Asian Corporate Governance Association (ACGA)

"10 Years of CG Reform in Asia: What has Changed? How does Japan Compare?"

Presentation by
Jamie Allen, Secretary General, ACGA, Hong Kong
at the
White & Case / AIMA Seminar
November 7, 2007, Tokyo

Agenda

1. A decade of CG reform in Asia
   - The three “disciplines” of corporate governance
2. The evolution of market discipline
3. How does Japan compare?

Some initial observations

- Asian securities markets have become significantly more "rules-based" since 1997/98—due to international pressure, competition between markets, and national self-esteem.

- While decrying "one size fits all", most Asian governments have followed the global CG template (to varying degrees). Not much regulatory innovation. The latest idea ("principles-based regulation") is borrowed from the UK.

- Competition for capital is now leading to two-tier regulatory structures, influenced by the AIM market in London (eg, Singapore, but not Hong Kong).

➢ All of this reflects the global nature of capital markets, but also the non-linear nature of CG reform (similar to the story in the US). No "Asian model" of corporate governance is appearing. But at the same time, the "Anglo-Saxon model" is being forced to respond to "ESG" pressures. "Best practices" evolve.

1. A Decade of CG Reform

- An early metaphor was the “three-legged stool”, meaning that corporate governance requires three things to work:
  - **Regulatory discipline**: strong rules and enforcement
  - **Corporate self-discipline**: enlightened self-interest in the implementation of best practices
  - **Market discipline**: investors, bankers, bondholders and intermediaries sending signals to listed companies through market prices and the exercise of legal rights
- The first stools had one long leg and two very short ones!

Regulatory discipline 2007:

Scores for rulemaking exceed scores for enforcement, institutions, culture

Market	CG Rules & Practices	Enforcement (public/private)	Political/ Regulatory	IGAAP	CG Culture
Hong Kong	60	56	73	83	61
Singapore	70	50	65	88	53
India	59	38	58	75	50
Taiwan	49	47	60	70	46
Japan	43	46	52	72	44
Korea	45	39	48	68	43
Malaysia	43	35	56	78	33
Thailand	58	36	31	70	39
China	43	33	52	73	25
Philippines	39	19	38	75	36
Indonesia	39	22	35	65	25

Source: "CG Watch 2007", ACGA & CLSA. Scores in %.

Regulatory discipline:
Encouraging CG best practices through codes and guidelines

National codes of corporate governance

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Japan (JCGF)* India (CII)*	Korea Thailand India	M'sia	JCGF (revised) Indonesia Singapore	China Phils Taiwan	Korea (revised)	HK (revised) (Japan)	India & Sing'pore (revised)	Indonesia & Thailand (revised)

Related guidelines (selected)

1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
				China INEDs	Phils INEDs China banks			China banks (revised)	Indonesia banks

