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Asian Corporate Governance Association (ACGA)

"The Corporate Governance Rollercoaster in China: How Should Investors Respond?"

Presentation by:

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Agenda

1. ACGA's assessment of corporate governance in China
2. Questions on the recent stock market boom and bust
3. What can investors do to help to raise CG standards in China?

Introduction to ACGA

- An independent, non-profit membership association dedicated to facilitating improvements in corporate governance in Asia through research, advocacy and educational initiatives. Founded in Hong Kong in 1999 following—and as a response to—the Asian Financial Crisis of 1997-98.

- ACGA is unusual in having a membership that includes participants from across sectors and geographies. More than 100 organisations, including:
  - Global and regional pension funds and institutional investors
  - Listed companies based in Asia
  - Major multilateral banks
  - International leaders in accounting, insurance and financial services
  - University business schools

- Institutional investor members manage more than US$20 trillion globally.

Membership Network

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













































1. A short history of CG reform in China

The Asian Financial Crisis was the turning point for CG reform in Asia. China, though less directly affected, was influenced by these trends and got an early start with some quite bold reforms:

Year	CG Developments in China
2001	Guidelines on independent directors (CSRC)
2002	National Code of Corporate Governance (CSRC)
2003	Directive on quarterly reporting (CSRC)
2005	Bank governance guidelines (China Banking Regulatory Commission) and start of State-owned Assets Supervision and Administration Commission (SASAC) pilot programme on boards in central SOEs.
2007	Convergence of accounting and auditing standards with IFRS/ISA
	CSRC launched three-year campaign to strengthen listed company governance—use of funds, operation of board, internal controls.
2008	SSE launched its Corporate Governance Index
2013	CBRC new Corporate Governance Guidelines for commercial banks
2014	CAPCO guidelines on INEDs. CSRC rules on separate counting and disclosure for votes by the minority.

How we rank China: "CG Watch"

"CG Watch" survey. Market scores: 2010 to 2014					
(%)	2010	2012	2014	Change 2012 vs 2014 (ppt)	Trend of CG reform
1. = Hong Kong	65	66	**65**	(-1)	Weak leadership, tough enforcement
1. = Singapore	67	69	**64**	(-5)	International vs local contrast continues
3. Japan	57	55	**60**	(+5)	Landmark changes, can they be sustained?
4. = Thailand	55	58	**58**	-	Improving, but new legislation needed
4. = Malaysia	52	55	**58**	(+3)	Improving, but still too top-down
6. Taiwan	55	53	**56**	(+3)	Bold policy moves, can they be sustained?
7. India	48	51	**54**	(+3)	Bouncing back, Delhi more supportive
8. Korea	45	49	**49**	-	Indifferent leader, more active regulators
9. China	49	45	**45**	-	Focus on SOE reform, enforcement
10. = Philippines	37	41	**40**	(-1)	Slow reform, improved company reporting
10. = Indonesia	40	37	**39**	(+2)	Big ambitions, can they be achieved?

Source: ACGA, CLSA

"CG Watch 2014": Category scores

Market category scores

(%)	Total	CG Rules & Practices	Enforcement	Political & Regulatory	IGAAP	CG Culture
1. = Hong Kong	**65**	61	71	69	72	51
1. = Singapore	**64**	63	56	64	85	54
3. Japan	**60**	48	62	61	72	55
4. = Thailand	**58**	62	51	48	80	50
4. = Malaysia	**58**	55	47	59	85	43
6. Taiwan	**56**	48	47	63	75	47
7. India	**54**	57	46	58	57	51
8. Korea	**49**	46	46	45	72	34
9. China	**45**	42	40	44	67	34
10. = Philippines	**40**	40	18	42	65	33
10. = Indonesia	**39**	34	24	44	62	32

Source: ACGA, CLSA

CSRC vs SFC enforcement 2015

Enforcement category	CSRC (to August 31, 2015)	SFC (to August 18, 2015)
Market manipulation	10	-
Insider trading	7	4
Utilising unpublished information	6	-
Non-standard trading procedures / disseminating fictitious information	19 (including 5 major securities firms in August)	-
Operational failure	-	10
Regulatory breaches (eg, unlicensed trading)	-	11
Banning/suspensions	-	10
Cold shoulders / disqualifications	-	6
Total	42	42

2. Questions on the boom/bust

- Should any government / regulator be actively encouraging people to invest in stocks?
- Were the rules on margin trading too permissive?
- Was the official media irresponsible in pumping up the market boom?

The monetary policy context

1. Change of the benchmark rate of one-year loan/saving:

No.	Effective Date	The benchmark rate of one-year loan		The benchmark rate of one-year saving	
		Change ↓	Rate after change	Change ↓	Rate after change
1	2014.11.22	40 basis points	5.6%	25 basis points	2.75%
2	2015.3.1	25 basis points	5.35%	25 basis points	2.5%
3	2015.5.11	25 basis points	5.1%	25 basis points	2.25%
4	**2015.6.28**	25 basis points	4.85%	25 basis points	2%
5	2015.8.26	25 basis points	4.6%	25 basis points	1.75%
6	**2015.10.24**	25 basis points	**4.35%**	25 basis points	**1.5%**

