"ACGA White Paper on Corporate Governance in Taiwan"

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CONTENTS

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- Ms. Alexis Krajeski, F&C Asset Management, London
- Ms. Karin Ri, Hermes Fund Managers, London
- Dr. Daniel Summerfield, Universities Superannuation Scheme, London

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ACGA takes full responsibility for the accuracy of this paper and any errors contained in it are our own.

Jamie Allen
Asian Corporate Governance Association, Hong Kong
February 24, 2011

Executive Summary & Recommendations

Thanks to its dynamic corporate sector and world-class IT industry, Taiwan enjoys a high profile in the global economy in spite of its small size. Over the past decade it has made a series of improvements to its corporate governance system and, in certain areas, has undertaken innovative reforms. Within Asia, it generally ranks in the top half of surveys for the overall quality of its corporate governance regime.

Taiwan has further ambitions. In particular, it wants to elevate its financial markets to the level of the international elite and attract more overseas listings and investment into its stock market. Yet Taiwan remains a difficult and challenging market for long-term global institutional investors who are seeking to act responsibly, vote their shares and engage with companies. Moreover, governance practices at most listed companies have some way to go to match global standards.

ACGA has written this White Paper to describe several of the most urgent corporate governance issues that we and our members see in Taiwan. We also aim to offer constructive and detailed suggestions on how these issues can be addressed. The paper focuses on three key areas:

- Shareholder meetings and voting
- Board effectiveness
- Shareholder rights

We believe that if Taiwan brings its corporate governance regime more closely into line with global best practices, this would help to attract more investment and make its capital markets more internationally competitive. Our underlying philosophy is that common standards across markets help to lower transaction costs, enhance investor confidence and communication, and boost trade and investment. This does not mean that corporate governance will or should become identical in different countries and markets—local cultural and social factors will ensure that differences remain. But where common standards can be achieved—and help to create a more level playing field for all shareholders, as well as improved corporate governance generally—we believe that it is in a country's own interest to pursue this goal.

Our hope is that the points and recommendations raised in this document will serve to stimulate a lively exchange of views among and between government officials, legislators, financial regulators, stock exchanges, listed companies, as well as both domestic and foreign investors in Taiwan.

A summary of the three issues covered in the White Paper, and our recommendations for specific actions, follow:

1: Shareholder Meetings and Voting
Foreign investors often find it difficult to exercise their right to vote in an informed manner at shareholder meetings in Taiwan. In order to improve the management and transparency of shareholder meetings in Taiwan, and to allow all shareholders (domestic and foreign) sufficient time to cast informed votes and operate on a level playing field, we encourage financial regulators to undertake, as a matter of urgency, a systematic review of the entire shareholder voting system in Taiwan. We encourage listed companies to review their shareholder meeting procedures—from the release of meeting

handbooks to final vote counting in the annual general meeting and publication of results—and to voluntarily adopt global best practices as soon as possible.

Our specific recommendations fall into two groups—those for regulators and those for companies—with some overlap between them. Some of the challenges in the voting system ideally, or ultimately, require a regulatory response. Yet there is no reason why this should stop companies from addressing some of these problems on their own, before new rules have to come into force. There are also areas where improvements can be achieved more quickly and effectively through a voluntary best-practice approach, rather than by regulation.

A. *For regulators:*

1.1 Encourage or require companies to hold their annual general meetings earlier than June to avoid clustering. The Company Act allows companies to hold AGMs within six months of the end of their fiscal year (normally the end of the calendar year), hence meetings in April or May should be possible. Regulators could encourage de-clustering further by restricting the number of AGMs to no more than 100 per day from 2012.

1.2 Pass a rule requiring meeting agendas to remain fixed once the final meeting handbook is published.

1.3 Require meeting handbooks/agendas to contain the names and detailed biographies of all nominees for election as directors and supervisors. If an election is contested, require companies to release full details of any competing slate of directors and supervisors (all nominations, therefore, would need to reach companies early enough to be included in meeting handbooks). Remove the right to nominate director and supervisor candidates just before or in the AGM itself.

1.4 Eliminate extemporary resolutions (special motions) from AGM agendas.

1.5 Allow foreign institutional investors to give proxies to other investors.

1.6 Permit split voting so that a registered shareholder and a custody institution may divide up its votes and allocate them towards different outcomes on a single resolution.

1.7 To facilitate electronic voting, adopt a truly straight-through e-voting system that allows shareholders to transmit their votes directly to share registrars up to one day before the meeting.

B. *For companies:*

1.1 Consider holding AGMs before June.

(Note: Starting from their 2011 fiscal year, listed companies must release their audited annual accounts within three months of the end of that year—compared to four months now. This means, for example, that companies with a December

31, 2011 year-end must release their audited accounts by March 31, 2012 at the latest. This should make it easier to hold AGMs earlier.)

1.2 Release final meeting agendas/handbooks at least 28 days before the AGM.

1.3 Translate meeting handbooks into English if foreign ownership is significant (more than 10% of outstanding shares). These should be made available at the same time as the Chinese version.

1.4 Ensure final AGM agendas contain the names and detailed biographies of all nominated directors and supervisors, not just those of independent director candidates (see Appendix 1).

1.5 Ensure that items on the final agenda are fixed and not subject to further revision.

1.6 Eliminate extemporary resolutions (special motions) from AGM agendas.

1.7 Conduct voting by poll for all resolutions at the AGM and any other shareholder meeting. Engage an independent scrutineer for the poll (eg, a share registrar/transfer agent or auditor). Voting by poll means counting every share voted, regardless of how and when it was cast (see page 17 for a description of voting by poll.) The credibility of AGM results will be enhanced if polls are used.

1.8 Publish full voting results with a detailed breakdown of all "for", "against" and "abstain" votes within 24 hours of the conclusion of the meeting. The results could be published on either the company website or that of the stock exchange, or both. (Ideally, the results should also be made known in the meeting.)

2: Board Effectiveness

In order to improve board effectiveness in Taiwan, the role of independent directors should be broadened and strengthened. We recommend that listed companies implement the following measures as best practices (if they are not already doing so):

A. For companies:

2.1 Appoint a minimum of three independent directors as soon as practicable. Over the following few years, they should ideally comprise one-third of the board. It is important, however, that the quality of people appointed as independent directors is high and quality is not sacrificed for quantity. Equally important is the corporate and industry experience and knowledge that independent directors bring to the board. Appointing independent directors should not be a box-ticking exercise

2.2 Establish an audit committee comprised only of independent directors and chaired by one of them.

2.3 Set up other key board committees, such as those in charge of nomination and risk management. Directors on board committees should have clearly delineated roles and responsibilities. These committees should comprise a majority of independent directors and be chaired by one.

2.4 Undertake self-evaluation of board and director performance on an annual basis, and organise training programmes for directors. Disclose this information in annual reports, along with the board attendance records of directors.

2.5 Shorten the period between director elections, so as to enhance accountability and investor confidence in boards.

B. For regulators:

2.1 If companies continue to opt not to establish audit committees in favour of retaining supervisors, we recommend that the supervisory system be made more independent from management, the controlling shareholder and the board. For example, companies could be required to appoint a number of independent supervisors (at least three). The role of supervisors should be reconsidered and their sweeping powers on paper reviewed to see if they are realistic or practical. And they should be encouraged to function as a group (ie, a board of supervisors), not individually.

3: Shareholder Rights

In order to bring Taiwan’s rules on takeovers, substantial shareholder disclosure, voluntary delistings and private placements more closely into line with global best practices, we recommend that Taiwan regulators implement the following measures:

3.1 Review the current, overly complicated regulatory requirements for mandatory general offers (acquisition of 20% or more shares within 50 days) and amend in line with the international threshold of 30%.

3.2 Lower the threshold for disclosure of substantial shareholdings from 10% to 5% of total issued shares, so that investors can better ascertain a large shareholder’s effective stake.

3.3 Require shareholder approval for all proposed voluntary delistings, and raise the current approval threshold of two-thirds of total shares. A higher threshold should be set after inviting the views of the investment community and other market participants, including global investors, through the establishment of an expert taskforce that would produce a report for public consultation. Moreover, remove the ability of the board to decide a delisting on its own. And close the loophole allowing a lower approval threshold for delistings in case of mergers.

3.4 Set a finite threshold for the maximum amount and a lower threshold for the price discount of shares that can be issued through private placements in any 12-month period. We believe the reasonable targets are a 5-10% ceiling on the size of private placement issuances, and 10% on the discount offered for the price of the new shares. A higher threshold on the size and discount may be allowed in exceptional circumstances (eg, a company facing bankruptcy), or where companies have a genuine need for a larger placement, but only after independent shareholder approval has been given in an AGM or EGM.

Introduction

Taiwan has one of Asia's most developed economies and many of its leading companies are deeply integrated into global supply chains. It has produced companies that have built global brands in high-tech consumer goods and others that are considered leaders in corporate governance in the region. Like other markets in Asia, Taiwan has steadily raised the bar on corporate governance for listed companies over the past decade. It has brought its accounting and financial reporting standards closer into line with international norms, and improved non-financial reporting standards. It has made it easier for minority shareholders to nominate directors (indeed, Taiwan has one of the most democratic board nomination systems of its kind anywhere). And it has led the way in creating a statutory institution for the protection of small shareholders—the Securities and Futures Investor Protection Center.

