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Asian Corporate Governance Association (ACGA)

"An Update on Corporate Governance In Asia: Regional Overview & Five Hot Topics"

Presentation by
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Agenda

1. Rating Corporate Governance Quality in Asia
   - Background
   - Foreground

2. Five Hot Topics

3. Conclusion

Introducing ACGA

- The Asian Corporate Governance Association (ACGA) was formed in 1999 to facilitate the implementation of effective corporate governance in Asia. Our scope of work covers research, advocacy and educational events in 11 Asian countries.

- ACGA is incorporated in Hong Kong as a non-profit association and is independently funded by a corporate membership base.

1. Rating Corporate Governance Quality in Asia: "CG Watch" Survey

Market	2004[1]	2005[2]	2007[3]
1. Hong Kong	67	69	67 ↓
2. Singapore	75	70 ↓	65 ↓
3. India	62	61 ↓	56 ↓
4. Taiwan	55	52 ↓	54
5. Japan	-	-	51
=6. Korea	58	50 ↓	49 ↓
=6. Malaysia	60	56 ↓	49 ↓
8. Thailand	53	50 ↓	47 ↓
9. China	48	44 ↓	45
10. Philippines	50	48 ↓	41 ↓
11. Indonesia	40	37 ↓	37

1. Introduced a detailed survey and scoring methodology in 2004.
2. Made the methodology more regorous in 2005.
3. Enhanced the methodology further in 2007. (No survey in 2006.)

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

Why scores in "CG Watch 2007" were lower

- Methodology became more rigorous
- "The more we looked, the less we found"
- Varying degrees of regulator, issuer and investor complacency in booming markets
  - "The job is done, we now just need to refine the rules"
- Political paralysis (eg, Korea) or upheaval (eg, Thailand)
- Accounting + auditing standards & practices lagged international norms more than expected (in many markets)

“CG Watch 2007” category scores

Market	CG Rules & Practices	Enforcement	Political/ Regulatory	IGAAP	CG Culture	TOTAL
1. Hong Kong	60	56	73	83	61	67
2. Singapore	70	50	65	88	53	65
3. India	59	38	58	75	50	56
4. Taiwan	49	47	60	70	46	54
5. Japan	43	46	52	72	49	52
=6. Korea	45	39	48	68	43	49
=6. Malaysia	44	35	56	78	33	49
8. Thailand	58	36	31	70	39	47
9. China	43	33	52	73	25	45
10. Philippines	39	19	38	75	36	41
11. Indonesia	39	22	35	65	25	37

Source: “CG Watch 2007”, ACGA & CLSA Asia-Pacific Markets

Figures in %

Regional strengths (2007)

- Improved financial reporting: improvements apparent in frequency, speed, substance, consolidation of accounts, director pay, stock-option expensing
- Quality of reporting, auditing and investor communications among large issuers was generally good and improving
- Regulators appeared to have got the message that enforcement needed improving
- Quality of information dissemination through stock exchange websites (eg, issue reports and announcements) improving in many markets
- Professional and director training quite extensive

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Regional weaknesses (2007): Independent directors & audit committees

Market	Is there a robust definition of independent director?	Are audit c'tees mandatory and implemented?	Are audit committees functioning independently?
China	Somewhat	Yes	Marginally
Hong Kong	Somewhat	Yes	Somewhat
India	Somewhat	Yes	Somewhat
Indonesia	Somewhat	Yes	Marginally
Japan	No	Somewhat	No
Korea	Somewhat	Yes	Somewhat
Malaysia	Somewhat	Yes	Marginally
Philippines	Somewhat	Yes	No
Singapore	Somewhat	Yes	Somewhat
Taiwan	Somewhat	Somewhat	Marginally
Thailand	Marginally	Yes	Marginally

Source: "CG Watch 2007"

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Disclosure weaknesses (2007)

- The quality of financial and non-financial reporting among small- and mid-cap listed firms was lagging.
- Late reporting deadlines in certain markets.
- Continuous disclosure of price-sensitive information generally poor.
- Inadequate rules on disclosure of takeover bids.
- Draft IPO prospectuses provided only to certain investors & analysts in some markets.
- AGM agendas and circulars often lacked sufficient detail.
- Publication of detailed AGM vote results often non-existent.

The foreground

- What is the impact of the current financial crisis on corporate governance reform in Asia?

  - **“The emotional reaction”**: The credit crunch “proves” that US corporate governance is a flawed model. We should no longer follow it.

  - “**The considered reaction”:** The credit crunch highlights yet again the importance of corporate governance. We need to strengthen governance further, using whichever ideas and practices are best.

- The emotional reaction offers nothing new—just more of the status quo.
- The considered reaction allows for a critique of current rules/practices both in one’s own market and the US, UK, Europe, and so on—hence offers a way forward.

Anglo-Saxon?

- Some believe that today's "global standards" of corporate governance are merely Anglo-Saxon ideas, not relevant to non-Western cultures. We believe this view is mistaken:
  - Global standards reflect and reinforce core principles of governance, such as accountability, fairness and responsibility, that are relevant in all cultures and markets.
  - International investment, like trade, depends on a common set of rules to function effectively.