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

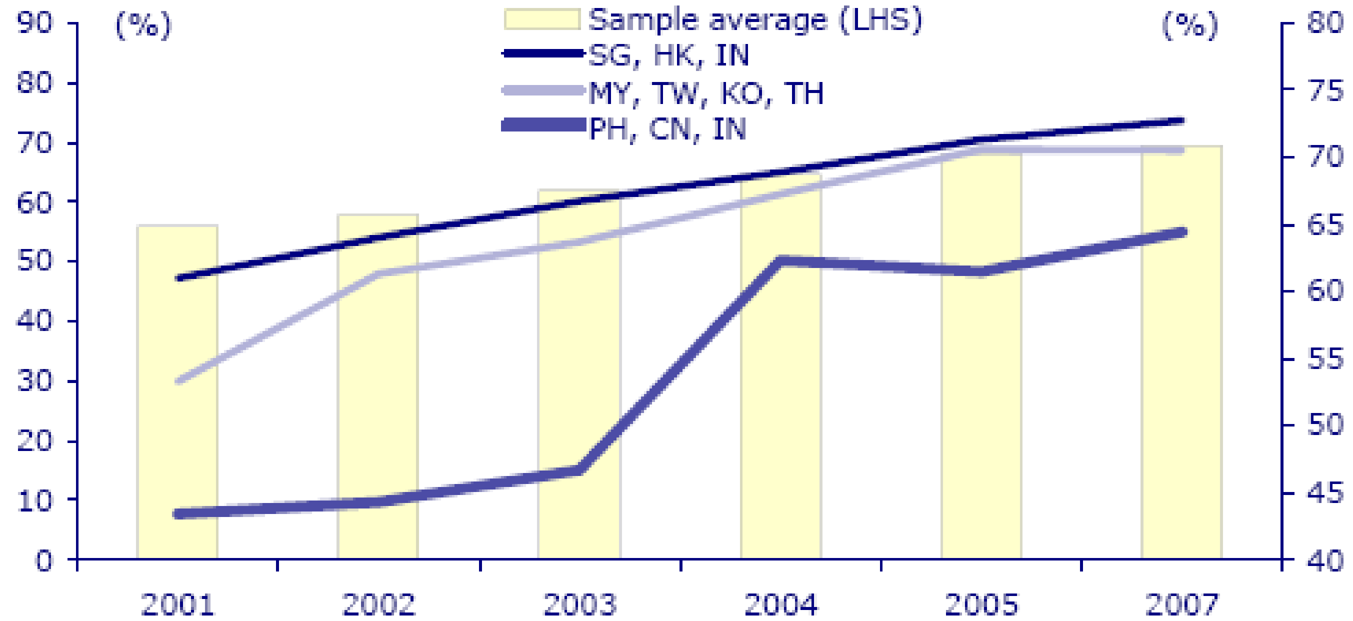
Corporate self-discipline 2007

- **Déjà vu at the top**:
  - "CG Watch 2002": top companies for CG quality included Infosys, TSMC, HSBC, Kookmin Bank, CLP, Singapore Press
  - "CG Watch 2007": top companies included HSBC, Sharp, HK Exchanges, TSMC, Infosys and CLP
- **An unimpressive middle**:
  - The average improvement in score for company CG from 2005 to 2007 was only +1.2 percentage points across Asia ex-Japan. This took the average company score to just 51.1% in "CG Watch 2007".
  - Note: Average improvement in company scores across Asia from 2001 to 2005 was +3.1 percentage points per year. Hence, the pressure to improve CG has reduced, says CLSA, as markets have risen and investors have taken greater risks.

Scores differ between countries

Figure 29

Changes in CG scores for overall sample (2001-07)



Source: CLSA Asia-Pacific Markets

But implementation generally lags rules

Market	Are audit c'tees mandatory and implemented?	Are audit committees functioning independently?
China	Yes	Marginally
Hong Kong	Yes	Somewhat
India	Yes	Somewhat
Indonesia	Yes	Marginally
Japan	Somewhat	No
Korea	Yes	Somewhat
Malaysia	Yes	Marginally
Philippines	Yes	No
Singapore	Yes	Somewhat
Taiwan	Somewhat	Marginally
Thailand	Yes	Marginally

Source: "CG Watch 2007"

2. The evolution of market discipline

- "Market discipline" is normally seen as the poor cousin to regulatory discipline—it is less developed and often regarded as ineffective. The usual charges are that:
  - Investors (retail and institutional) vote with their feet, rather than vote their shares.
  - Institutional investors do not incorporate CG into their investment process.
  - Fund managers are incentivised to "free ride" rather than engage with companies.
  - Manager compensation (and assessment) is short-term, hence investment horizons are short-term.
  - Intermediaries (investment banks) and banks are barely in the CG game.

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Seeds are being planted

- Share voting is increasing in Hong Kong, Singapore, Taiwan, Thailand, Korea, Japan
  - Some effects are being seen (eg, more self-discipline among some large companies in HK on new share placement mandates)
- Institutions are engaging more with companies, regulators and, significantly, with each other
  - From letter writing and speaking in conferences to one-on-one meetings with companies and informal discussion groups
- A few brave fund managers are standing their ground
  - Privatisation deals & voluntary delistings in Malaysia
- ACGA working with custodian banks in Singapore and our members to seek an amendment to the Companies Act
  - “Two proxy rule” re shareholder meetings

Voting in Hong Kong

Bank of East Asia, AGM 2007 **For** **Against**

6.	To amend the Articles of Association of the Bank.	666,531,979 (100.00%)	0 (0.00%)
	As more than 75% of the votes were cast in favour of the resolution, the resolution was carried.		
7.	To grant a general mandate to the Directors to issue additional shares.	456,962,422 (68.57%)	209,452,364 (31.43%)
	As more than 50% of the votes were cast in favour of the resolution, the resolution was carried.		
8.	To grant a general mandate to the Directors to repurchase the Bank's own shares.	665,339,249 (99.87%)	870,400 (0.13%)
	As more than 50% of the votes were cast in favour of the resolution, the resolution was carried.		
9.	To extend the general mandate granted to the Directors pursuant to item 7.	395,992,412 (59.48%)	269,775,250 (40.52%)
	As more than 50% of the votes were cast in favour of the resolution, the resolution was carried.		