Despite its standing in the global economy, however, corporate governance in Taiwan has some way to go to match global standards. Although it ranks equal fourth in "CG Watch 2010", the latest regional survey from ACGA and CLSA Asia-Pacific Markets, its score of 55% implies that significant areas of weakness remain. One fact that often surprises investors is that independent directors and audit committees are still not mandatory for all listed companies in Taiwan (unlike almost all other major markets in Asia, with Japan being the main exception). Newly listed companies must appoint independent directors and several leading companies have done so voluntarily, but some of its biggest companies still have not made the change. Instead of audit committees, most Taiwan companies rely for their checks and balances on the long-established supervisor system—an institution that many admit is usually not independent of management and faces considerable challenges in being effective.

Taiwan is also a difficult and challenging market for many long-term institutional investors who are seeking to be active owners and engage with local companies. Take proxy voting, for example. In a 2006 survey by ACGA covering 10 markets across the region, Taiwan ranked second last after Japan. The result prompted ACGA and its investor members to prioritise engagement in Taiwan to improve such practices. To their credit, the response of Taiwan regulators and a number of listed companies was positive: certain rules and practices improved and more changes are in the pipeline. Yet five years on, the voting system remains inefficient, opaque and overly complicated in many areas, and fails to provide all shareholders with a level playing field.

On balance, we believe that the development of corporate governance in Taiwan to date has been piecemeal and inconsistent. One reason for this is the dominance of family-controlled companies and their resistance to stronger reforms. Many family owners are clearly not keen to see outsiders on their boards or more transparent voting procedures at their shareholder meetings. Another impediment is the nature of Taiwan's stock markets, which remain largely retail investor-driven with a high turnover rate. The relative lack, or small size, of long-term institutional investors—both domestic and foreign—means that sustained market pressure for better corporate governance is noticeably absent in Taiwan. A third factor—and in some ways the most intractable—is the country's legislature, the Legislative Yuan, where new bills and regulatory amendments routinely get held up for months or even years for various political reasons.[1] For example, a landmark legal amendment to allow “split voting” in shareholder meetings—one of the biggest problems for both global investors and also local companies seeking sufficient quorum—has been delayed in the legislature for almost two years. (It recently underwent its first reading, along with a package of other company law amendments. Two more readings are required.)

As a result, financial regulators, while not passive, have also not been as proactive as they might have been in pushing forward reforms—especially when it comes to resolving delays in the legislative process. We appreciate that Taiwan’s civil law and cultural traditions largely dictate that most rule changes must be written down in “hard law” (ie, legislation and supplementary regulations) in order to affect the behaviour of local corporations. But amending law is a cumbersome process. If more use could be made of stock exchange listing rules and voluntary best-practice guidelines to raise standards, that could be very beneficial for capital market development and investor confidence. This also envisages financial regulators and the stock exchanges playing a greater leadership role in encouraging and persuading companies to make improvements on a voluntary, rather than compliance, basis.

The spirit of this “White Paper” is that there are many areas where listed companies could make voluntary improvements in their corporate governance so as to align themselves with global best practices. They do not always need to wait for regulators to force them to act. Indeed, such voluntary action is a simple way for companies with a commitment to good corporate governance to differentiate themselves from their competitors, lower their risk profile and make themselves more attractive to investors. It is also, in our experience, often a cost-effective way for a market to start implementing new standards.

For ACGA, Taiwan will continue to be a major focus of our advocacy work. In 2010 we held our annual conference in Taipei for the first time, while earlier the same year we wrote to 31 large listed companies (comprising the top holdings of our investor members) and urged them to adopt global best practices in the organisation of their annual general meetings (AGMs). Encouragingly, several companies wrote back and responded positively to our suggestions. Indeed, it would be fair to say that leading Taiwan companies are increasingly taking an open-minded view on corporate governance matters. This has certainly been our experience over the past two to three years.

The aim of this White Paper is to outline some of the more urgent issues of concern to ACGA and our investor members regarding corporate governance in Taiwan, and to offer specific recommendations on how they could be redressed. Some of the recommendations are addressed to regulators, while others are intended for listed companies. We have made no attempt to cover everything, hence the omission of an issue (such as insider trading or related-party transactions) should not be taken to mean that ACGA and our members are unconcerned about it.

As one leading Taiwanese industrialist told us, ‘CG reform is as much a cultural undertaking as it is a regulatory one’. Only when people’s ideas and attitudes shift, can

[1] For example, we were told that some Taiwanese legislators are reluctant to make certain changes that would enhance the rights of minority shareholders for fear of unwittingly allowing mainland Chinese interests to increase their influence on local companies.

real and lasting change be expected. We realise that this process is already underway in Taiwan, and hope that the points and recommendations raised in this document will serve to stimulate a lively exchange of views among Taiwanese legislators, regulators, stock exchanges, listed companies, as well as both domestic and foreign investors. We hope that this paper will be seen as a constructive contribution to the further advancement of Taiwan’s capital markets and economy.

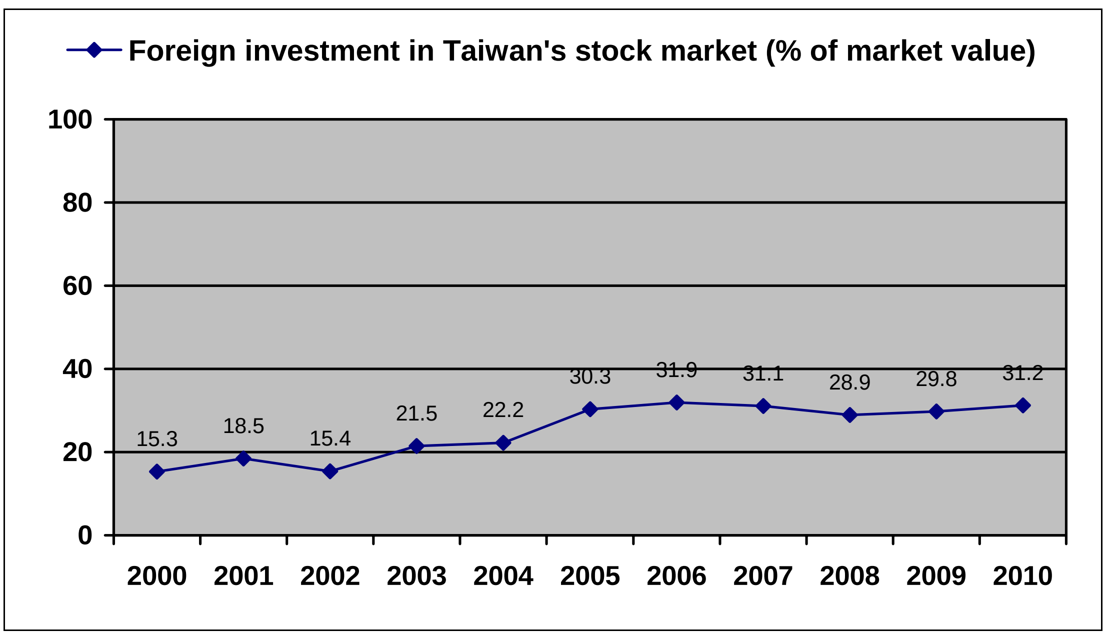
Issue 1: Shareholder Meetings and Voting

Foreign investors have long found it more difficult to exercise their right to vote in an informed and efficient manner at shareholder meetings in Taiwan than in most other Asian markets. If Taiwan is serious about internationalising its capital markets, it is in its interest to align its shareholder voting system with global best practices.

Participating in and voting at annual and extraordinary general meetings (AGMs and EGMs) of companies are fundamental rights of shareholders. Voting is also a valuable mechanism through which shareholders can voice their approval or disapproval of the performance of the company and its board of directors, and exercise checks and balances. While Taiwan has made improvements in this area in recent years, it continues to have one of the most challenging shareholder voting systems in Asia.

Why is Taiwan receiving so much attention from global investors on this issue? In part, because its high-tech driven economy has attracted increased levels of foreign investment over the past decade. In 2000, foreigners held just 15.3% of the shares on Taiwan's stock market by market value. By 2005 this had doubled (see the chart below). In absolute terms, the increase has been even more impressive—'net accumulated inward investment' in the stock market more than tripled from about US$31 billion in 2000 to almost US$109 billion in 2005 and then increased by another 52% to around US$166 billion in 2010.

Of perhaps greater importance is the fact that many foreign pension funds and fund managers active in the Taiwanese market view the voting of shares as fundamental to their role as responsible shareowners. It is one way they can exercise their fiduciary duty to their clients and beneficial owners. And it is often the first step to becoming more engaged with companies on corporate governance issues.



Source: Securities and Futures Bureau, Financial Supervisory Commission.

While the figures above may seem impressive, it is clear from the graph that the percentage share of foreign investment in the stock market has stayed flat for the past five years. In absolute terms, the volume of investment did rise significantly from 2005 to 2010. But a closer look at changes from year to year tell a somewhat different story: volumes increased rapidly in 2006, rose slightly in 2007, then fell in 2008 before rising again in 2009 and 2010. This data no doubt reflects competition from other markets in Asia as well as the impact of the global financial crisis. However, anecdotal evidence from foreign investors also suggests that weaknesses in corporate governance in Taiwan have adversely affected the willingness of some to invest in the country. One major regional fund manager, for example, has only two Taiwanese companies in its model Asia large-cap portfolio (compared to four from Korea, seven from India, seven from Singapore and 10 from Hong Kong).

More foreign investment, as well as deterred foreign investment, means that it makes competitive sense for Taiwan to raise its corporate governance standards—and voting systems should be one of the easier parts of the equation to get right. But this is not an exercise just for the good of foreign investors—domestic institutions and retail shareholders would benefit as well. It is worth noting that Taiwan's Public Service Pension Fund is also starting to take voting more seriously and is meeting with portfolio companies and challenging them at times on such things as financial transparency, board structure, risk management and compensation policy. Indeed, this is in line with a region-wide trend of state pension and investment funds taking a more active role in corporate governance.

