter co-signed by 32 members.
- Engaged directly with six companies in person in Seoul in March 2014. (One of our members engaged with several more.)

Outcome to Date

- In the recent proxy March season, nine companies presented audited accounts before their AGMs and in time for shareholders to vote on them.
- A further eight firms promised to address the issue before next year.
- Company IR officers appreciated receiving the letter, as it gave them a stronger argument internally to resolve this problem.

Advocacy Achievement – Japan

Issue

Olympus accounting scandal in Japan in 2011: fraudulent behaviour by senior management resulted in threatened delisting by Tokyo Stock Exchange (TSE)—an outcome damaging for all stakeholders.

ACGA Initiative

- ACGA coordinated a letter to TSE co-signed by 16 members holding around 17% of Olympus shares.
- Engaged directly with the TSE.
- Proposed that, rather than being delisted, the company should be converted to a “Security on Alert” and senior management prosecuted

Outcome

- Olympus not delisted, but converted to a “Security on Alert” by TSE.
- Senior executives jailed.
- From a low of ¥650 at the time of our letter, the share price has since recovered to ¥3,170.

Membership Network

ACGA is unusual in having a membership that includes participants from across sectors and geographies.

- Almost 100 organisations, including:
  - Global and regional pension funds and institutional investors
  - Listed companies based in Asia
  - Major multilateral banks
  - International leaders in insurance, auditing and law
  - Universities and business schools
- Institutional investor members manage more than US$14 trillion globally.
- Members include company representatives from Hong Kong, Korea, Singapore, Taiwan, Indonesia and Thailand.
- We have around1,000 contact persons within our member companies and organisations.

Membership Network

- ACGA's membership network comprises a broad range of around 100 Asian and global organisations with a strong interest in corporate governance. Members include:

SWIRE PACIFIC

J.P.Morgan Asset Management

CLP 中電

tsmc

apg APG Asset Management Asia 荷蘭匯盈投資亞洲有限公司

NORGES BANK INVESTMENT MANAGEMENT

MORRISON&CO

PGGM

UBS

Standard Life Investments

CALSTRS

Investec Asset Management

BLACKROCK® 貝萊德

CalPERS

USS UNIVERSITIES SUPERANNUATION SCHEME LIMITED

ROBECO The Investment Engineers

Aberdeen Simply asset management.

Legal & General INVESTMENT MANAGEMENT

F&C Investments

HERMES

BAILLIE GIFFORD

CAPITAL GROUP

Allianz Global Investors

Henderson GLOBAL INVESTORS

Andra AP-fonden Second Swedish National Pension Fund - AP2

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