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Asian Corporate Governance Association (ACGA)

"What is corporate governance with Chinese characteristics?"

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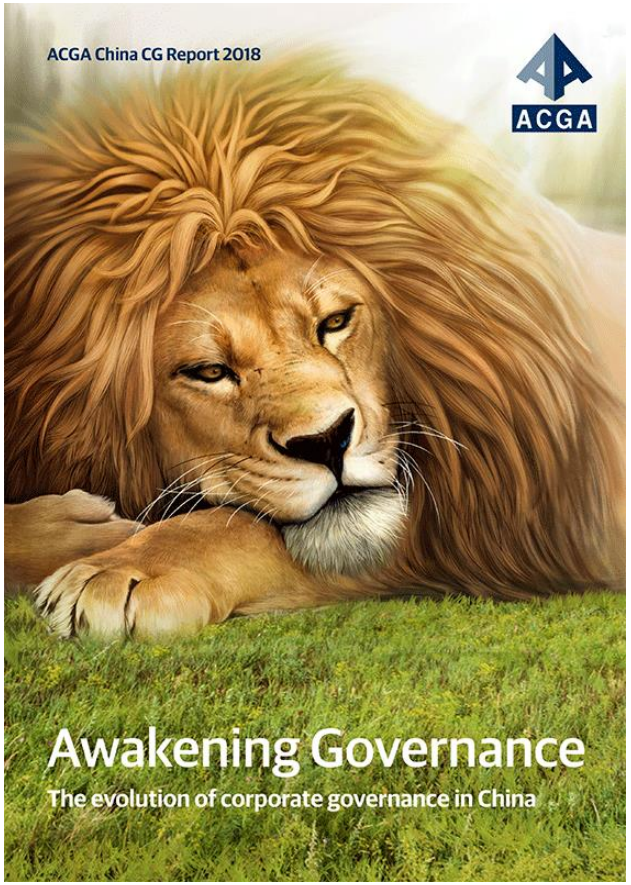
Agenda

1. Report objectives
2. Regulatory context
3. CG with Chinese characteristics
4. CG Diagnostics
5. CG Watch 2018 - China



1. Report objectives

- Explain China's unique and evolving system of corporate governance to foreign investors.

- Explain the relevance of new global CG best practices to China listed companies and institutional investors.

- Make recommendations to regulators, companies and investors for moving CG forward in China.

2. Regulatory context

- China introduced a range of "global standards" of corporate governance in the mid-1990s to early 2000s. This helped to build credibility among international investors, but did not resolve some deep-seated local governance problems.

- The past decade has seen a stronger emphasis on local governance solutions driven by the state/Party. Often very prescriptive and rules-based.

- A hybrid system: "We will improve regulatory rules to ensure they are suited to the Chinese context and in accord with international standards". (13th Five-Year Plan: 2016–2020)

3. CG with Chinese Characteristics

1. The Party Organisation/Committee: Leadership core

2. SOEs vs POEs: Similarities and differences

The Party Organisation: Leadership core

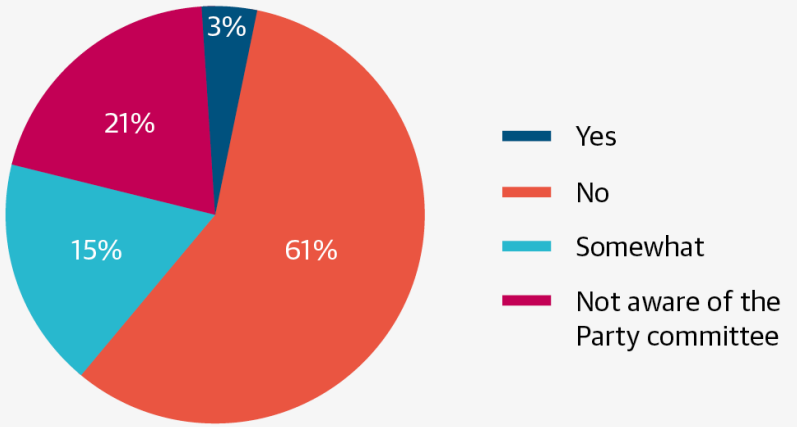
- Since 2010 the CPC and SASAC have issued several policy statements that seek to strengthen and clarify the leadership of Party organisations in SOEs.
- In 2013, the CPC Organisation Department and SASAC issued a policy opinion on the role of Party organisations as the political core in central SOEs under a "modern corporate system".
- On 24 August 2015, the CPC Central Committee and State Council published the "Guiding Opinions on Deepening SOE Reform". This reaffirmed the political importance of "cross-offices".
- In late May 2016, SASAC published an article in its publication Qiushi (Seeking Truth)to further strengthen Party leadership in SOEs and it proposed for the first time the "pre-approval" role of Party Committees.
- On 30 September 2018, CSRC issued the first amended CG Code with a new clause asking all SOEs to change their articles to reinforce the leadership role of Party Committee (Article 5).