Source: People's Bank of China

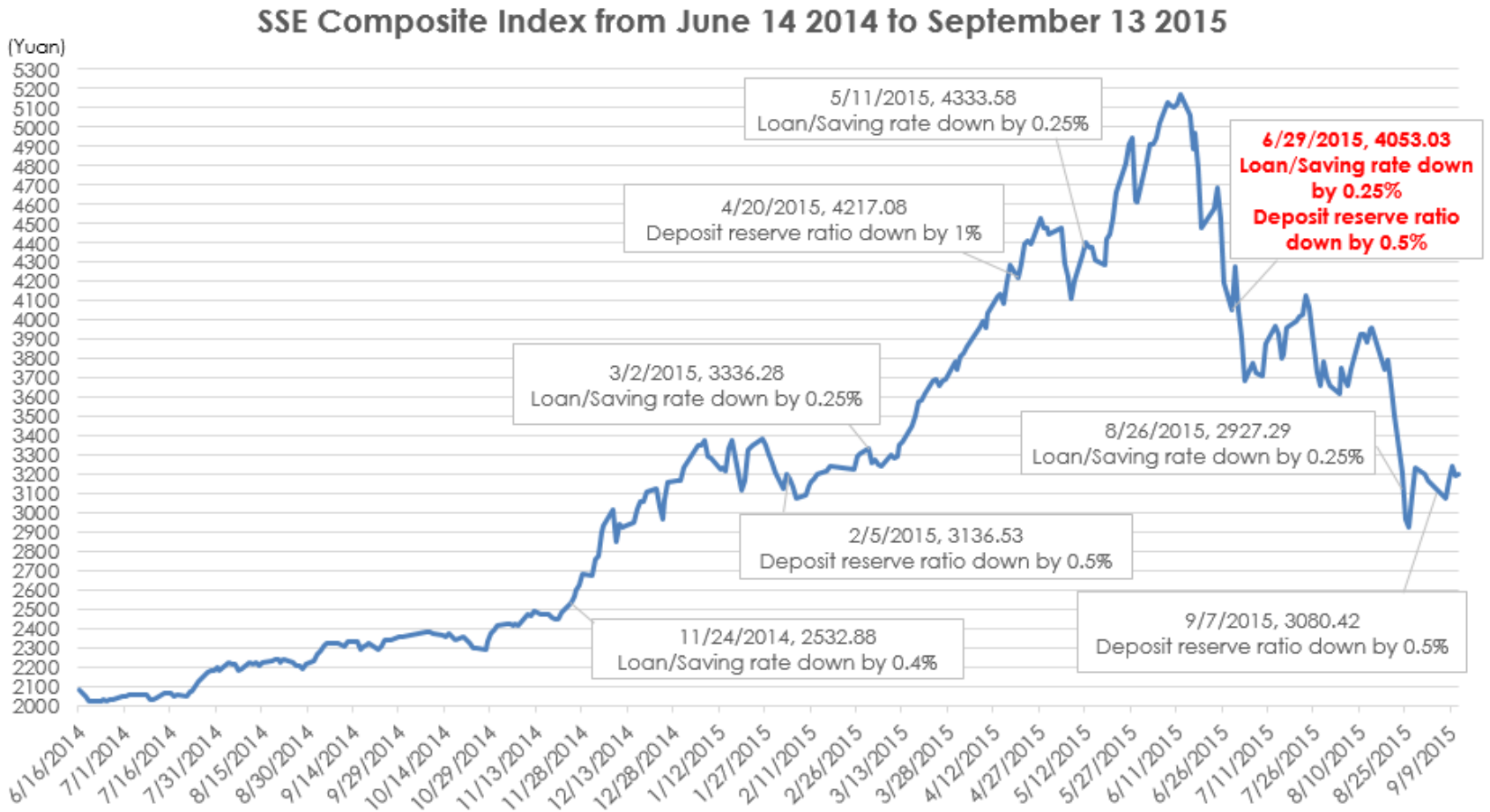
1. Change of the deposit reserve ratio:

No.	Effective Date	Change ↓	The Deposit Reserve Ratio before change		The Deposit Reserve Ratio after change	
			Large Financial Institutions	Small-Medium Financial Institutions	Large Financial Institutions	Small-Medium Financial Institutions
1	2015.2.5	50 basis points	20%	16.5%	19.5%	16%
2	2015.4.20	100 basis points	19.5%	16%	18.5%	15%
3	**2015.6.28**	50 basis points	18.5%	15%	18%	14.5%
4	2015.9.6	50 basis points	18%	14.5%	17.5%	14%
5	**2015.10.24**	50 basis points	17.5%	14%	**17%**	**13.5%**

Source: People's Bank of China

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Monetary policy and market performance



