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Asian Corporate Governance Association (ACGA)

"Asian CG Market Rankings and Trends since 2000"

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Agenda

1. Synchronised swimming
2. Overview of 11 Asian markets
3. Hong Kong vs. Singapore
4. The rising middle
5. The bottom four
6. Market category scores
7. Conclusion

1. Synchronised swimming:
Scores converging, moving in tandem

- The main story of "CG Watch 2012" was one of contrasting states of reform in North and Southeast Asia, with the latter showing more verve than the former.
- The past two years has brought a more mixed outcome:
  - Trouble at the top in the region's two international financial centres;
  - Marked improvements in all but one of five markets in the middle tier, moving in lock step;
  - A degree of stagnation in layer three;
  - Bottom two markets come equal last.
- It is like watching a huge exercise in regional synchronised swimming!

2. Overview of 11 Asian markets

- **Hong Kong and Singapore**: Scores fall due to regulatory conflicts of interest, out-of-date institutional structures, opposition to reform from the usual suspects, and many other factors.
- **Middle markets**: More cause for hope -
  - **Thailand:** No fall in score – a big surprise.
  - **Japan**: Leapt into third (again) due to Abe action, better enforcement.
  - **Malaysia**: Continues to improve, mostly thanks to government efforts.
  - **Taiwan and India**: Finding their reform mojo again. Will it last?
- **Korea and China**: Some improvements, but losing ground as regional benchmarks rise, hence scores stay the same.
- **The Philippines and Indonesia**: Former going sideways, latter gets new lease of life.

Market rankings & scores, 2014

CG Watch 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: Asian Corporate Governance Association

3. Hong Kong vs Singapore

We no longer see a substantive difference in overall CG quality.

- Both are struggling to balance "international standards" with "market competitiveness".
- Each has arrived at the same destination through quite different routes, with 41 of the 94 questions scoring differently.
  - Largest number of differences in CG Rules & Practices and Enforcement;
  - Fewest in IGAAP (Accounting and Auditing), though the total score quite different due to HK's weak audit regulatory system.
- Enforcement:
  - Hong Kong has much stronger securities enforcement by the SFC vs MAS.
  - HK much tougher on insider trading, market manipulation.
  - Singapore scores better on some aspects of "market enforcement", such as nomination of independent directors by minorities and whether retail shareholders participate actively in AGMs.

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4. The rising middle
Japan, Thailand, Malaysia, Taiwan and India

The view from the middle of our survey is considerably more uplifting.

- These five markets are the most motivated to achieve higher scores.
- Some have responded explicitly to recommendations made in previous "CG Watch" reports, especially Taiwan.
- Concerted effort to strengthen CG policies and regulations
  - **Japan and Taiwan** - major new CG policy initiatives.
  - **Thailand and Malaysia** - moving ahead with pre-existing plans.
  - **India** - a resurgent interest in company law reform and CG.
- Enforcement scores higher for all five markets, mostly due to the efforts of regulators.
- "Market enforcement" gradually building, but still nascent and not well organised (though retail is stronger in Thailand and Malaysia).

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6. The bottom four
Korea, China, Philippines and Indonesia

Despite flat scores, some aspects of the governance systems of Korea and China have improved.

- Higher scores for Enforcement in both markets; almost entirely due to the efforts of regulators.
- **Korea** held back by a lack of leadership on CG policy from Park administration, a failure to progress with legislative amendments, weak CG culture among the *chaebol*, and constant rotation of officials responsible for financial regulation.
- **China** saw marginal falls in three categories: CG Rules & Practices, Political and Regulatory Environment, and IGAAP (Accounting and Auditing). Relative to other markets, China's CG standards are slipping.
- SOE reform in China should be a positive, if it can be implemented effectively (ie, more autonomy for central SOEs, less government interference).

Philippines and Indonesia

Philippines struggling to move up, Indonesia shows a more concerted effort.

- **Philippines** gains points in CG Rules and Practices due to a new requirement for an Annual CG Report, and also in CG Culture due to improved IR and new retail shareholder group, SharePhil.
- Held back by poor scores in Enforcement and Accounting/Auditing, the result of weak regulators and limited disclosure of enforcement activity.
- **Indonesia** has a new "CG Roadmap" that envisages widespread rule changes, including a revised and more practical CG Code.
- New super regulator, the OJK, should be a catalyst for sustained reform. Some progress also apparent in audit regulation.
- Can it succeed? Much depends on political will, increasing regulatory resources and ensuring the right people are in place.