This chapter outlines the key challenges for institutional investors in shareholder voting in Taiwan and concludes with a series of recommendations for regulators and companies. We encourage financial regulators to undertake, as a matter of urgency, a systematic review of the entire voting system in Taiwan and make wholesale, rather than piecemeal, reforms.

Clustering of AGMs

Investors who plan to vote actively or attend AGMs in Taiwan encounter problems even before the meeting season begins. Along with their peers in Japan, a vast majority of listed companies schedule their annual meetings on the same dates over a span of two weeks, usually in June. This is despite the fact that the Company Act allows companies to hold AGMs within six months of the end of their fiscal year. In contrast, it is only 90 days in Japan.

The usual reason cited for clustering meetings is to thwart so-called "professional shareholders"[2] who disrupt AGMs in order to extract some inducement from companies. While holding meetings on the same day makes it harder for these people to cause disruption, it also makes it difficult for legitimate shareholders to scrutinise all the resolutions being proposed by companies and limits the number of meetings they can attend in person. Indeed, when ACGA and one of its investor members tried to attend AGMs in and around Taipei over a two-week stretch in June 2010, we were only able to fit in a handful due to scheduling conflicts (see box on next page). Since many of the companies we wanted to see held their meetings at the same time, we were repeatedly forced to choose one over another.

[2] A term traditionally used as a euphemism for gangsters who disrupt AGMs with questions. However, not all shareholders who ask questions at AGMs can be fairly described as gangsters.

Navigating the AGM thicket

An ACGA member, Gerard Fehrenbach of PGGM Investments in the Netherlands, visited Taiwan in mid-2010 to vote on behalf of his clients in as many AGMs as he could and, while there, to convey the shared views of several global investors on issues such as voting by poll. This was the second year in a row in which PGGM had attended AGMs in Taiwan in person, making it one of the few foreign investors to travel there for this purpose.

Although PGGM held 211 Taiwanese companies in its portfolio, Mr Fehrenbach found it challenging to attend more than five meetings over a two-week period. This was because 164 of the 211 companies staged their meetings during that time, usually in the morning, and not always in the same city. Finding the venue was also not always easy: an instruction form from a custodian bank for one AGM had the wrong address on it!

The following table shows the practical impact of clustering. It contrasts the meetings that PGGM did attend with those held on the same day (nearly all of which it had hoped to attend).

	June 15	June 18	June 22	June 23	June 25
AGM attended	TSMC	Acer	Nanya Plastics	China Steel	Formosa Plastics
Other large-cap companies holding AGMs	MediaTek Delta Electronics UMC Far EasTone Telecoms Siliconware Precision Industries	Taiwan Mobile Cathay Financial Holding Chunghwa Telecom HTC AU Optronics Yuanta Financial Holding Compal Electronics Wistron	Tripod Technology	Mega Financial Holding Uni-President Enterprises	Fubon Financial Holding

In order to help rectify the situation, Taiwanese regulators notified all listed companies in January 2010 that no more than 200 meetings could be held on the same day; in previous years, up to 600 took place on one day. Every company was required to register the date of its AGM with its stock exchange before March 15, 2010.

Although an improvement, this new rule still resulted in 200 companies—many of them Taiwan's top 30 companies by market capitalisation—holding their AGMs on June 15th, 17th, 18th and 25th. Most meetings were held in the morning, with few scheduled in the afternoon. Clearly, clustering of meetings remains a problem.

To more fully resolve this issue, AGMs should be spread over two to three months—and particularly those of large-cap firms. This would allow institutional investors to attend as many meetings as possible in person and to vote in a more informed manner.

Meeting notices and agendas
Under the Company Act, listed companies must notify their shareholders of an AGM at least 30 calendar days in advance. This may appear to be in line with best global practice, however the notice usually contains only basic information on the time, venue and a list of draft resolutions for the meeting. The detailed—but not always fixed—agenda for Taiwanese AGMs is found in a document called the "meeting handbook", which as of 2010 must be published at the latest 21 days beforehand (previously, the deadline was 15 days). While regulators should be commended for mandating the earlier publication of the meeting handbook, three weeks is not enough time for most global investors to digest the information and decide how to vote. Global best practice is at least 28 days.

Why is three weeks not long enough? Because cross-border institutional investors must typically vote no later than about nine days before an AGM, according to deadlines set by their global custodian banks, which in turn need to meet early deadlines set by local custodian banks (so as to give the latter sufficient time to process votes, an exercise that is still partly manual). This leaves foreign investors only about 12 days in which to absorb the detailed agenda (meeting handbooks in Taiwan can often run to 30 or more pages) and make an informed vote. This period is concentrated by the clustering of meetings and the fact that most global investors will probably be voting at dozens, if not hundreds, of AGMs in other parts of Asia and Europe around the same time.

Voting is further complicated in Taiwan by the tendency of some companies to change the content or numbering of their meeting agendas shortly before their AGM. Therefore, if an institutional investor votes according to the information in the original meeting handbook, its votes will likely be invalidated during the final tally.

Information in meeting handbooks is also often incomplete. A crucial omission in many is the names and biographies of director candidates: if there are competing slates of directors[3], companies only need to disclose the names, professional and educational backgrounds of independent directors. If there are no competing slates of directors being nominated by shareholders, there is still no requirement in the company law or listing rules for companies to disclose the names and biographical details of any candidates. Companies, therefore, often do not release the names of the final list of director candidates until five or ten days before the AGM (and some do not disclose any candidates until the actual day of the AGM). Many foreign institutional shareholders who want to vote their proxies in an informed manner will simply vote against or abstain on any unknown director candidate at the time of voting.

A related problem is the lack of information in English, which means foreign investors lose additional time translating the meeting handbook or relying on summary translations from proxy voting advisors. Historically, most Taiwan companies have published their financial reports and company announcements only in Chinese (the websites of most

[3] Contested elections are easier in Taiwan than in most markets, since any shareholder with just 1% or more of the total number of outstanding shares can propose director candidates (Article 192-1, Company Act).

listed firms also have poor English sections). This is improving somewhat: the Taiwan Stock Exchange (TWSE), for example, produced an English template of the AGM meeting handbook and made this freely available in 2010. But the limited information available to non-Chinese speakers, and the lack of English fluency among many Taiwan executives, make voting and engagement with companies more challenging for foreign investors than in many other international markets.

Voting by acclamation versus voting by poll

Voting by acclamation
Almost all listed companies still rely on antiquated procedures for the actual voting at shareholder meetings. Voting on most resolutions is usually done by “acclamation”—whereby shareholders (or their custodian bank representatives) are deemed to be in support, unless they verbally object in the AGM—rather than by a poll, which entails the counting of all the votes cast by proxy and in the AGM. While companies are legally required to count the individual votes in the election of directors and supervisors, they do not have to do so for other resolutions—unless they are contested and/or stipulated otherwise in the articles of incorporation. In 2010, one company in Taiwan started to vote by poll on all resolutions voluntarily. Prior to that year, no listed company in Taiwan had adopted modern techniques for voting by poll, although some companies did publish the detailed results of all proxy votes received before their AGM. While this does not constitute full voting by poll, it is a step in the right direction.

Voting by acclamation or a show of hands was a tradition suited to the earliest stock companies, when the total body of shareholders was small enough to fit into one room. For a modern listed company with tens of thousands of shareholders spread out across the globe, however, any voting system other than an accurately cast and counted poll deprives shareholders of the right to one share, one vote. In a vote by acclamation or show of hands, someone with 100 shares has the same number of votes—one—as someone with 1,000 or 1,000,000 shares.

Many listed companies maintain that vote by acclamation is more efficient—ie, quicker—than voting by poll. Indeed, some companies strive for as short a meeting as possible. One told us that their 2010 AGM was wrapped up in 15 minutes (which says a lot about how AGMs are regarded in Taiwan as a pro-forma event). Voting by acclamation favours incumbent management, because it is like-minded and supportive shareholders who tend to turn up for the meeting. Since custodian banks often deliver proxy votes directly to company representatives, even if many of the proxy forms contain “against” or “abstain” votes, investors attending the AGM may have no idea about the existence of these dissenting views. This is because in a vote by acclamation, dissenting proxy votes of outside shareholders may not even be cast (ie, the person acting as proxy may not shout out any disagreement).

Voting by poll
The concept of voting by poll is simple enough. It means that every share voted, regardless of how and when it was cast, should be counted. Voting by poll ensures a full and fair count of the votes and, in recognition of this fact, is becoming the gold standard globally. It is mandatory in Hong Kong for all resolutions at all shareholder meetings, is now standard for almost all Thai listed firms, and is widely practised among large-cap companies in China, the UK, Netherlands and Canada. ACGA strongly recommends listed Taiwan companies to adopt voting by poll voluntarily for all resolutions.

How to vote by poll

For many companies, the term “voting by poll” conjures up the dreaded notion of “voting by ballot”. A ballot refers to cases where companies have to organise an impromptu count of all votes on one resolution, because a few shareholders have called for it. The count is usually done manually—a process that normally takes about half an hour to 45 minutes. The assumption, therefore, is that counting the votes for all resolutions at an AGM would take most or all of the day (since 10-12 resolutions x 30-45 minutes = 5-9 hours).