Source: ACGA

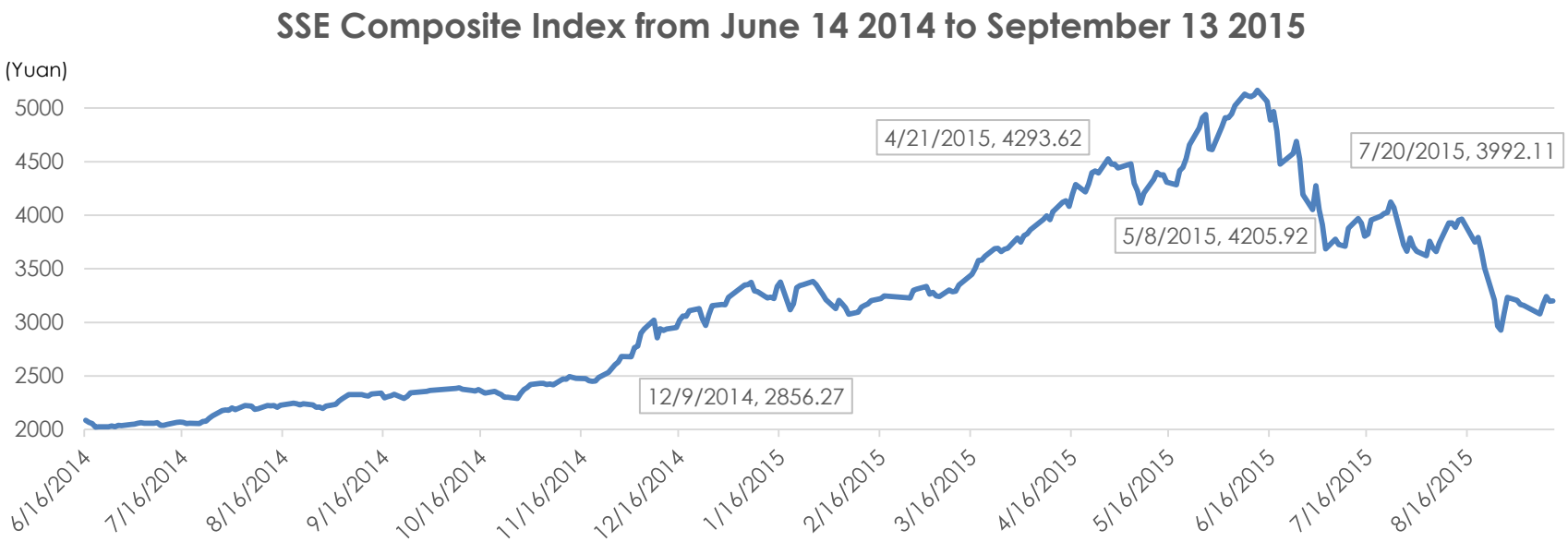
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A short history of margin trading

- **2010.01.08** The State Council agreed to launch margin trading and short selling trial.
- **2010.03.31** China launched its margin trading and short selling trial programme in Shanghai and Shenzhen Stock Exchanges.
- **2013.04** Major securities firms in China lower the barrier of margin trading and short selling from account balance of 500K to 100K.
- **2014.08.07** Some major securities firm in China further lowered the barrier of margin trading and short selling from 100K to 50K and other firms followed afterwards.
- **2014.09.12** Shanghai and Shenzhen Stock Exchanges jointly announced an increase to 205 stocks in total (104 for Shanghai and 101 for Shenzhen) on the margin trading and short selling target list.
- ***2015.01** Securities firms set the barrier of margin trading and short selling back to account balance of 500K.

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What the People's Daily said…



- ***2014.12.9*** *"As long as the stock market fluctuations have not threaten the domestic economy, the government should not interfere into it."*
- ***2015.4.21*** *"SSE 4000 is only the starting point of the Chinese bull market."*
- ***2015.5.8*** *"The momentum of a long-term bull market has not changed."*
- ***2015.7.20*** *"Government intervention in a stock market crisis is an international convention."*

Source: People's Daily

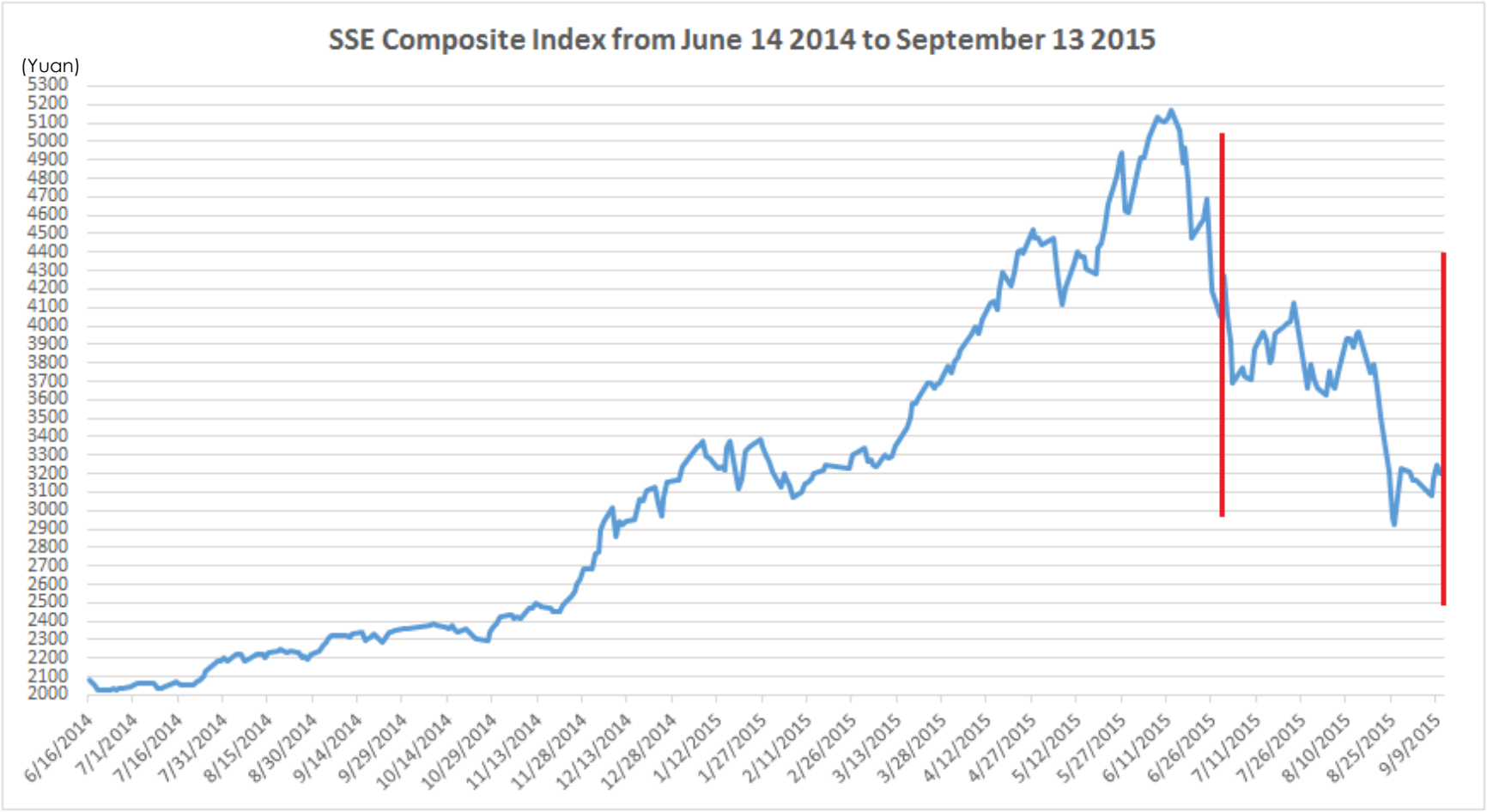
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Policies to "save" the market