7. Market 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: Asian Corporate Governance Association

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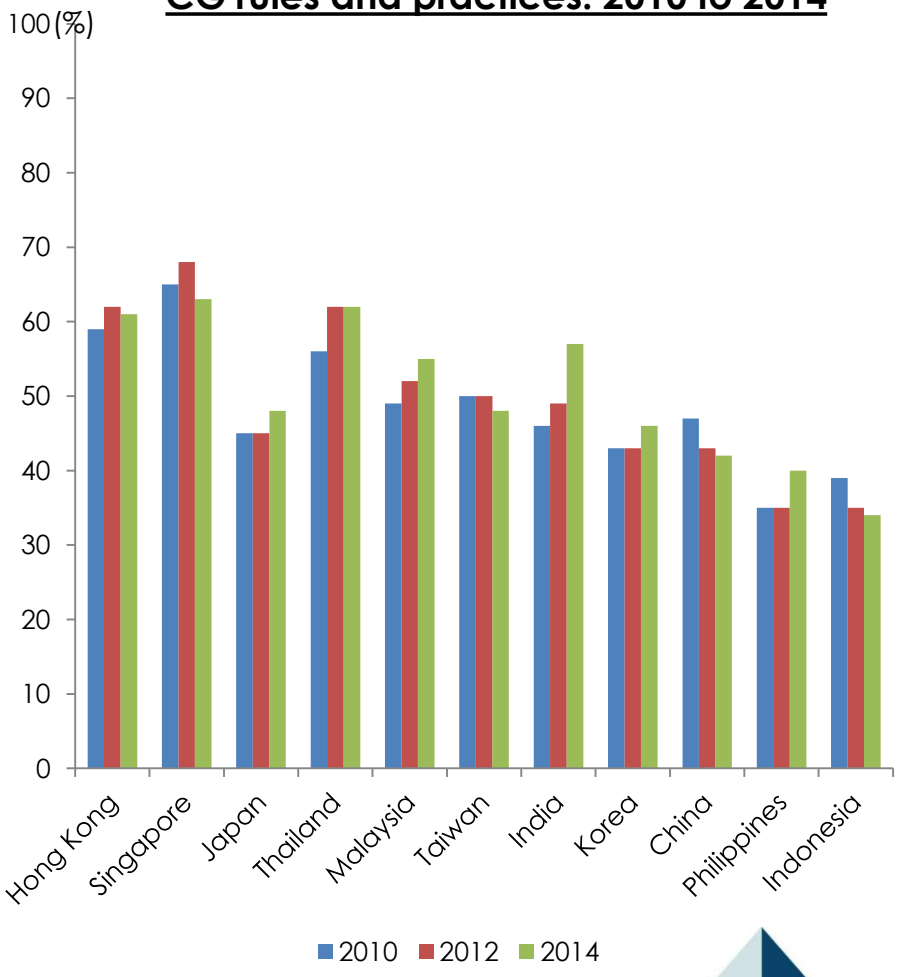
CG Rules & Practices

- Almost half the region shows some improvement over the past three surveys.
- Top two markets both slip, as do Taiwan, China and Indonesia; Thailand stays the same.
- One reason for the slippage is the introduction of three new questions on sustainability reporting, and more detailed research on such things as financial reporting and executive remuneration.
- Asia still has much room for improvement on CG rules - a warning flag for investors.