Differences between US and UK corporate governance

Issue	US	UK
Chairman & CEO	Traditionally the same person (but some change occurring).	Normally a separation of roles.
Board composition	An executive chairman/CEO with a group of independent directors.	More of a balance between executive, non-executive and independent directors.
Shareholder rights	Powerful litigation rights, but generally weak shareholder rights.	Much weaker litigation rights, but stronger shareholder rights.
Director elections	"Plurality" voting*, not majority voting (although this is starting to change).	Majority voting.

*In plurality voting, shareholders cannot vote "against" candidates, they can only "withhold" votes. A director will be elected as long as one shareholder votes in favour.

2. Five Hot Topics

1. Independent directors
2. Shareholder meetings and voting
3. Continuous disclosure
4. Disclosure of cross-shareholdings
5. Focus on ESG

Topic 1: Independent directors

- Although the principle and practicality of board independence is questioned by many (most vociferously in Japan!), the concept of the “independent director” refuses to die. Why?
  - When implemented well, an independent board can bring considerable value to a business.
  - Minority shareholders (retail and institutional) generally have more confidence in companies with independent directors. This becomes even more important for cross-border investors.
  - Without independent directors, management will only ever be held partially accountable (ie, by auditors, shareholders, regulators).

Role of independent directors

- ACGA believes that most listed companies in Japan would benefit from having independent* directors on their boards, and that investor confidence in domestic capital markets would increase as a result.
- Independent directors can contribute in two broad ways:
    1. Assisting management in improving corporate governance, broadly defined.
    2. Providing an independent perspective on corporate strategy and large transactions (assuming he/she has business expertise and is listened to by management).
- Global companies can benefit from having directors with different skills and geographic knowledge—an idea that an increasing number of Japanese companies accept.

**For our definition of "independent", see ACGA's presentation to the METI Corporate Governance Study Group, Feb 13, 2009.*

Board structures differ around the world, but certain principles and best practices are commonly agreed

	OECD Principles	USA	UK	Germany*	HK	China#	Japan
Board structure	Not defined	Single	Single	Two-tier	Single	Two-tier	Two-tier
Directors should be accountable to shareholders	Yes	Yes	Yes	Yes (and to employees)	Yes	Yes	Yes
Boards should be independent of, and supervise, management	Yes	Yes	Yes	Yes	Yes	Yes	No
Boards should form independent committees (eg, audit, nomination)	Recommended	Yes	Yes	Yes	Yes	Yes	No

*Answers refer to the Supervisory Board in Germany.
#In China, there is also a "board of supervisors" that supervises directors and senior managers.

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Topic 2: Shareholder meetings & voting

- Shareholder meeting practices have gradually improved in Japan: final meeting notices are being released earlier and more notices/business reports are being translated into English. Some de-clustering of dates is occurring. Yet the proxy voting system overall does not meet global standards.

- **ACGA recommendations:**
  - Final meeting notices and business reports to be released 28 calendar days before meetings (and translated).
  - Leading companies to hold AGMs earlier to avoid clustering.
  - Detailed results of voting to be published one day after the annual meeting. (At a minimum, this should include the results of all "proxy votes" received before meetings.)
  - The next step is the counting of votes of shareholders attending the meeting.

Topic 3: Continuous disclosure

- A major area of weaknesses in many corporate governance regimes in Asia concerns the continuous disclosure of "material information".
- Most jurisdictions have rules requiring listed companies to announce price-sensitive information to the market as soon as possible, but these rules are only imperfectly followed and enforced.
- This issue has gained prominence as a result of the credit crisis and huge losses sustained by some companies in derivatives trading (eg, CITIC Pacific in Hong Kong) or the sudden loss of customers and markets.

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Topic 4: Disclosure of Cross-Shareholdings

- We are concerned by the increasing volume of cross-holdings between Japanese companies. There is a significant risk that they fail to operate in the interests of wider shareholders.
- Cross-holdings can also act as a takeover defence by entrenching existing management.
- Non-strategic cross-holdings can be an inefficient use of capital and may discourage management from optimising shareholder value.
- We believe that raising capital for non-economic purposes is inappropriate and other shareholders will become increasingly concerned by underperformance of companies with large non-strategic cross-holdings.
- Mutual cooperation is possibly better secured through conventional contractual arrangements.
- Better disclosure, which is different from the current 5% rule, is clearly vital in our view. We commend Eisai in taking the lead in improved voluntary disclosure but we feel that widespread voluntary disclosure is unlikely in the near future and support some form of mandatory disclosure regime.

Topic 5: Focus on ESG

- "CSR" (corporate social responsibility) has changed and morphed into "ESG" (environmental, social, governance).

- ESG brings a greater focus on the need for investors to incorporate environmental, social and governance **risks** into the investment process. For example:
  - United Nations Principles of Responsible Investment (UNPRI).
  - Greater attention paid on whether newly listed companies meet requisite environmental and labour standards.
  - Global pension funds are look for fund managers who can invest along ESG lines.

- Question: Should it be E + S + G, or G as the basis for E & S?

3. Conclusion

- Corporate governance reform is a dynamic process--an attempt to continuously improve the financial system and create a more level playing field for participants.

- Reform efforts are never perfect or complete, but without them investor confidence and trust would not return.

- The current financial crisis should not be used as an excuse to do nothing or roll back the clock. It is an opportunity to move forward and strengthen the credibility of companies and capital markets.

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