- **2015.7.1** Stock settlement fees lowered by about 33%.
- **2015.7.3** CSRC increased QFII quota from US$80 billion to US$150 billion.
- **2015.7.4** State Council decided to postpone IPOs, reopen date not known.
- **2015.7.4** CSRC asked 21 security firms together to buy at least 120 billion yuan in blue-chips ETF and asked 25 fund companies to buy their own equity funds and hold at least for one year.
- **2015.7.8** Ministry of Finance promised that it will not sell its shareholdings and asked management of major listed companies to hold their own shareholdings for next six months.
- **2015 7.8** China Security Finance Corporation provided 260 billion yuan (US$41.87 billion) in credit lines to 21 brokerages to help them buy stocks via proprietary trading.
- **2015.7.9** CSRC started cooperation with the Ministry of Public Security to investigate several alleged market manipulation cases.
- **2015.9.12** CSRC announced 240 million yuan fines for four major domestic brokers for not properly following margin trading rules.

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Market performance after "saving policies"

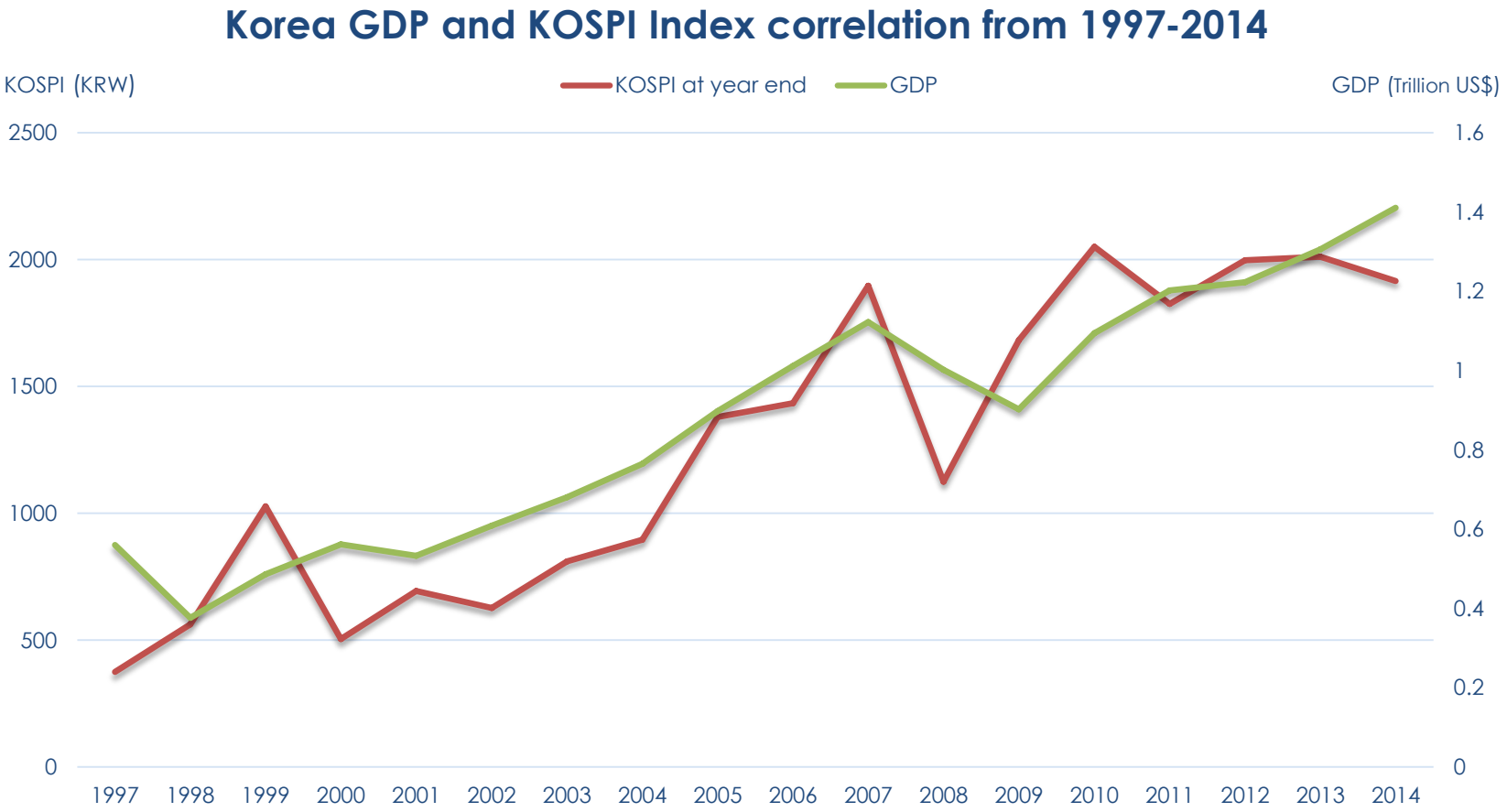


Source: Yahoo Finance

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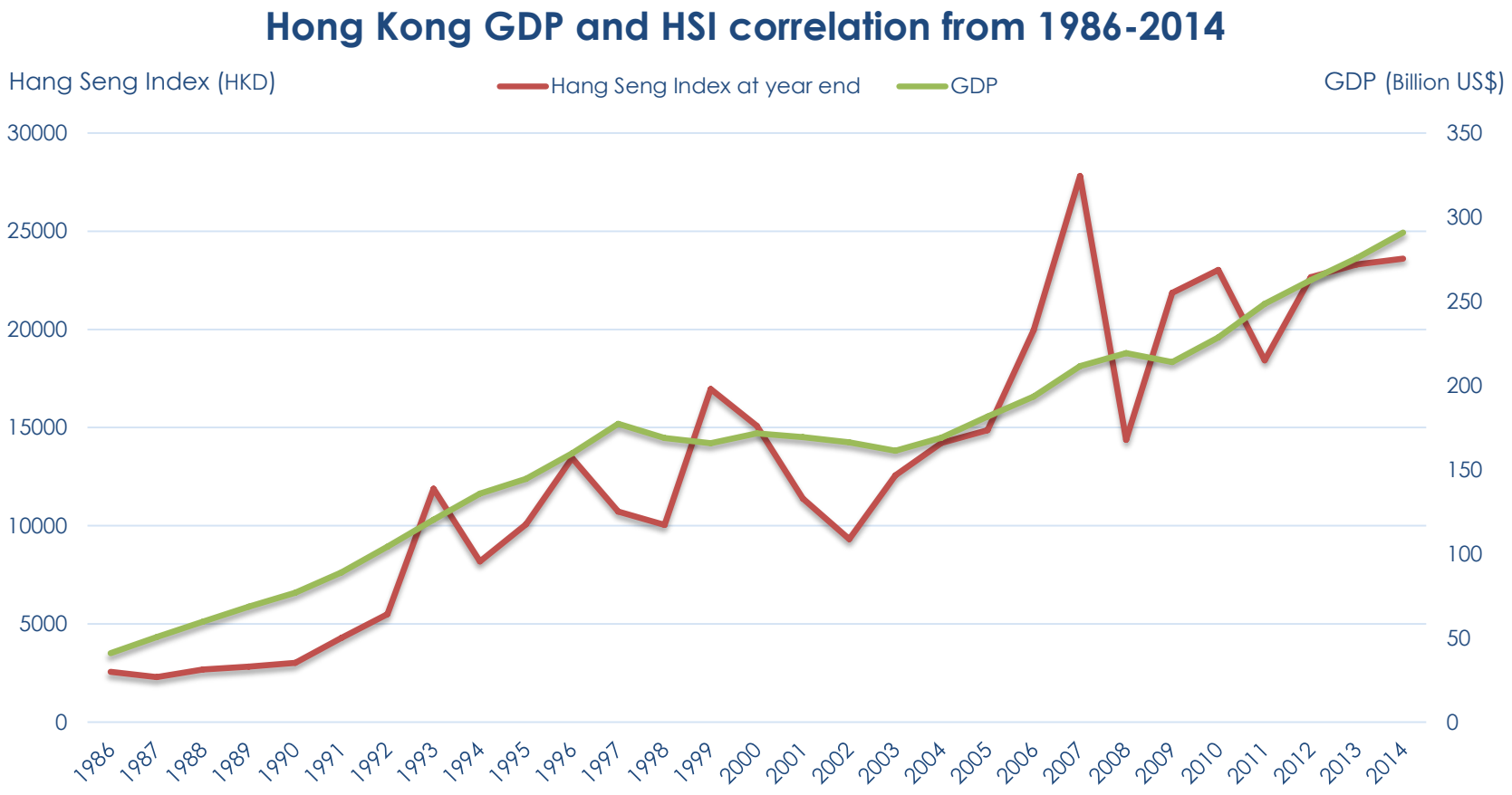
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Economic development and market performance