The Party Organisation: Leadership core – 2

- The Party Organisation (PO) has the right and duty to pre-approve the "three important, one large" decisions.
- Strong overlap ("cross offices") between the PO and the board of directors (BOD), supervisory board (SB), and senior management.
- The PO has a basis in the Company Law, CPC Constitution and the newly amended CG Code.
- Article amendments since late 2015, including POEs, overseas-listed Chinese companies and foreign-invested Chinese companies.

Is the Party's role clear? Fig 3.1

Foreign investor views on whether the Party committee has a clear and accountable role in listed companies



Source: ACGA Foreign Institutional Investor Perceptions Survey 2017

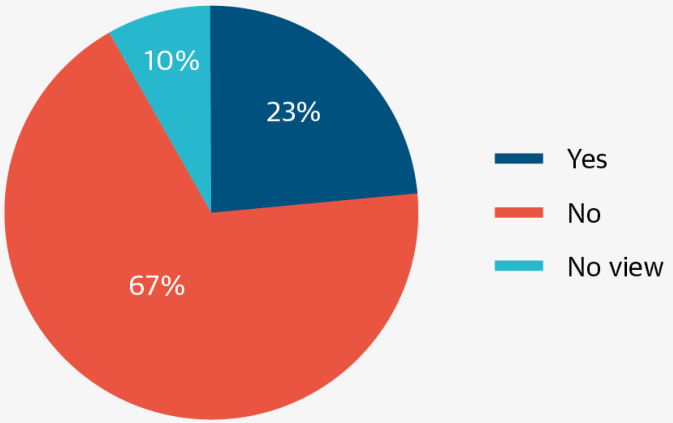
Recommendations: More disclosure on the role of the PO. A "Report of the PO" like the BOD and SB reports.

SOEs vs POEs: Similarities and differences

- Despite major differences in ownership structure, management and performance, privately owned enterprises (POEs) share similar attributes and challenges as SOEs: the imbalance of concentrated ownership, an insider mindset, policy uncertainty, controlled markets, the need to maintain good government relations, formation of Party orgs.
- Slightly less than a quarter of foreign respondents prefer them as an investment proposition *(see chart)*.
- Only 10% of China respondents see POEs as better governed than SOEs *(see chart over)*.

Do you prefer investing in POEs? Fig 3.11

How foreign investors view investing in privately owned enterprises compared to state-owned enterprises in China



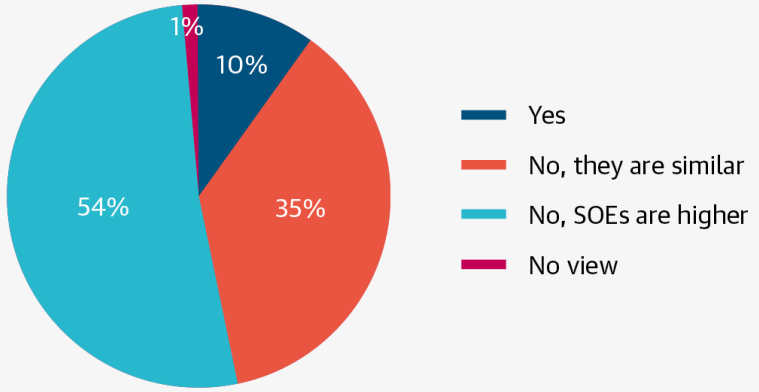
Source: *ACGA Foreign Institutional Investor Perceptions Survey 2017*

SOEs vs POEs – 2

- Significant differences are seen, however, in the level of government intervention in POEs, and the importance of the chairman *(see charts over)*.
- Since 2015, SOEs are increasingly being categorised by role and function, such "commercial enterprises" vs "public welfare enterprises".
- An SOE's category will determine its objectives, governance reform path, performance metrics, evaluation system, and so on.

