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Asian Corporate Governance Association (ACGA)

“Corporate Governance Reform in Asia: Fact, Fiction and Fantasy”

Presentation by

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at the

Fidelity Investments, Asian Institutional Roundtable

Hong Kong, June 29, 2006

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Agenda—Corporate Governance Reform in Asia

1. Fact
   - Hard evidence of progress since the financial crisis of 1997/98
2. Fiction
   - Areas where "progress" is based as much, if not more, on story than current reality
3. Fantasy
   - Concepts that have little basis in current reality
4. How is Asia doing overall?

1. Fact: New rules for a new era

The pattern of rule-making by countries since the late 1990s:

New best practice codes (global standards)	Next: Amend listing rules	Later: Amend securities laws ..
.. and company laws	Follow IAS/ IFRS	Follow ISA
Influenced by PCAOB	Revise & update codes and rules	Follow US SEC on style

Fact: New codes of best practice

National codes of corporate governance

1997	1998	1999	2000	2001	2002	2003	2004	2005
	Japan (JCGF)* India (CII)*	Korea Thailand India	M'sia	JCGF (revised) Indonesia Singapore	China Phil Taiwan	Korea (revised)	HK (revised) Japan	India & Singapore (revised)

Related guidelines (selected)

1997	1998	1999	2000	2001	2002	2003	2004	2005
				China INEDs	Phil INEDs India IPOs China bank boards			China bank boards (revised)

*Private-sector codes:
JCGF = Japan Corporate Governance Forum
CII = Confederation of Indian Industries

Fact: CG of companies improving (mostly/slowly)

"CG Watch 2005": Changes in average company scores, 2004 vs 2005 (%)
(Ranked according to 2005 scores)

	2004	2005
Asia large caps	**61**	**62.9**
Hong Kong	64.2	65.6
Thailand	62	63.5
Singapore	61.1	62.8
Malaysia	62.5	62.4
Korea	56.8	61.4
Taiwan	54.9	56.5
India	54.9	56.2
Philippines	56.3	51.8
China	51	50.4
Indonesia	44.3	43.3

Source: CLSA Asia-Pacific Markets, October 2005

Fact: Chinese boards becoming more diverse

Bank of China (HK) **(HK listed)**	Six of 13 directors are independent. Two are from Hong Kong, one from Singapore and three from the US. The number of independents has doubled in the past three years.
China Construction Bank **(HK listed)**	Came to market with two major strategic investors: Bank of America and Temasek (Singapore). Four of 15 directors are independent, including one from China, one from Japan, one from Hong Kong and one from the US.
Lenovo **(HK listed)**	Board was changing before its acquisition of IBM's PC business in May 2005. Now more diverse: the chairman is from China; the CEO from the US; and both the non-executive directors and the independent directors (four of 12) are a mixed group.
CNOOC Ltd **(HK-listed)**	Five of 12 directors are independent. One of them, Ken Courtis, questioned last year's attempted takeover of Unocal. He has since retired.
China Aviation Oil **(Singapore listed)**	In early March 2006, voted in a wholly new board, including three independent directors (one of whom, Lim Jit Poh, is the chairman). This forms part of its restructuring following its oil derivatives trading scandal in 2004.

Source: ACGA research

Fact: Chinese INED pay on the rise

- ACGA original research into the pay of independent directors in China over 2002-2004 has found:
  - Average annual remuneration of such directors in 2004 at the 25 largest A-share firms in Shanghai (by market cap) and the 15 biggest in Shenzhen was just Rmb55,000 (US$6,800).
  - But some leading firms paid more in 2004:

Baoshan Iron & Steel	**250,000**	25% increase on 2003.
Minsheng Bank	**156,000**	270% increase on 2003.
China Unicom	**120,000**	Zero increase over 2003, but a 50% increase on 2002.
Jiangsu Expressway	**106,000***	6% increase on 2003.
Yanzhou Coal	**93,000***	Zero increase over 2003; 3% on 2002.

Source: ACGA research **Overseas directors only.*

2. Fiction: INEDs & Audit Committees are effective

Rules on independent directors and audit committees in Asia in 1997			
Country	**Official code of best practice?**	**"Independent directors" required?**	**Audit committees required?**
China			
Hong Kong	Yes	Yes	
India			
Indonesia			
Japan			
Korea			
Malaysia		Yes	Yes
Philippines			
Singapore		Yes	Yes
Taiwan			
Thailand			

Source: ACGA research

Rules today: the form is there …

Country	Date of main code (s)	"Independent directors" required?	Audit committees required?
China	2002	Yes	Yes
Hong Kong	1993/2004	Yes	Yes
India	1999	Yes	Yes
Indonesia	2001	Yes	Yes
Japan	2004	Optional	Optional
Korea	1999	Yes	Yes (large firms)
Malaysia	2001	Yes	Yes
Philippines	2002	Yes	Yes
Singapore	2001/2005	Yes	Yes
Taiwan	2002	Yes	Yes
Thailand	1999	Yes	Yes