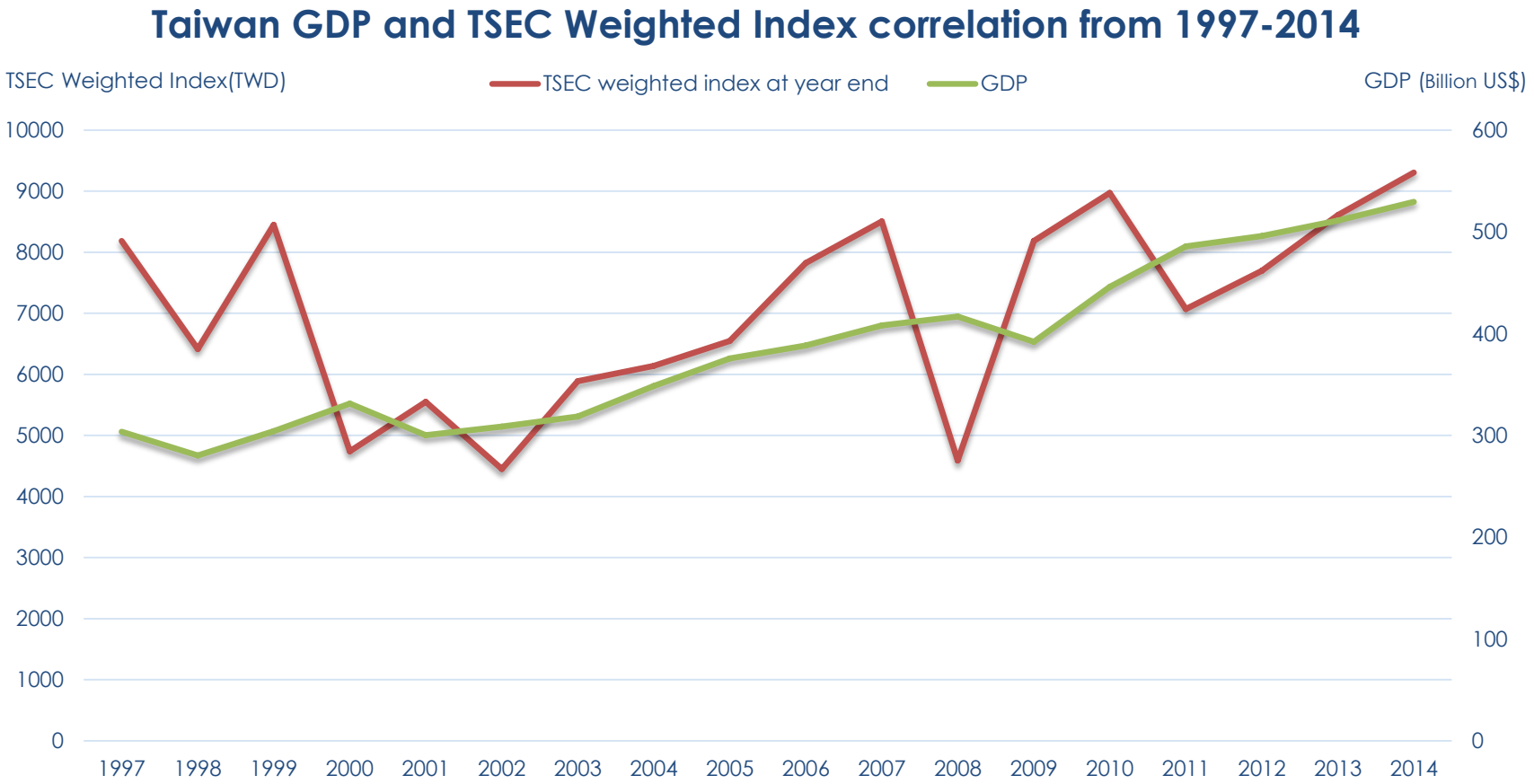
Source: World Bank and Yahoo Finance

Economic development and market performance



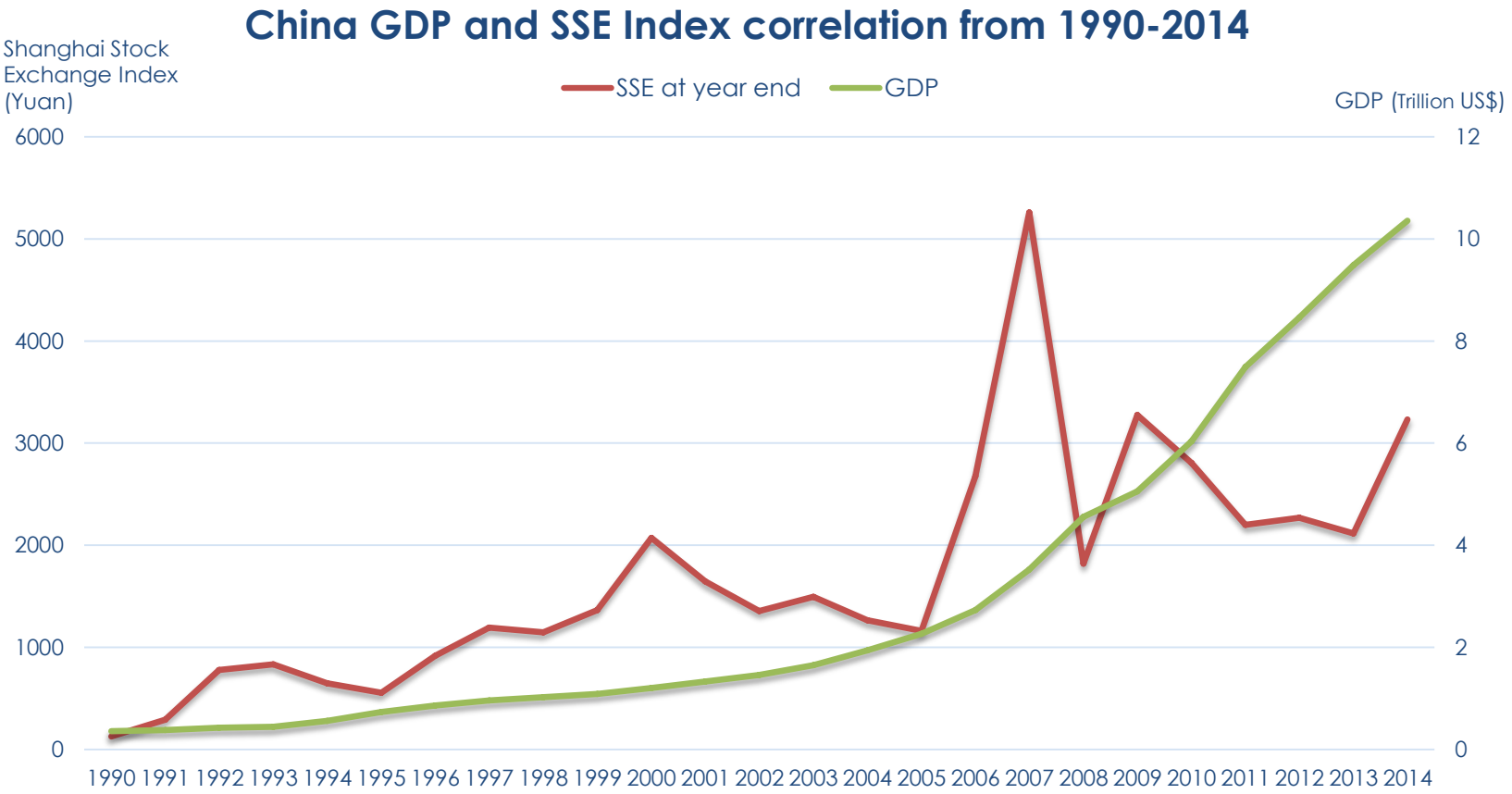
Source: World Bank and Yahoo Finance

Economic development and market performance