Are POEs better governed? Fig 3.12

How China listed companies view the quality of corporate governance in privately owned enterprises compared to state-owned enterprises

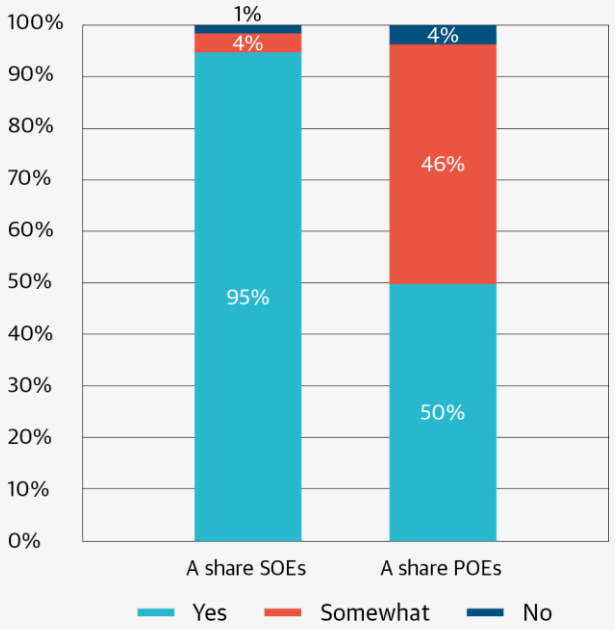


Source: *ACGA China Listed Company Perceptions Survey 2017*

Perceptions on POE governance

Does the state intervene in company decision-making? Fig 3.13

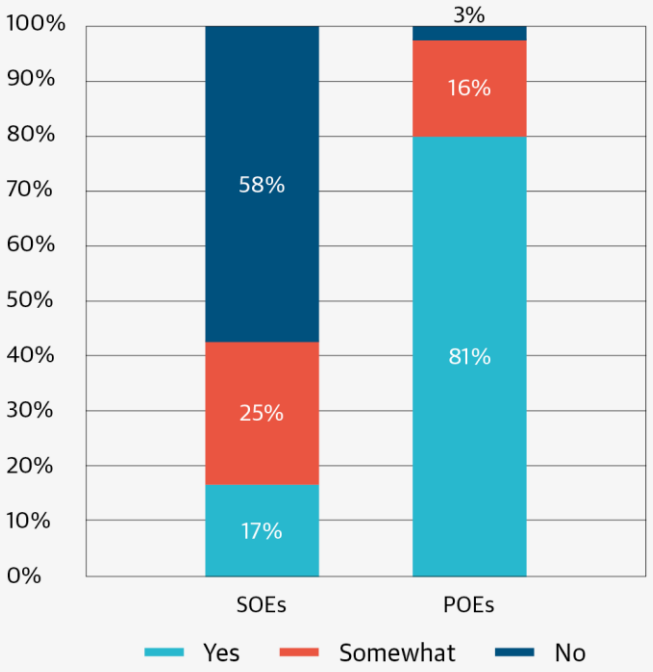
How foreign institutional investors view Chinese government intervention in the decision-making of SOEs compared to POEs



Source: ACGA Foreign Institutional Investor Perceptions Survey 2017

Does the chairman matter? Fig 3.14

Does the individual holding the position of chairman influence foreign investment in SOEs and POEs?



Source: ACGA Foreign Institutional Investor Perceptions Survey 2017

4. CG Diagnostics

We propose 60 questions to ask of companies. A selection:

1. If the company is a privately owned enterprise, does the state own a stake and/or have influence?
2. Is there clear accountability for each governance body inside the company (including the Party Committee, Board of Directors, etc)?
3. What substantive role does the nomination committee play in the process of nominating directors, especially independent directors?
4. Are there any obvious obstacles for supervisors to challenge the board or management? Does its role overlap with the audit committee?
5. Is there any incentive scheme for directors and managers that links remuneration to company performance?
6. Has the company set up an internal audit department? Does it report to the audit committee?