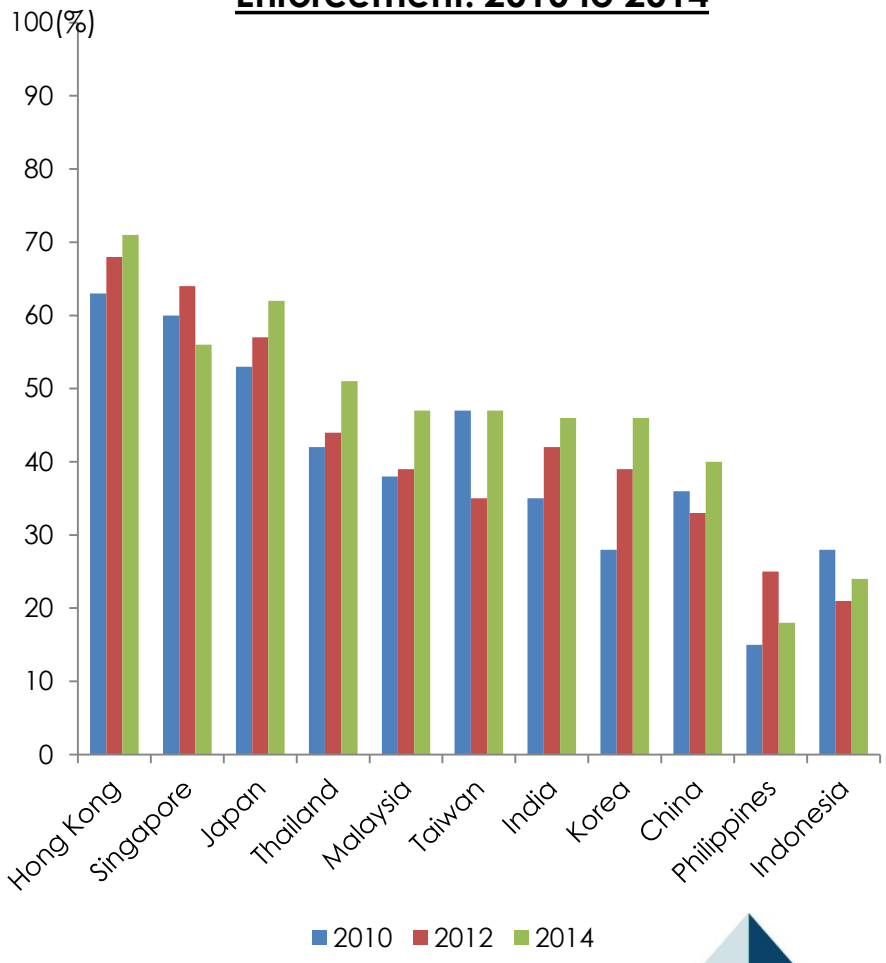
CG rules and practices: 2010 to 2014



Enforcement

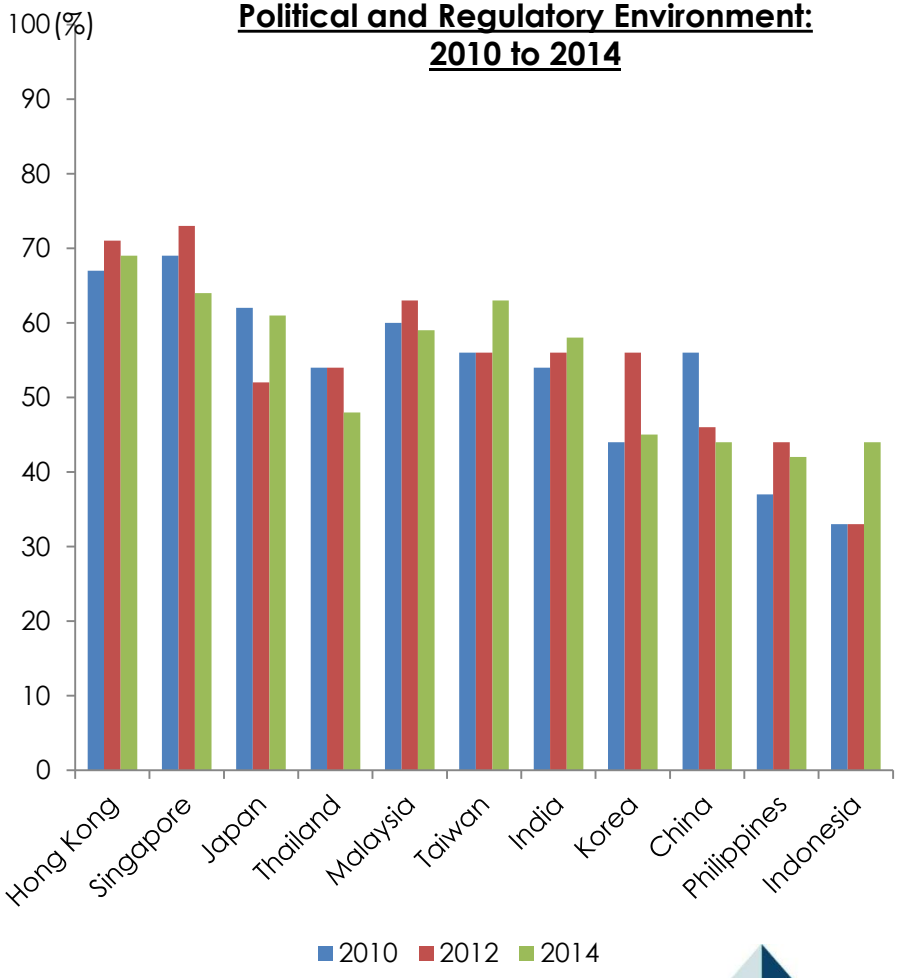
- Rising scores in nine of the 11 markets show regulators see the value of good enforcement to investor confidence and market credibility.
- Improved scores in Japan, Malaysia and, to a lesser degree, Thailand, also take into account efforts by governments and/or institutional investors to develop "stewardship codes".
- Taiwan's higher score is partly the result of more engaged foreign institutional shareholders, while India's has risen with more active participation by domestic institutions.