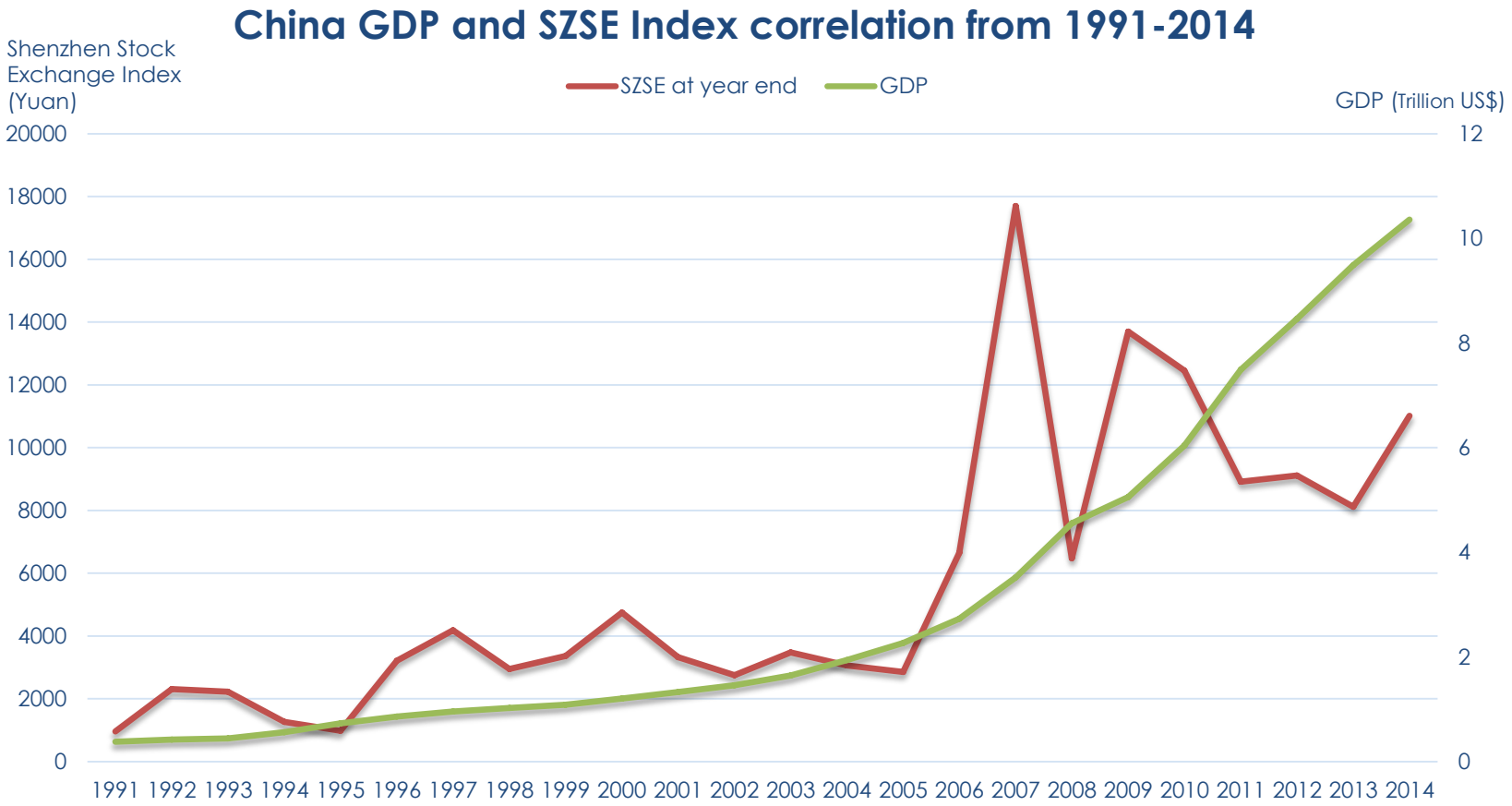
Source: World Bank and Yahoo Finance

Economic development and market performance



Source: World Bank and Yahoo Finance

Economic development and market performance



Source: World Bank and Yahoo Finance

Why is China out of sync?