This is not how modern polls are taken. One cheap and simple method involves collecting completed voting forms from shareholders at the end of the meeting, then closing the meeting and quickly counting the vote (either manually or with computers) before announcing it later the same day, or first thing the following morning, to the stock exchange. This system is common in Hong Kong, where shareholders do not mind waiting a few hours for the final results. Another method is more immediate—using electronic voting pads to cast votes in the meeting, with results shown after just a few seconds. This system is prevalent in the UK and Europe, and is gradually being adopted in Singapore. It is more expensive than the first option, but usually quite affordable for large firms and not unreasonable given the total cost of preparing for and holding an AGM. Many firms also find that the enhanced communication with shareholders and the PR benefits of using wireless voting technology help to outweigh the costs.

It is important to point out that in both cases described above, the length of the AGM is not extended by taking a poll.

Electronic voting, proxy solicitation and special motions

Befitting Taiwan’s reputation as an IT powerhouse, in 2006 regulators amended the law to allow electronic transmission of share votes. In 2009, the Taiwan Depository & Clearing Corporation (TDCC) established a domestic e-voting platform called “StockVote”. It allows shareholders to vote electronically ahead of the AGM. It does not yet facilitate full “straight-through” transmission of votes all the way to company share registrars, however, since the votes of foreign institutional investors are still transmitted to sub-custodian banks in Taiwan who then convey them to companies.

Thus far, the adoption of StockVote has been limited: only six companies signed up to use it in 2010. The main reason for the reluctance of listed companies is that the vast majority of them prefer to vote by acclamation. Taiwan regulators are aware of this, which is why in July 2009 the Executive Yuan, the cabinet, approved for presentation before parliament an amendment to Article 177-1 of the Company Act authorising, “the competent authority, by considering the scale, shareholder numbers and structure of shareholders of such company, and other situations it deemed to be necessary, may order a company to include electronic voting as one of the company’s shareholder meeting voting methods”. Shareholders who exercise their voting power through e-voting (as well as their sub-custodians) shall be deemed to have attended an AGM. When the proposed amendment becomes law, companies will also be allowed to use e-voting platforms other than TDCC’s. The bill is under review by the Legislative Yuan[4].

[4] Cross-strait politics may influence the outcome in the legislature. A KMT source says the opposition party worries that, with e-voting, mainland interests will be able to more easily manipulate AGM results in Taiwanese companies. However, executives of listed Taiwanese companies that ACGA talked to dismissed such concerns.

But the resistance among listed Taiwanese companies to straight-through e-voting , as well as non-paper-based voting at the AGM itself (eg, by using an electronic voting pad), is strong. One reason is sheer conservatism: people are not used to counting proxy votes cast in electronic form (because proxies normally arrive in boxes of paper sent by custodian banks). A related issue is the concern about the certification of votes cast on hand-held electronic devices at an AGM. There is some confusion as to whether the Financial Supervisory Commission (FSC), the country's peak financial regulator, or its Securities and Futures Bureau (SFB) must certify the technology before it can be used.

According to some local custodian bankers, many companies also do not like the concept of e-voting because it would stop them from being able to solicit blank proxy ballots from retail shareholders (who receive a token gift in return). All votes cast electronically must have specific voting instructions.

Indeed, proxy solicitation rules and practices in Taiwan merit closer scrutiny. For one, foreign institutional investors (FINIs) can only receive but not give power of attorney to other shareholders to vote on behalf of them or others, while local investors can do both (see box on next page). Hence, the only way a FINI could run a solicitation campaign would be to seek proxies from domestic investors—which would be a challenge.

Meanwhile, many listed companies solicit proxies to ensure passage of company-proposed resolutions. Yet it is unfair for companies to be able to solicit proxies when some of their shareholders are effectively barred from doing the same. The purpose of proxy solicitation by a company should be strictly limited to ensuring that legal quorum requirements are met, not for influencing voting results. From the moment company representatives receive detailed (interim) results of proxy votes, the company should also be prohibited from conducting further proxy solicitation. In the interest of fairness, both company management and shareholders should be in the same position with respect to proxy solicitation before the AGM.

Another sticking point in the adoption of e-voting is the concern among some companies that it will affect their ability to secure the necessary quorums and pass special- or extemporary-motion resolutions at shareholder meetings. These resolutions are a peculiar feature at AGMs in Taiwan. They allow shareholders present in the AGM to spontaneously propose any topic to discuss or even an ad-hoc resolution to vote on, potentially forcing the meeting to continue open-ended. To prevent this, it is common practice for companies to turn to a friendly shareholder and invite him to propose a resolution to close the meeting. The problem with straight-through e-voting is that companies may not be able to secure the necessary quorum ("a majority vote of the shareholders present, who represent more than one-half of the total number of voting shares"[5]) to pass any special-motion resolution—should there be not enough proxy representatives showing up at the AGM because they no longer need to deliver paper ballots.

[5] Article 174, Company Act.

Fighting back with one hand tied: USS versus Taishin

In 2008, the Universities Superannuation Scheme (USS) of the UK led an intensive engagement with Chang Hwa Bank (CHB), in which it held a stake. Three years earlier, Taishin Financial Holding had acquired a 22.5% stake in CHB, with a view to a potential merger. Taishin bid for CHB in 2007, but was unsuccessful. However, the next year, a resolution was passed at CHB's AGM that reduced the number of seats on its board and consolidated Taishin's position. In USS's view, this development was against the interests of minority shareholders.

USS felt it needed to protect its rights as a minority shareholder in CHB. The fund's ensuing engagement culminated in a contested director election for the nine board positions. Taishin, the Ministry of Finance (MOF), union representatives and founder family representatives all proposed potential candidates.

Given the seriousness of the engagement, USS considered soliciting proxies of other foreign shareholders. However, regulations in Taiwan prevent foreign investors from soliciting proxies of other foreign investors. Unable to solicit proxies, USS raised domestic and foreign shareholder awareness of the issues through shareholder networks such as ACGA.

In addition, director candidates in Taiwan can be nominated right up until the start of the general shareholders' meeting. Due to the fluid situation, there was a possibility at the CHB AGM of late director nominees being proposed by the various parties; USS was concerned that the proxy ballot would therefore not reflect the final list of proposed directors. In other words, foreign investors who had to vote by proxy may not have been able to support or prevent the appointment of a nominee proposed after the proxy deadline.

Given these obstacles and uncertainties, USS decided to send a representative to the meeting to ensure that it could vote on any nominee proposed at the last moment. However, making these arrangements turned out to be extremely bureaucratic. For USS to be able to cast votes in the meeting, it had to send a legal representative who was permitted to instruct its sub-custodian bank's personal representative, who also attended the meeting.

Following written assurances from the MOF that best practice corporate governance would be applied and maintained at CHB, USS felt comfortable voting for the Ministry's independent nominees (MOF had a 19% stake in CHB). In the end, Taishin succeeded in getting all five of its nominated directors elected, while the MOF saw all four of its nominees voted onto the board. CHB remains a standalone financial institution.

While the end result was positive for USS, the fund identified a number of weaknesses with cross-border voting in Taiwan:

The director nomination process: There is no requirement for listed companies to disclose all the candidates being nominated for election before a shareholder meeting. Therefore, foreign investors voting by proxy may be forced to submit their votes without a complete picture of all potential nominees.

Appointing personal representatives to vote: Sub-custodian bank representatives are not normally allowed to use their discretion in a meeting to change a vote based on new information. This means foreign investors must normally make a final voting decision before the proxy deadline and are unable to change their vote when new information is released later.

Soliciting proxies: Regulations in Taiwan prevent foreign investors from soliciting proxies of other foreign investors.

For many foreign shareholders, too, special-motion resolutions present thorny obstacles to exercising their full voting rights. Taiwan's law (Article 177-1 of the Company Act) assumes that any shareholder voting electronically has "waived his/her/its voting power in respective of any extemporary motion(s)". If special-motion resolutions with important business implications are proposed, this clause places any shareholder voting electronically in a discriminatory position. Most FINIs, therefore, would like to see Taiwan eliminate extemporary-motion resolutions and, as in other jurisdictions, adopt a fixed agenda—including a final slate of nominated directors—that cannot be changed after the deadline for sending out the meeting handbook. This would make all voting items clear weeks before the shareholders meeting, as well as ease the hesitation of listed Taiwanese companies to adopt straight-through e-voting. However, a proposal currently under consideration by Taiwan regulators does not go that far. This is an amendment to the Company Act that would not completely eliminate special-motion resolutions, but would allow only shareholders holding stakes of 1% or more to propose them at shareholder meetings.

Split voting – a view from a UK investor

"Taiwan is one of the very few international markets where split or partial voting is not permitted. Split voting allows a shareholder to divide its share votes and allocate them towards different outcomes (ie, for, against, abstain). If the shares are held through a custodial or nominee account (which is considered to be the legal shareholder), the restriction on split voting often invalidates the votes investors have submitted. As a result, it has limited the ability of shareholders to protect their interests and to have an effective voice on important proposals. For companies, too, not allowing split voting may cause problems if they are seeking a required level of quorum to pass certain resolutions at a shareholder meeting.

"A beneficial owner, such as a pension fund, often has many external fund managers and sets up a number of trading accounts for each fund manager. However, in Taiwan, the shareholder rights for voting are aggregated at the beneficial owner level under one Investor ID, and companies tend to maintain records based on the Investor ID. In such circumstances, not allowing split or partial voting means that unless all the fund managers cast votes and vote in the same way, the votes will not be counted as valid instructions. Although it is a common practice for foreign institutional investors to hold shares through a number of intermediaries, it is often difficult for investors to obtain from the proxy voting chain consistent and accurate confirmation about their votes. Therefore, the practical problems stemming from current Taiwanese regulations regarding split or partial voting are not always widely recognised or discussed.