Source: ACGA research

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But the substance is often lacking

Question	CHINA	HK	INDIA	INDO	KOREA	MALAY	PHIL	SING	TAI	THAI
Audit committees: mandatory and implemented?	Some	Yes	Yes	Some	Some	Yes	Yes	Yes	Marg	Yes
Are audit c'tees functioning independently?	No	Some	Some	Marg	Marg	Some	No	Some	Marg	Marg

"Some" = Somewhat
"Marg" = Marginally

Source: CLSA & ACGA "CG Watch 2005"

Fiction: Asia is developing "disclosure-based" regimes

New rules do require enhanced disclosure ...

Question	CHINA	HK	INDIA	INDON	KOREA	MALAY	PHIL	SING	TAI	THAI
Is quarterly reporting mandatory?	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Must ownership stakes above 5% be disclosed?	Yes	Yes	Yes	Some	Yes	Yes	Yes	Yes	Some	Yes
Detailed disclosure of material transactions?	Some	Yes	Yes	Some	Yes	Yes	Yes	Yes	Yes	Yes
Is there a national policy to converge with IAS/IFRS?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

"Some" = Somewhat

Source: CLSA/ACGA "CG Watch 2005: The Holy Grail"

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But true "disclosure" regimes a long way off

- Regulators continue to vet IPO prospectuses in detail, not just on disclosure grounds, but sometimes qualitative ones as well.
  - Listing entry requirements remain quality based.
  - Stricter controls on sponsors.
- Some regulators vet company annoucements (eg, quality of language in Hong Kong).
- "Continuous disclosure" practices (and enforcement) remains weak in many markets.
- Rules on mandatory disclosure regarding takeovers also weak in some markets (eg, Shin Corp deal in Thailand).
- Disclosure rules and enforcement would have to get a lot better before investors in Asia could rely on disclosure alone.

3. Fantasy: "Global standards" are easily implemented

- Global principles and standards of corporate governance apply as much to Asia as any other region. Economic integration and cross-border investment (direct and portfolio) requires standardisation of rules. But <u>implementation</u> of standards must at least take account of Asia's:
  - Concentrated corporate ownership structures (family and state) + "insider traditions"
  - Generally weak "compliance culture" + untrained directors and managers (from a CG perspective)
  - Generally weak legal systems and controlled judiciary
- Asian regulators need to be innovative, where necessary, to develop implementation rules and training systems suited to their own markets. This may require going further than global best practices (eg, allowing minority shareholders a greater say in the nomination and election of independent directors).
- Yet Asian regulators are normally restrained by political considerations from addressing such issues.

Fantasy: An Asian model of corporate governance?

- Some argue that Asia needs its own system of corporate governance: due to different cultures, level of stock market development and corporate ownership structures to the West. But:
  - "Asia" is not one homogenous cultural, ethnic or linguistic block. Values and thinking varies.
  - Legal systems in Asia have differing legacies—either common law or civil law.
  - Regulatory systems in Asia have differing philosophies and approaches.
  - Which country or system would an "Asian model" be based upon?
  - How would an Asian model meet the need of global standardisation in basic rules?

4. How is Asia doing? "CG Watch" country scores

Note: Lower scores a result of stricter methodology.

Country[1]	2000	2001	2002	2003[2]	2004[3]	2005[4]
Singapore	75	74	74	77	75 ⇩	70 ⇩
Hong Kong	71	68	72	73	67 ⇩	69
India	56	54	59	66	62 ⇩	61 ⇩
Malaysia	32	37	47	55	60	56 ⇩
Taiwan	57	53	58	58	55	52 ⇩
Korea	52	38	47	55	58	50 ⇩
Thailand	28	37	38	46	53	50 ⇩
Philippines	29	33	36	37	50	48 ⇩
China	36	34	39	43	48	44 ⇩
Indonesia	29	32	29	32	40	37 ⇩

1. Ranked in descending order according to 2005 score.
2. First year in which ACGA collaborated with CLSA.
3. Introduced more rigorous scoring methodology in 2004.
4. Enhanced methodology further in 2005.

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Source: "CG Watch", a joint report by CLSA Asia-Pacific Markets and ACGA

Why country ratings were lower last year

- Country ratings trended downwards in 2005 not because of an actual decline in corporate governance standards or less effort on the part of regulators.

- Rather, it was a result a more rigorous survey methodology, which has brought to light:
  - Weaknesses in the detail of laws and regulations.
  - Poor implementation of key corporate governance regulations (eg, audit committees).
  - Poor regulatory track record against insider trading and market manipulation.
  - Gap between national accounting and auditing policies and practices.
  - CG best practices not gaining deep traction among the average listed company.
  - Fragmented and uncoordinated shareholder activism and engagement. Limited “private enforcement”.

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