- Majority of market cap historically dominated by big SOEs, yet majority of new jobs and economic value is being created by the private sector. (This does not apply to Shenzhen, however.)
- Historic reliance on bank loans rather than equity capital raising.
- Arbitrary moratoriums on IPOs. While these may have helped the index in the short term, they have also damaged trust in the market among sophisticated investors and its role as an efficient allocator of capital.

No	Date	No. trading days	Performance of SSE Index
1	July 21 – December 7, 1994	98	+65.75%
2	January 19 – June 9, 1995	96	+18.36%
3	July 5, 1995 – January 3, 1996	128	-12.6%
4	July 31 – November 2, 2001	69	-13.57%
5	August 26, 2004 – January 23, 2005	101	-7.86%
6	May 25, 2005 – January 2, 2006	264	+49.53%
7	September 16, 2008 – July 10, 2009	191	+43.09%
8	November 16, 2012 – Jan 17, 2014	274	+1.89%
9	July 4, 2015 – Nov 30, 2015	**103**	**-7.29%**

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4. What can investors do?

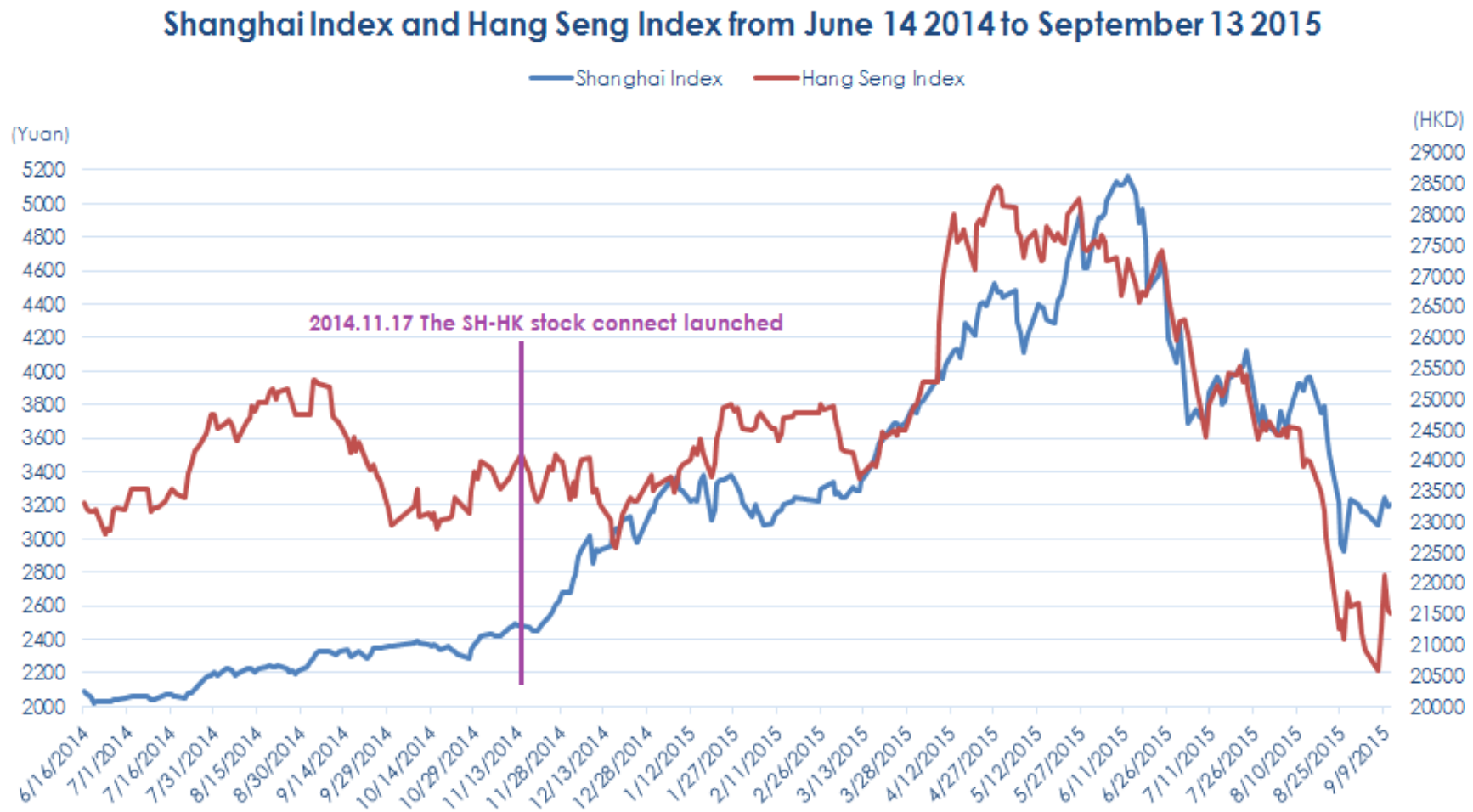
Institutional investors cannot change the structure of the market overnight, nor can you influence monetary policy. However individually and collectively the industry could play a positive role over the next 5-10 years. For example, engaging with the government for:

1. More policy consistency, less arbitrary decision-making (eg, no more IPO moratoriums).
2. Stricter rules on voluntary suspensions.
3. Stricter rules on margin trading for small accounts.
4. More consistent, transparent and expanded regulatory enforcement.
5. Upgraded CG standards for companies—China's CG Code is now quite out of date (2001).

- And engage with companies who will listen to your advice.

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Correlation between SSE and HSI



Source: Yahoo Finance

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