"Addressing the issue of split and partial voting, and removing limitations on the voting process is a generally accepted practice in most jurisdictions. In its *White Paper on Corporate Governance in Asia* published in 2003, the OECD recommended that 'custodians and nominees should be able to split or apportion their votes to carry out the instructions of the beneficial owners for whom they act'. Among major Asian markets, Taiwan and Korea are the only ones where split voting restrictions are still in place. However, in Korea, the rules are more accommodating. There, split voting is called voting "in disunity". When securities sub-accounts under a single investment ID hold the same stock and there is disunity among those sub-accounts for different fund managers, current Korean regulations require that custodian or sub-custodian banks advise companies of such votes at least three business days prior to the shareholder meeting. Thus, although companies could invalidate the split votes, generally they do not; hence, the limitations imposed in Korea are less serious than in Taiwan.

(Continued over)

> "Since 2006, ACGA and its members have been advocating a rule change in Taiwan related to split and partial votes. We were very pleased to learn that a proposal for amendments to the Company Act (Article 181) had been submitted by the Financial Supervisory Commission and the Ministry of Economic Affairs in 2008 for the Legislative Yuan's approval. However, to our disappointment, the legislature has yet to take action. We urge the Legislative Yuan to give this matter a high priority for final approval, so that the existing restrictions on split and partial votes will be lifted in time for the AGM season in 2011. We consider this very important for the development of responsible share ownership and corporate accountability in Taiwan."
>
> Hermes Fund Managers, UK

Disclosure of voting results

Disclosure standards in Taiwan for voting results at shareholder meetings are generally lax. The current rule in the Company Act (Article 183) only requires that "resolutions adopted at a shareholders' meeting shall be recorded in the minutes of the meeting, which … shall be distributed to all shareholders of the company within 20 days after the close of the meeting". Accordingly, companies do not immediately release detailed for/against results in their meeting minutes or on their websites, opting instead to simply declare resolutions "resolved". And for director elections—which require poll voting—companies usually reveal the votes in favour but not those against, because directors are often elected using cumulative voting[6] and shareholders cannot cast votes "against". However, the global best practice is to release full results of all votes cast by proxy and at the AGM no later than the day after the meeting.

Prompt publication of detailed voting results would enhance the transparency of the voting process and raise the quality of shareholder meetings in Taiwan. It would send a powerful message of respect to all shareholders, and would be especially welcomed by foreign investors who are active or considering becoming more active in the Taiwan market. The Securities and Futures Bureau is of the opinion that the proposed amendment expanding e-voting will prompt more companies to publish detailed voting results. But if Taiwanese regulators are serious about promoting better disclosure of AGM outcomes, they may need to introduce specific rules in this area.

Recommendations

Foreign investors often find it difficult to exercise their right to vote in an informed manner at shareholder meetings in Taiwan. In order to improve the management and transparency of shareholder meetings in Taiwan, and to allow all shareholders (domestic and foreign) sufficient time to cast informed votes and operate on a level playing field, we encourage financial regulators to undertake, as a matter of urgency, a systematic review of the entire shareholder voting system in Taiwan. We encourage listed companies to review their shareholder meeting procedures—from the release of meeting handbooks to final vote counting and publication of results—and voluntarily adopt global best practices as soon as possible.

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[6] In cumulative voting, shareholders can choose to allocate their voting shares in whatever blocks they want in favour of director nominees of their choice, rather than casting an equal number of their voting shares to all nominees. For example, instead of voting 100 shares each to five director nominees, a shareholder can cast all 500 available shares to a single nominee or 250 shares each to two nominees, and so on.

Our specific recommendations fall into two groups—those for regulators and those for companies—with some overlap between them. Some of the challenges in the voting system ideally, or ultimately, require a regulatory response. Yet there is no reason why this should stop companies from addressing some of these problems on their own, before new rules have to come into force. There are also areas where improvements can be achieved more quickly and effectively through a voluntary best-practice approach, rather than by regulation.

A. *For regulators:*

1.1 Encourage or require companies to hold their annual general meetings earlier than June to avoid clustering. The Company Act allows companies to hold AGMs within six months of the end of their fiscal year (normally the end of the calendar year), hence meetings in April or May should be possible. Regulators could encourage de-clustering further by restricting the number of AGMs to no more than 100 per day from 2012.

1.2 Pass a rule requiring meeting agendas to remain fixed once the final meeting handbook is published.

1.3 Require meeting handbooks/agendas to contain the names and detailed biographies of all nominees for election as directors and supervisors. If an election is contested, require companies to release full details of any competing slate of directors and supervisors (all nominations, therefore, would need to reach companies early enough to be included in meeting handbooks). Remove the right to nominate director and supervisor candidates just before or in the AGM itself.

1.4 Eliminate extemporary resolutions (special motions) from AGM agendas.

1.5 Allow foreign institutional investors to give proxies to other investors.

1.6 Permit split voting so that a registered shareholder and a custody institution may divide up its votes and allocate them towards different outcomes on a single resolution.

1.7 To facilitate electronic voting, adopt a truly straight-through e-voting system that allows shareholders to transmit their votes directly to share registrars up to one day before the meeting.

B. *For companies:*

1.1 Consider holding AGMs before June.

(Note: Starting from their 2011 fiscal year, listed companies must release their audited annual accounts within three months of the end of that year—compared to four months now. This means, for example, that companies with a December 31, 2011 year-end must release their audited accounts by March 31, 2012 at the latest. This should make it easier to hold AGMs earlier.)

1.2 Release final meeting agendas/handbooks at least 28 days before the AGM.

1.3 Translate meeting handbooks into English if foreign ownership is significant (more than 10% of outstanding shares). (These should be made available at the same time as the Chinese version.)

1.4 Ensure final AGM agendas contain the names and detailed biographies of all nominated directors and supervisors, not just those of independent director candidates (see Appendix 1).

1.5 Ensure that items on the final agenda are fixed and not subject to further revision.

1.6 Eliminate extemporary resolutions (special motions) from AGM agendas.

1.7 Conduct voting by poll for all resolutions at the AGM and any other shareholder meeting. Engage an independent scrutineer for the poll (eg, a share registrar/transfer agent or auditor). Voting by poll means counting every share voted, regardless of how and when it was cast (see page 17 for a description of voting by poll.) The credibility of AGM results will be enhanced if polls are used.

1.8 Publish full voting results with a detailed breakdown of all “for”, “against” and “abstain” votes within 24 hours of the conclusion of the meeting. The results could be published on either the company website or that of the stock exchange, or both. (Ideally, the results should also be made known in the meeting.)

Issue 2: Board Effectiveness

The role of independent directors at listed Taiwanese companies should be strengthened to improve board decision-making and its oversight of management. This would enhance investor confidence.

An effective board of directors is a critical component of good corporate governance. It is the role of the board to set the broad strategic direction of the company, monitor the performance of management and safeguard the interests of all shareholders. To do its job properly, the board must maintain a certain distance from management and the controlling shareholder so that it can evaluate the company's operations objectively, and ensure the maximisation of long-term corporate value.

In most developed markets, a system of independent directors has evolved to enhance board accountability. While inside directors know more about a company's operations than outsiders, they are more likely to have narrower perspectives and conflicts of interest. By providing a wider and more candid perspective to board deliberations, external directors can generate more open and constructive discussions on key issues facing the company than if only insiders were present.

Yet at many listed Taiwan companies that ACGA and our investor members follow, the board of directors includes few independent members. Many companies continue to be family-controlled, with board positions filled largely by senior executives and representatives of controlling shareholders or founders. Even at the most globalised of companies, the lack of board independence is surprisingly commonplace. And among companies that have appointed independent directors, rarely are there more than two. In all, as of March 2010, only 288 of 741 listed companies had independent non-executive directors (INEDs), according to the Taiwan Stock Exchange (TWSE).

Board independence

Taiwan's basic corporate governance framework incorporates aspects of both the Anglo-Saxon unitary board structure (introduced only in the past decade) and the German supervisory board system (introduced under the earlier influence of Japan). As a result, Taiwanese regulations only partially mandate listed companies to appoint independent directors. The relevant rules are:

- **Article 14-2 of the Securities and Exchange Act (SEA)**: This regulation stipulates that "a company that has issued stock in accordance with this Act *may* appoint independent directors in accordance with its articles of incorporation". In 2006, the SEA was amended to grant regulators the power to require companies to appoint independent directors, "not less than two in number and not less than one-fifth of the total number of directors" in view of "the company's scale, shareholder structure, type of operations, and other essential factors". This last stipulation now applies to all listed companies with paid-in capital of NT$50 billion or more, financial holding companies, banks and insurance companies.

- **Article 9-9 of TWSE's listing rules**: Since 2002 all newly listed companies have been required to appoint not "less than two independent directors" and "at least one of them must be a professional in accounting or finance".

The same regulations also lay down requirements for audit committees and supervisors:

- **Article 14-4 of the SEA**: The 2006 amendment required listed companies to establish either an audit committee or a supervisory system. If a company chooses an audit committee, it must have no fewer than three persons and all must be independent directors. The committee's resolutions require approval of at least half of its members. As of October 2010, just 31 TWSE-listed companies and 19 GreTai Securities Market-listed companies had an audit committee. (The GreTai Market is the second board for smaller, growth companies.)

- **Article 9-9 of TWSE's listing rules**: Since 2002, a newly listed company that has not established an audit committee must appoint at least three supervisors. The supervisors are not required to be independent (but see the note on p27).