(4) KPMG (Certified Public Accountants), auditors of the Bank, acted as scrutineer for the vote-taking at the 2007 AGM. KPMG's work was limited to certain procedures requested by the Bank to agree the poll results summary prepared by the Bank to poll forms collected and provided by the Bank to KPMG. The work performed by KPMG in this respect did not constitute an assurance engagement made in accordance with Hong Kong Standards on Auditing, Hong Kong Standards on Review Engagements or Hong Kong Standards on Assurance Engagements nor did it include provision of any assurance or advice on matters of legal interpretation or entitlement to vote.

For and on behalf of
The Bank of East Asia, Limited
Molly HO Kam-lan
Company Secretary

Hong Kong, 12th April, 2007

As at the date of this announcement, the Executive Directors of the Bank are: Dr. The Hon. Sir David LI Kwok-po (Chairman and Chief Executive), Mr. Joseph PANG Yuk-wing (Deputy Chief Executive) and Mr. CHAN Kay-cheung (Deputy Chief Executive); Non-executive Directors of the Bank are: Dr. LI Fook-wo, Mr. Aubrey LI Kwok-sing, Dr. William MONG Man-wai, Tan Sri Dr. KHOO Kay-peng, Mr. Richard LI Tzar-kai, Mr. Eric LI Fook-chuen and Mr. Stephen Charles LI Kwok-sze; and Independent Non-executive Directors are: Mr. WONG Chung-hin, Dr. LEE Shau-kee, Dr. Allan WONG Chi-yun, Mr. Winston LO Yau-lai, Mr. Thomas KWOK Ping-kwong, Mr. TAN Man-kou and Mr. Kenneth LO Chin-ming.

"Please also refer to the published version of this announcement in South China Morning Post."

CG "focus funds" emerging

- Definition: A fund that works actively with companies to improve strategy, finance and governance, then reaps above-average returns over the medium-term. Investors should be able to exert more influence over smaller companies (vs large ones) and there is less information in the market. These are not "good governance" funds.

- **Japan:** Nissay Hermes Stewardship Fund; Taiyo Fund; SPARX Asset Management; Ichigo Asset Management + various hedge funds. Not all are pure focus funds, but similar in many respects.

- **Korea:** Korea Corporate Governance Fund; Allianz Global Investors Value Creation Fund.

Obstacles and challenges

Market	Can minority shareholders easily elect an INED?	Are pre-emption rights for minority shareholders firmly protected?	Is there a trend of large listed companies voting by poll?
China	No	No	Somewhat
Hong Kong	Marginally	Marginally	Yes
India	Marginally	Marginally	Marginally
Indonesia	No	Largely	No
Japan	No	No	No
Korea	No	Marginally	No
Malaysia	No	Marginally	No
Philippines	No	No	No
Singapore	Marginally	Marginally	No
Taiwan	Marginally	Marginally	No
Thailand	No	Somewhat	Somewhat

Source: "CG Watch 2007"