Enforcement: 2010 to 2014



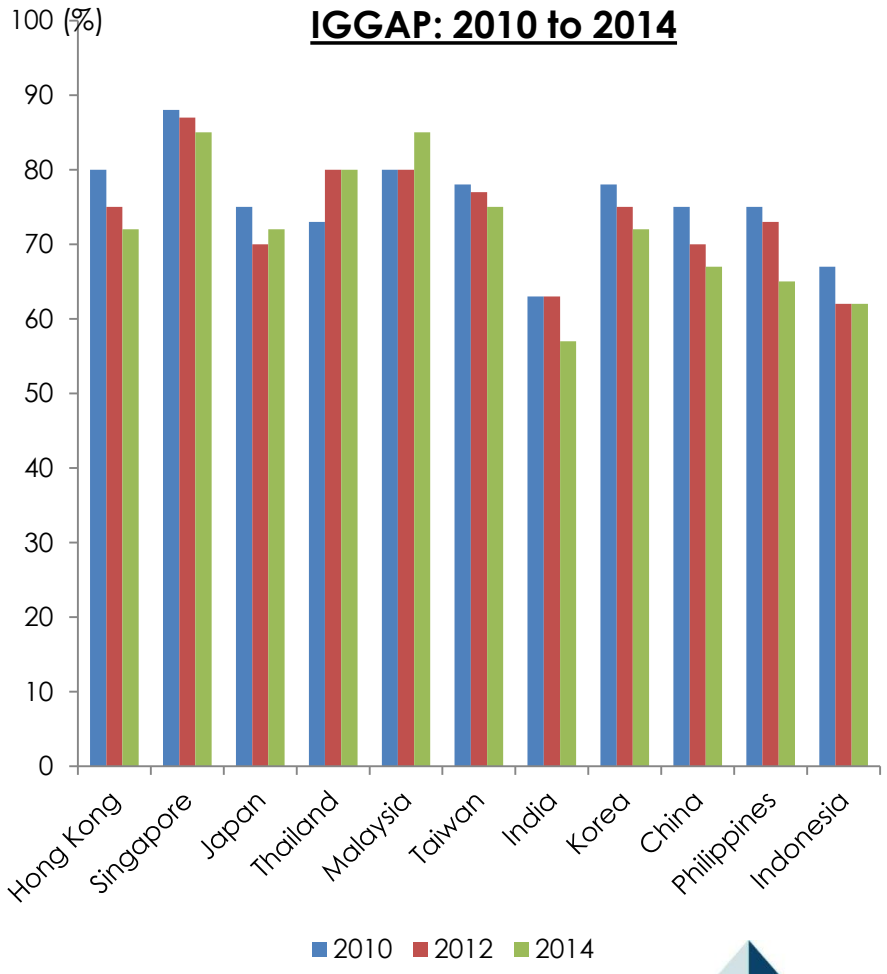
Political & Regulatory Environment

- Scores undermined by weak or uneven leadership on corporate governance in many markets, hence the lack of a clear and consistent strategy
- Corruption and inadequate attempts to control it are also a major issue.
- A new question on public governance and civil service ethics has brought scores down for some markets.