Independent boards and foreign investment

"The lack of independence on Taiwanese boards has directly limited our investment potential in the country. If Taiwanese companies improved board independence, we would most likely increase our holdings in the market. When evaluating companies in emerging markets, we look for them to have a board with at least one-third independent directors, and ideally a majority of INEDs, if there is no controlling shareholder. Only five of the 15 Taiwanese companies we reviewed in the last year for our specialist emerging market equities ESG[7] fund met this standard; indeed two had no independent directors at all. Historically, families controlled these businesses. However, as their ownership positions receded, their control over the board has not done so. There is a mismatch between ownership and control in Taiwan, with outside investors having more skin in the game but less representation.

"Taiwan's board independence standards are most closely aligned with standards for satellite emerging markets, including Nigeria and Turkey. On a regional basis, Taiwan is severely lagging major emerging Asian economies including Korea, Malaysia and China. Poor governance may have been one contributing factor as to why Taiwan was rejected for promotion to developed market status by MSCI in its 2010 review.

"In the 2010 voting season, investors were routinely asked to approve the devolution of responsibility for providing company loans to the chairman of the board of listed companies. In many cases, the size of the capital loans to be provided to a subsidiary or affiliated entity was up to 10% of net value of the company. But because the chairman is not independent and there is almost no independent board oversight of the chairman, there was a real risk that the company may provide loans for non-performing businesses that could weaken the balance sheet. Only with better board oversight and regular reporting on related-party transactions, would we feel comfortable devolving this responsibility.

"A similar issue arose with companies requesting authority to provide guarantees and endorsements to subsidiary companies. We understand that providing such guarantees can substantially reduce the cost of capital for those businesses and therefore be beneficial to investors. However, the same concerns apply as noted above. We are concerned that, with no board oversight and limited transparency, the board may end up supporting unhealthy or non-core businesses and therefore damaging the balance sheet. We cannot support significant off-balance-sheet risks and therefore opposed requests to provide guarantees or endorsements greater than 50% of the net asset value of the group."

F&C Asset Management, UK

[7] Environmental, social, governance

The concept of the supervisor in Taiwan requires some explanation in order to understand better the country's corporate governance framework. According to the Company Act, supervisors are people other than board directors or company executives, and who are meant to exert important checks on the actions of the board and management. Articles 218 and 219 of the Act empower each of them individually to investigate the business and financial conditions of the company at any time, audit its accounting and other records for shareholder meetings, and compel the board to cease any act that is illegal or violates the company's own articles of incorporation or shareholders' resolutions. All listed companies must elect a minimum of two supervisors at a shareholder meeting, and newly listed companies must appoint at least three. Supervisors can attend board meetings, serve up to three years and be re-elected.

The current set-up, which stops short of mandating independent directors for all listed companies, is a result of a compromise between regulators and the corporate sector (and their political allies). In 2004, Taiwan's legislature rejected a bill that would have required at least one-quarter of boards to be independent directors for all listed companies; and would have eventually replaced supervisors with an audit committee entirely composed of independent directors[8]. The next year, the Financial Supervisory Commission (FSC) submitted a revised and watered-down bill containing the above stipulations in Article 14 of the SEA in order to secure its passage through the legislature.

While this may have been the best possible political outcome at the time, we believe that the current supervisory system is unlikely to prove as effective over time as an audit committee system. Taiwan's regulators are aware that supervisors at some companies are failing to exercise their full powers as intended, and are discussing ways to coax more out of them[9]. Many foreign investors are also unsure about how effective a role supervisors play in companies with no audit committees. Despite the legal definition, there is a widespread perception that supervisors are often too close to board members and senior company executives to be able to discharge their oversight role properly. Such impressions may be dispelled if all companies had independent supervisors. But Taiwan's current legal regime allows a loophole for companies to operate without independent supervisors—or independent directors.

To promote greater accountability, Taiwanese regulators should embrace the global best practice of setting up audit committees and mandate them for all listed companies. Having an audit committee is widely recognised to be a fundamental component of an independent board. And directors who would sit on the committee are inherently much more powerful players than supervisors, because they are part of the board's formal decision-making process and can directly influence the outcome by exercising their voting rights. The law in Taiwan already requires the presence of at least three independent directors on an audit committee to ensure its impartiality and objectivity.

If, however, the supervisory system is retained, it should be made more independent. Further enhancing the system would require, at a minimum, that all listed companies appoint only independent persons to the position. With non-independent supervisors, there will always be doubts about their ability or willingness to check and balance the decisions of the board, despite the considerable powers assigned to them by law.

[8] Andrew Jen-Guang Lin, *International Securities Regulation: Taiwan*, (Oxford: Oceana, 2006), 109-110.
[9] *Corporate Governance in Taiwan*, (Taipei: Securities & Futures Institute, 2009), 18.

(**Note**: Previously, Taiwan's two securities markets required all newly listed companies to have one independent supervisor. In 2006, the concept of "independent director" was incorporated into the Securities and Exchange Act and became a legal term, but the concept of "independent supervisor" was not. As a result, the Taiwan Stock Exchange decided to remove the terminology of independent supervisor from its listing rules, while the GreTai Securities Market changed the title from independent supervisor to "independently functioning supervisor" and retained this requirement for newly listed companies on its over-the-counter market.)

Independent directors
There is also a need to toughen the criteria for the independence of independent directors. Even when Taiwan companies have independent directors, there are doubts as to whether they are genuinely independent from company insiders and whether their views are taken seriously within the board. For starters, Taiwan's regulations are weak on the definition of an independent director[10]. To be considered independent, two years prior to being elected he/she could not have been, among others:

- A company employee, director or supervisor;
- A substantial shareholder or his/her family member;
- A commercial, legal, financial or accounting service provider.

In other jurisdictions, an independent director candidate would have to meet similar conditions—but with a three to five year "cooling off" period. (ACGA, however, believes that former employees and advisors should be ruled out altogether as independent directors; although they could serve as non-executive directors.)

The qualifications required for an independent director are also overly narrow. Ideally, independent directors should be individuals with extensive corporate or industry experience and with a sense of what good governance entails. But these are not the first people Taiwanese companies turn to. Regulations stipulate only that such directors need to have/be:

- A minimum of only five years' work experience in "commerce, law, finance or accounting";
- A professor in the above areas;
- A judge, prosecutor, attorney or CPA.

A related problem is that when independent directors do have industry experience, companies routinely ask investors to waive non-compete clauses. Given the highly concentrated and competitive nature of some sectors in Taiwan, such as high-tech, directors should not sit on the boards of competing companies.

How much influence an independent director can realistically exert depends largely on the attitude of the board chairman, who is often the company founder or controlling shareholder, according to local CG experts. In carrying out research for this paper, ACGA has encountered executives who truly appreciate the value that independent directors can bring to their companies, as well as those who are dismissive of both the function and views of independent directors.

[10] See *Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies.*

Yet it would be fair to say that awareness of the importance of good corporate governance among Taiwanese executives is gradually rising. This is partly due to the globalisation of Taiwan companies and partly to the emerging internal board dynamic between independent directors and the others. Inevitably, a process of mutual adjustment and education is taking place. Mindful of their legal obligations and reputations, independent directors are becoming more vocal and assertive in wielding their powers, especially at companies with audit committees. “I have retired and have enough money,” says one prominent former businessman who now serves on two boards. “So [protecting] my reputation is very important.”

Meanwhile, the more open-minded Taiwanese tycoons and board chairmen see that ignoring the interests of minority shareholders can potentially throw up unproductive conflicts for the company. Still others, who are hoping to pass on family control of the company to the next generation, may soon realise that independent directors can play the role of an impartial arbiter among feuding family members, according to one academic who serves as an independent director.

Building an independent and more effective board at listed Taiwanese companies is a work in progress. Many companies are moving in the right direction, but clearly there is a long way to go. One area that needs to be addressed is the lack of board committees at many companies. This makes it difficult to know who is responsible for key board functions and, when problems arise, where the accountability lies.

(**Note**: On November 24, 2010, Taiwan’s President announced that an amendment to the Securities and Exchange Act, Article 14-6, had been passed that would require all listed companies and those traded over-the-counter to establish a remuneration committee. Detailed guidelines are expected to be announced by regulators in 2011.)

Director elections

In Taiwan, all directors are elected simultaneously and are almost always appointed to three-year terms. This means shareholders are only able to vote once every three years and are limited in their ability to hold directors accountable for their performance during this period. In some European markets, such as Germany and the Netherlands, directors are also not elected annually. But unlike Taiwan, investors in those places have the right to “discharge directors” (that is, vote on whether they have fulfilled or discharged their responsibilities properly and may continue to serve on the board). While the long tenure of directors in Taiwan may encourage them to adopt a long-term perspective on issues facing the company, and help to align their views more closely with the interests of long-term investors, it could also create problems if companies are allowed to retain underperforming directors.

The company law in Taiwan states that companies must hold elections for directors at least once every three years. It is legally permissible, therefore, for companies to hold them more frequently. We would encourage listed companies to consider shortening the period between director elections, so as to enhance accountability and investor confidence in boards.

Recommendations

In order to improve board effectiveness in Taiwan, the role of independent directors should be broadened and strengthened. We recommend that listed companies implement the following measures as best practices (if they are not already doing so):

A. *For companies:*

2.1 Appoint a minimum of three independent directors as soon as practicable. Over the following few years, they should ideally comprise one-third of the board. It is important, however, that the quality of people appointed as independent directors is high and quality is not sacrificed for quantity. Equally important is the corporate and industry experience and knowledge that independent directors bring to the board. Appointing independent directors should not be a box-ticking exercise.