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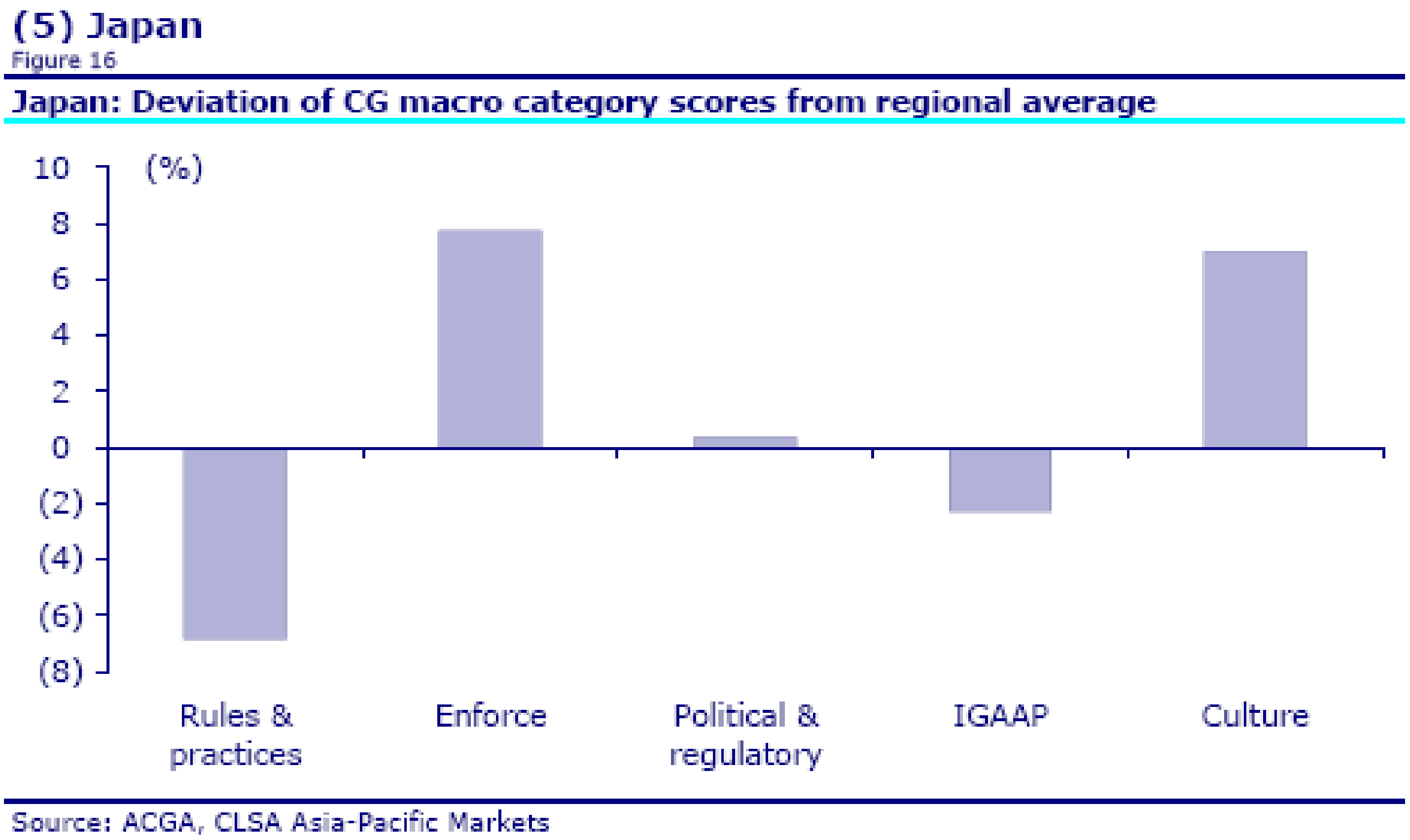
3. How does Japan compare?

Country/market	2005 Rank	2007 Rank
Hong Kong	2	1
Singapore	1	2
India	3	3
Taiwan	5	4
Japan	-	5
Korea	=6	=6
Malaysia	4	=6
Thailand	=6	8
China	9	9
Philippines	8	10
Indonesia	10	11

Relative strengths in enforcement and culture



Contradictions in Japan

- Japan has chosen not to adopt “global” standards in governance organisation, yet Japanese companies are increasingly global and reliant on overseas markets for growth (eg, the auto industry). Managing cross-border risks will likely get more difficult.
- Japanese companies have some of the best management in the region, yet most seem to see limited value in better governance—although disclosure has certainly improved.
- Listed companies do all the hard stuff with regard to proxy voting (ie, collecting votes, counting votes), but in most cases see no reason to publish the results.
- The government has not adopted a national code of best practice (a set of CG principles), but has gone further than any other Asian country in adopting SOX-like rules.

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Conclusion

- The three-legged stool is getting some longer legs: market discipline is starting to balance regulatory discipline, especially as the limitations of the latter become more apparent.
- Corporate self-discipline remains largely a big company game, but there is certainly scope for big improvements in CG among small and mid-sized firms (and space for focus funds to work in).
- Japan stands out for enforcement and culture—relative to other Asian markets—but perhaps needs more focus in its rules and guidelines. Is there an overarching policy on corporate governance?

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