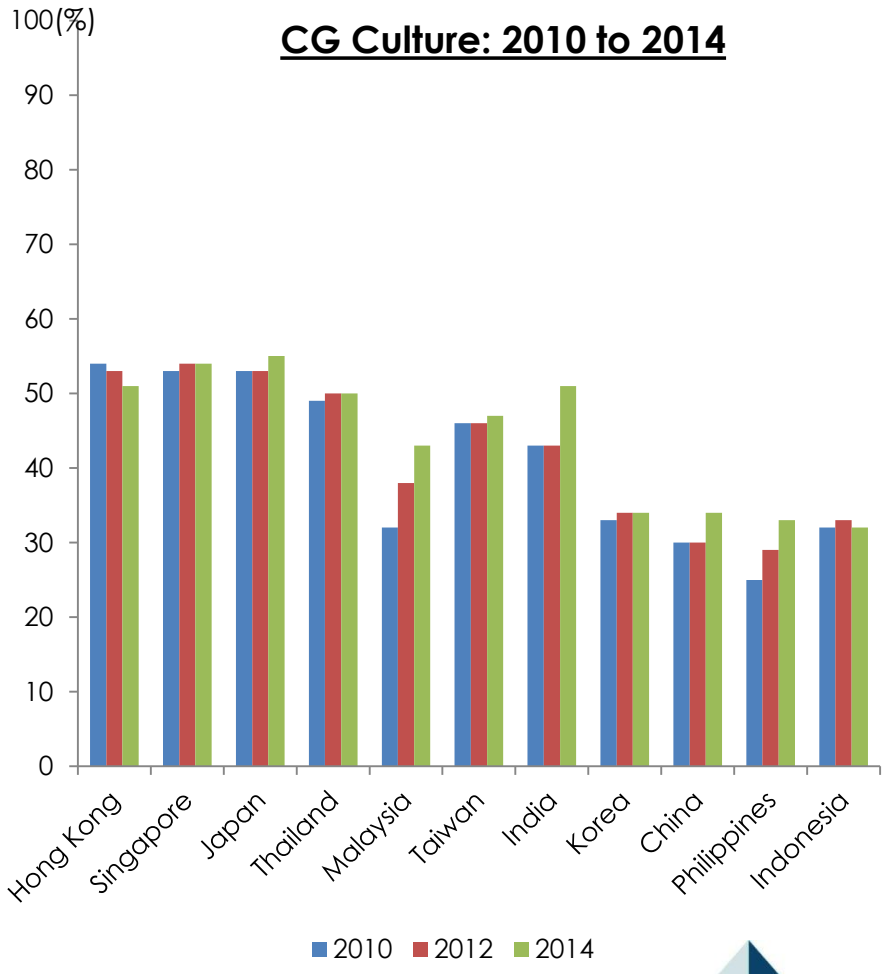
IGAAP (Accounting and Auditing)

- Scores weaken as we get tougher on assessing audit regulation.
- Hong Kong, India and the Philippines all lack a proper independent audit regulator.
- Singapore has an effective audit regulator, but its lower score represents the fact it still lacks disciplinary powers against CPA firms.
- Malaysia's score has risen due to an active audit regulator, which does have a full suite of powers against both firms and individual auditors.



CG Culture

- Malaysia stands out due to its new institutional investor code, some voluntary voting by poll and improved communication by companies.
- India's score jumps up because voting by poll is now effectively mandatory and domestic institutions more active.
- China does a bit better because its larger state enterprises are showing more interest in CG as a result of renewed SOE reform.
- Philippines gets a bump due to better communication by companies and the new shareholder group, SharePhil.



Positive changes since 2000

- New corporate reporting regimes – financial and non-financial – with greater focus now on price-sensitive information disclosure
- Improved regulatory enforcement – administrative, civil, criminal – and stronger regulatory institutional structures
- Strengthening private enforcement – voting, engagement, activism
- Enhanced accounting and auditing standards, stronger audit regulation
- More balanced and strategically focussed boards
- Considerable focus on the internal controls of listed companies
- Growing dialogue between listed companies and their shareholders

Ongoing negatives

- Formulaic corporate reporting (especially on CG and ESG)
- More disclosure in 20-F reports of Asian ADRs than in some local annual reports
- IPO prospectuses still contain basic disclosure not required afterwards
- Weak rules on related-party transactions in many markets
- Compromised police and judiciary in certain markets; corruption unchanging
- Majority of institutional investors (not ACGA members!) are still happy to free ride, become interested only after a crisis
- Better listed companies are getting better in terms of CG, yet majority appear to see little upside and are not incentivised by the market

8. Conclusion

How are we doing 15 years after the Asian Financial Crisis?

- The region has a very different financial regulatory philosophy, a large body of new laws, regulations, CG codes and guidelines. Progress good in relative terms, but judged against "world class" standards is less impressive.
- Amending regulation is a tougher process than people realise: it gets caught up in local politics and depends on strong govern vascillates. More consistency would be good.
- Securities commissions are taking enforcement seriously, but disclosure of these efforts leaves a lot to be desired. Stock exchanges mostly less interested.
- What should investors be worried about?
  - Account preparation, especially among state enterprises and small issuers.
  - Conflicts of interest in the role of stock exchanges.
  - Weak shareholder rights in different markets, especially relating to takeovers and major or related-party transactions.
  - Audit quality, fees and audit industry capacity, the three are linked.

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