2.2 Establish an audit committee comprised only of independent directors and chaired by one of them.

2.3 Set up other key board committees, such as those in charge of nomination and risk management. Directors on board committees should have clearly delineated roles and responsibilities. These committees should comprise a majority of independent directors and be chaired by one.

2.4 Undertake self-evaluation of board and director performance on an annual basis, and organise training programmes for directors. Disclose this information in annual reports, along with the board attendance records of directors.

2.5 Shorten the period between director elections, so as to enhance accountability and investor confidence in boards.

B. *For regulators:*

2.1 If companies continue to opt not to establish audit committees in favour of retaining supervisors, we recommend that the supervisory system be made more independent from management, the controlling shareholder and the board. For example, companies could be required to appoint a number of independent supervisors (at least three). The role of supervisors should be reconsidered and their sweeping powers on paper reviewed to see if they are realistic or practical. And they should be encouraged to function as a group (ie, as a board of supervisors), not individually.

See over for ACGA's definition of "independent director"

ACGA's definition of independent director

An independent director should:

- Have an 'independent mind' and be capable of bringing an independent perspective to major corporate decisions.
- Be able to read company accounts and ask sensible questions about them.
- Have the expertise and authority to discuss issues with executive directors as equals.
- Be capable of considering the interests of all shareholders and the company as a whole, including the broader environmental and social risks facing the company.

An independent director should not:

- Have close family or personal ties with any of the company's advisors, directors or senior employees.
- Be a former employee or manager of the company.
- Hold cross-directorships or have significant links with other executive or non-executive directors.
- Be a representative of a major shareholder connected to the controlling shareholder or management, or be representatives of any special interest group, or former employees of such groups.
- Have commercial involvement with the company as professional advisers, major suppliers or customers.
- Be entitled to performance-related pay, stock options, or pensions.
- Hold other directorships in competing companies in a closely related industry.

After an independent director has served for 8-10 consecutive years, the shareholders of the company should evaluate his/her continuing role on the board.

Issue 3: Shareholder Rights

The protection of the interests of minority shareholders in Taiwan needs to be enhanced. Current rules on takeovers, substantial shareholder disclosure, voluntary delistings, and private placements do not provide sufficient safeguards for minority investors.

Takeovers and general-offer rules
Takeovers and mergers of listed companies in Taiwan are governed by various laws and regulations, mainly the Company Act, the Securities and Exchange Act, and the "Regulations Governing Tender Offers for Purchase of the Securities of a Public Company". However, enforcing rules to ensure that minority shareholder rights are sufficiently protected in the event of a change of control is a greater challenge in Taiwan than in most other regional and international markets.

Taiwan has quite a different general-offer regime compared to other markets—one where it is relatively easy for companies to avoid making a general offer. In Singapore, for example, takeovers are regulated by the Securities and Futures Act (SFA) and by the Take-over Code promulgated under section 139(2) of the SFA. The code is closely based on the UK's City Code on Takeovers and Mergers[11]. Mandatory offers are triggered when any person or corporation acquires, whether by a series of transactions over a period of time or not, shares which carry 30% or more of the voting rights of a company—as this is the level at which an effective change of control over a company is deemed to have occurred.

There are similar regulations in Hong Kong. The Takeovers Code in Hong Kong regulates acquisitions of shares in a company leading to a change of control, currently defined as a holding or aggregated holdings of 30% or more of the voting rights of the company. The aim of the rules in Singapore and Hong Kong is to ensure fair treatment of shareholders, particularly of minority shareholders, affected by takeovers or mergers.

In Taiwan, the relevant articles of the SEA and Article 11 of the "Regulations Governing Tender Offers for Purchase of the Securities of a Public Company" provide that "any person who individually or jointly with another person(s) intends to acquire within 50 days shares accounting for 20% or more of the total issued shares of a public company shall employ a public tender offer to do so".

Although the trigger point of 20% appears lower than in Singapore and Hong Kong, enforcing this requirement for mandatory offers in Taiwan is more complex. This is because the rules could easily be circumvented if a party acquired a stake slightly lower than 20% in 50 days. If the acquirer exceeded this threshold a few days later, a mandatory general offer would not be required despite a change of ownership and control. A repeat of such share acquisitions would obviously go against the interests of minority shareholders.

In short, we believe that the current regulations in Taiwan relating to takeovers need to be brought into line with standard practice in other regional and international markets. This would enhance investor confidence and assist the development of Taiwan's capital

[11] The UK Code was originally published in 1968 and laid down qualitative, not quantitative, criteria for mandatory offers. In 1972, a trigger of 40% was introduced; then reduced to 30% in 1974.

market. In this context, it is worth noting that even China introduced a mandatory trigger of 30% in 1998.

Comparison of rules on takeovers			
	Taiwan	**Singapore**	**Hong Kong**
Threshold for triggering mandatory offers	Acquisition of 20% or more of issued shares within 50 days	Acquisition of 30% or more of voting shares	Acquisition of 30% or more of voting shares

Disclosure of substantial holdings

Transparency surrounding substantial shareholdings is generally lower in Taiwan than in other markets. The global best-practice threshold for ongoing (ie, immediate) disclosure of substantial shareholdings is 5% of total issued shares, and almost all markets in Asia follow this standard. However, regulations in Taiwan require substantial shareholdings in a listed company be filed only when they exceed 10% of total shares (Article 1 of the "Directions for Filing Reports on Acquisitions of Shares" in accordance with Article 43-1 of the SEA). Although other rules require disclosure of stakes of 5% or more in the annual reports of listed companies, such disclosure is delayed, not immediate.

One exception to the 10% rule is that financial holding companies must disclose shareholders with stakes of 5% or more to the regulator.

We believe that Taiwan's regulations in this area should also be brought into line with global standards.

Voluntary delistings

A further challenge for minority shareholders is the issue of voluntary delistings. Although some observers in Taiwan believe that more companies—especially those with small public floats—should be delisted by regulators, there have been cases of voluntary delistings where shareholders were forced to accept inadequate offers (see box on the next page) or risk being caught with shares in an unlisted company. Such controversies suggest regulators need to tighten delisting rules to better protect the interests of minority shareholders.

The current requirement for voluntary delistings, as promulgated by the Taiwan Stock Exchange's "Application Procedures for Terminating the Listing of Securities by Listed Companies", is that "a listed company shall submit the matter of terminating the listing of its securities to the board of directors' meeting or the shareholders' meeting for approval via resolution; the shares of the consenting directors or shareholders shall be at least two-thirds of the listed company's total issued shares".

This means that the directors can act on behalf of all shareholders in a company and vote to delist it by passing a board resolution if they hold (or represent) more than two-thirds of the company's shares. Otherwise, an EGM must be called and the necessary quorum and approvals sought from the general body of shareholders.

There are several major flaws in these regulations from a corporate governance perspective:

- Delisting a company is a major decision that could have adverse effects on minority shareholders if not carried out fairly. Allowing the board of directors to make such a decision on its own—even if directors own a substantial proportion of the company's shares—deprives minorities of their right to have a say in what happens to the company. Hence, the only fair mechanism for deciding on a delisting is to call an EGM of all shareholders.
- If the directors and/or a controlling shareholder have a commercial or financial interest in delisting the company, then the EGM vote should be restricted to independent shareholders only (ie, those not affiliated to directors or controlling shareholders). Taiwan's regulations do not provide for this.
- The voting threshold of 66.6% is low by regional standards.

Delistings are even easier in Taiwan if done through a merger and then privatisation, as the following story relates:

How a delisting hurt a minority shareholder

"Company A was a leading business-software provider in Taiwan and mainland China, and was listed on the Taiwan Stock Exchange. In 2007, an investment firm (Company B), established by a private equity fund and the management of Company A, offered to purchase all outstanding shares of Company A at a price of NT$47.55 per share. As a whole, Company B and major shareholders of Company A controlled over 40% of the latter's shareholdings. Although the ultimate aim was to delist the company from the TWSE, an EGM was called to seek a merger between Company A and Company B, with the latter remaining as the surviving entity. We, a London-based institutional investor, owned 9.4% of shares in Company A, and believed that Company B's offer price was significantly lower than the intrinsic value of Company A.

"It seemed clear that the bidders had proposed a merger followed by privatisation in order to circumvent the TWSE rule requiring approval from a supermajority (ie, two-thirds) of shareholders for a delisting. For a merger proposal like this, support of only 50% of shareholders at an EGM is required. And since the incumbent management and insiders already controlled over 40% of Company A's shares, securing another 10% of support was unlikely to be difficult.

"For foreign investors like us, this was a doubly unpalatable situation. In addition to having the decision presented as a fait accompli, if we declined to accept Company B's buyout offer, our investment would no longer benefit from existing tax benefits when incurring capital gains as Company A was being privatised. As a result, we had to choose between accepting an unattractive offer or facing a punitive tax burden.

"This case is clearly an example of how current regulations in Taiwan fail to protect the interests of minority shareholders. Seemingly tough rules are too easily circumvented. And since there are no effective rules to protect minority shareholder interests in the event of squeeze-outs or sell-outs in Taiwan, in certain merger-and-acquisition cases like this, major shareholders are able to effectively force the hands of minorities."

Hermes Fund Managers, UK

Other developed markets in Asia set higher thresholds for the approval of delistings. In Hong Kong, for example, only independent shareholders are allowed to vote on them and not more than 10% of public-float shares (by value) can be voted against (or the delisting will fail). Hence, if the public float is the minimum of 25%, then not more than 2.5% of all shares can be voted against. Also, of the shares voted by independent shareholders in the EGM, at least 75% must be in favour of the delisting for it to proceed. In Singapore, the rule is simpler and the threshold lower—75% of total issued shares must support a delisting for it to pass. Yet a shareholder meeting is still required.

Private placements

Although many large Taiwanese companies are cash-rich, when they need to raise capital quickly, they turn to private placements. This is especially true of companies in Taiwan's capital-intensive, high-tech industry. Private placements are a legitimate way for companies to tap a select group of ready investors, but proper procedures should be in place to obtain the consent of existing shareholders and limit the damage to their interests from share dilution. But in Taiwan, regulations governing such placements are quite lax.

Unlike many other markets in Asia, Taiwan law imposes no ceiling on how many shares can be issued through private placements. Article 43-6 of the Securities and Exchange Act stipulates that a company can carry out a private placement by passing a resolution "by at least two-thirds of the votes of the shareholders present at a meeting of shareholders who represent a majority of the total number of issued shares". That is, a company needs to secure at least 66.6% of the votes in a meeting where more than 50% of all shareholders are represented.

As for the price of privately placed shares, an amendment to the "Directions for Public Companies Conducting Private Placements of Securities" that went into effect on September 1, 2010, for the first time put a ceiling of 20% on the discount that could be offered ("the price per share of the privately placed common shares may not be lower than 80% of the reference price[12]"). The amended rules also imposed a stricter deadline on public disclosure of a planned private placement (within two days from the date of the board resolution, rather than from the date the shareholders meeting notice is sent out), restricted private placements only to profitable companies, and required disclosure in the shareholder meeting notice if company insiders and related parties planned to subscribe to the offer.

While these measures were all an improvement, Taiwan's standards remain weaker than global best practices on private placements set by the UK's Pre-Emption Group in 1987. This body of financial experts established by the London Stock Exchange called for companies to issue no more than 5% of their existing share capital in private placements in any one year, no more than 7.5% cumulatively over any three-year period, and recommended a maximum discount of 5% of the most recent market price for such shares. Although these are only guidelines and not binding rules, they have since become the accepted standards in the UK market.

[12] The reference price is defined as the higher of "1) the simple average closing price of the common shares of the exchange-listed or OTC-listed company for either the one, three, or five business days before the price determination date, after adjustment for any distribution of stock dividends, cash dividends or capital reduction; or 2) the simple average closing price of the common shares of the exchange-listed or OTC-listed company for 30 business days before the price determination date, after adjustment for any distribution of stock dividends, cash dividends or capital reduction".

We believe it would be reasonable for Taiwan regulation to limit the size of private placements to an annual ceiling of 5-10%, with a maximum discount of 10% on the price of any new shares. These thresholds are based on the standards that global investors are seeking in other markets, such as Hong Kong and Singapore. In both places, the size of permitted placements in any 12-month period is high—20%. As for the discount, Hong Kong allows up to 20% and Singapore up to 10%. Global investors believe these levels are too high and potentially dilutive, hence they have been actively voting against AGM resolutions that allow companies to renew private placement mandates each year. Interestingly, the larger, blue-chip firms in Hong Kong and Singapore, and those with a good reputation on corporate governance, either tend not to do private placements or keep the size and discount within reasonable limits (ie, between 5-10%).

It should be pointed out, however, that companies in extreme financial distress (eg, facing bankruptcy) could have the flexibility to undertake larger private placements and at greater discounts if this was the only way they could avoid going out of business. Such a decision should be put to the general body of shareholders in an EGM, however, and not left to the board to decide. Moreover, some flexibility could also be given to companies that need a larger amount of capital than the thresholds above allow (such as young, high-growth companies) if they explain their reasons to shareholders in sufficient detail and put the decision to a vote of independent shareholders in an EGM.

Recommendations
In order to bring Taiwan's rules on takeovers, substantial shareholder disclosure, voluntary delistings and private placements more closely into line with global best practices, we recommend that Taiwanese regulators implement the following measures:

3.1 Review the current, overly complicated regulatory requirements for mandatory general offers (acquisition of 20% or more shares within 50 days), and amend in line with the international threshold of 30%.

3.2 Lower the threshold for disclosure of substantial shareholdings from 10% to 5% of total issued shares, so that investors can better ascertain a large shareholder's effective stake.

3.1 Require shareholder approval for all proposed voluntary delistings, and raise the current approval threshold of two-thirds of total shares. A higher threshold should be set after inviting the views of the investment community and other market participants, including global investors, through the establishment of an expert taskforce that would produce a report for public consultation. Moreover, remove the ability of the board to decide a delisting on its own. And close the loophole allowing a lower approval threshold for delistings in case of mergers.

3.3 Set a finite threshold for the maximum amount and a lower threshold for the price discount of shares that can be issued through private placements in any 12-month period. We believe the reasonable targets are a 5-10% ceiling on the size of private placement issuances, and 10% on the discount offered for the price of the new shares. A higher threshold on the size and discount may be allowed in exceptional circumstances (eg, a company facing bankruptcy), or where companies have a genuine need for a larger placement, but only after independent shareholder approval has been given in an AGM or EGM

Appendix 1: Disclosure rules for director nominees in Hong Kong

In their notices to shareholders for general meetings, listed companies in Hong Kong must disclose, among other things, the following details about director nominees:

Biographical data

- Full name and age;
- Positions held with the listed company and other members of the listed company's group;
- Experience including (i) other directorships held in the last three years in public companies and (ii) other major appointments and professional qualifications;
- Length or proposed length of service with the listed company;
- Relationships with any directors, senior management or substantial or controlling shareholders of the listed company;
- His/her interests in shares of the listed company;
- Amount of the director's or supervisor's remuneration and the basis of determining the director's or supervisor's remuneration;

Prosecutions, court orders, etc.

- Full details of any public sanctions made against him/her by statutory or regulatory authorities;
- Full details of any time he/she had been adjudged bankrupt or insolvent;
- Full details of any unsatisfied judgments or court orders of continuing effect against him/her;
- Full details of any business enterprise that has been dissolved or put into liquidation or bankruptcy (i) during the period when he/she was one of its directors, supervisors or managers, or (ii) within 12 months after his/her ceasing to act as one of its directors, supervisors or managers;
- Full details of any conviction for any offence:
- Full details where he/she has been identified as an insider dealer;
- Full details of any judgement where he/she has, in connection with the formation or management of any business enterprise, been adjudged by a Court to be liable for any fraud, breach of duty or other misconduct;
- Full details of any business enterprise of which he/she was or is a partner, director, supervisor or manager that has had its business registration or licence revoked at any time during the period when he/she was one of its partners, directors, supervisors or managers;
- Full details of any disqualification or ruling against him/her from holding, or deemed unfit to hold, the position of director, supervisor or manager of a business enterprise;
- Except where such disclosure is prohibited by law, full details of any investigation by any judicial, regulatory or governmental authority to which he/she is subject.

Source: Summarised from Articles 13.51(2) and 13.74, Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited[13].

[13] See http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/documents/chapter_13.pdf

Appendix 2: About ACGA

The Asian Corporate Governance Association (ACGA) is an independent, non-profit membership association dedicated to promoting long-term improvements in corporate governance in Asia through research, advocacy, and education.

ACGA carries out independent research in 11 major Asian markets. It engages in a constructive and informed dialogue with regulators, issuers, institutional investors and other key interest groups. And it organises educational events, including an annual conference, to raise awareness and provide a forum for discussion of timely corporate governance issues.

ACGA is best known for its “White Papers” and “Statements” on regulatory reforms in different Asian markets (eg, India, Japan, Singapore) and its regular “CG Watch”* survey of corporate governance in Asia—first undertaken in 2003. It has also developed a website, **www.acga-asia.org**, providing a wide range of data and analysis on corporate governance conditions and regulations in major Asian markets.

(*Carried out in collaboration with CLSA Asia-Pacific Markets, a Founding Sponsor of ACGA)

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Appendix 3: About the Contributors

F&C Asset Management

F&C Asset Management is a leading global diversified investment management group with a heritage spanning more than 140 years. Today, the London-headquartered group operates from offices in 12 countries and manages £106 billion of assets for a diverse range of institutional, insurance and retail clients across all major asset classes—equities, bonds, property and alternatives. In addition, F&C has been appointed to vote and/or engage in dialogue on environmental, social and governance issues on behalf of a further 20 investment institutions whose assets totalled £82 billion as of December 31, 2010. (www.fandc.com)

Hermes Fund Managers

Hermes is one of the largest asset managers in the City of London and is wholly owned by the BT Pension Scheme. As part of its Equity Ownership Service (EOS), it is dedicated to representing its clients in engagements with companies on issues relating to their long-term value and on public policy and best practice internationally. Hermes EOS also helps its clients to develop and implement policies and strategies on corporate governance and responsible asset management and to vote their shares intelligently. As of the end of December 2010, Hermes EOS had assets under advice of approximately US$110 billion. (www.hermes.co.uk)

PGGM Investments

PGGM Investments is a Dutch pension administrator and asset manager acting on behalf of, among others, Pensioenfonds Zorg en Welzijn, the Dutch pension fund for the healthcare and welfare sector and one of the largest pension funds in Europe. PGGM Investments currently has about €100 billion under management. (www.pggm.nl)

Universities Superannuation Scheme

Universities Superannuation Scheme (USS) is the second largest pension fund in the United Kingdom and the principal pension scheme for UK universities, acting for 378 universities and academic institutions. It had £31 billion in assets as of December 2010, and approximately 250,000 members. (www.uss.co.uk)