5. CG Watch 2018 – China

ACGA market CG scores

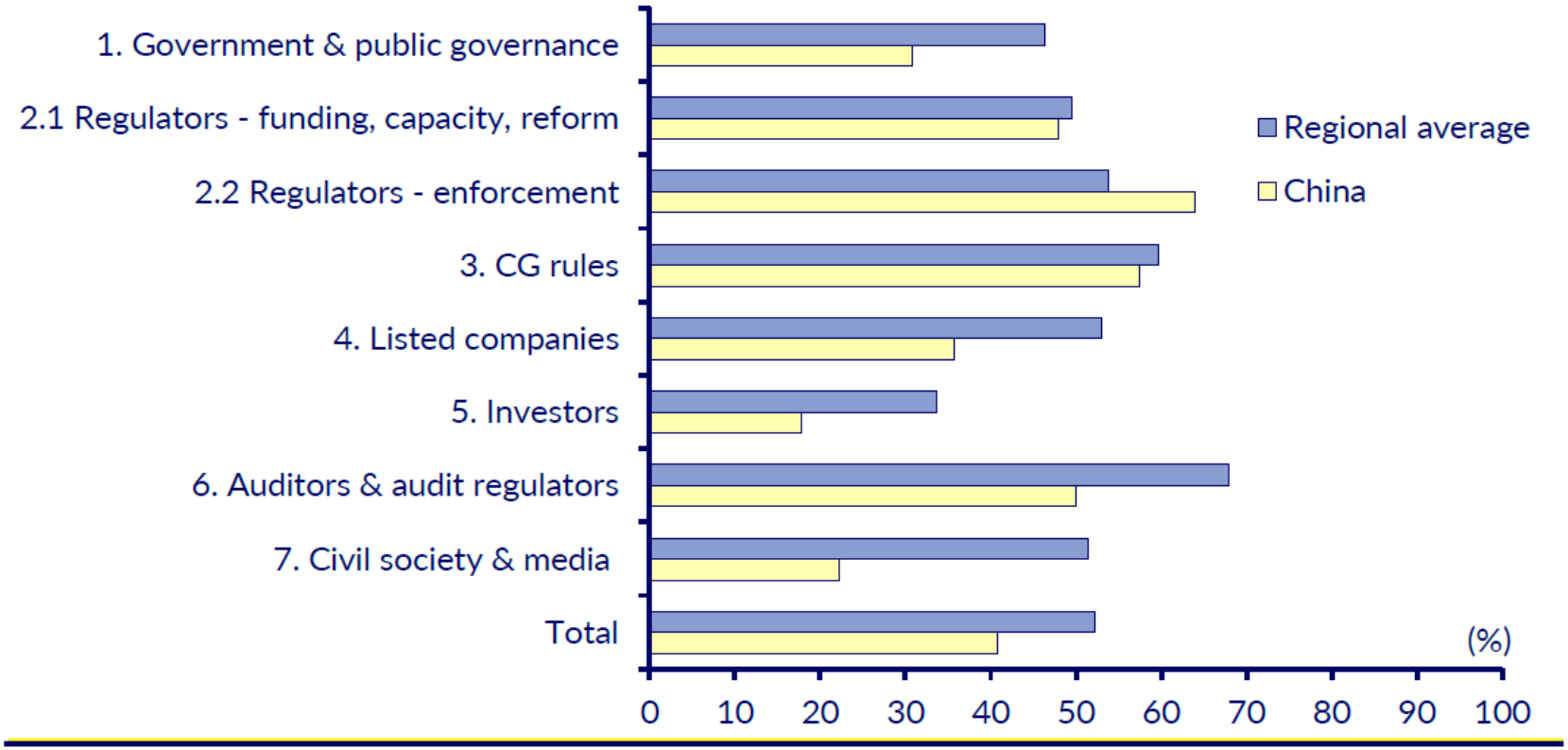
Market	Total (%)	Key CG reform themes and questions
1. Australia	71	Bank governance needs overhaul, time for a federal ICAC
2. Hong Kong	60	Going backwards on DCS, about to go forwards on audit regulation
3. Singapore	59	Going backwards on DCS, reform direction reflects contradictory ideas
4. Malaysia	58	Can new government rid the system of corruption and cronyism?
5. Taiwan	56	Moving forward, yet piecemeal reforms hinder progress
6. Thailand	55	Moving forward, yet corruption and decline in press freedom are concerns
=7. India	54	Bank governance needs overhaul, new audit regulator disappoints
=7. Japan	54	Heavy focus on soft law needs to be balanced with hard law reforms
9. Korea	46	Stewardship code gaining traction, but sadly so is DCS
10. China	**41**	**Reinforcement of Party Committees raises numerous questions**
11. Philippines	37	CG reform low on the government's priorities, direction unclear
12. Indonesia	34	CG reform low on the government's priorities, direction unclear

Source: ACGA

**CG Watch is a joint publication between ACGA and CLSA. ACGA carries out the market ranking survey.*

CG Watch 2018 – China breakdown

China CG macro category scores versusregional average (2018)



Source: ACGA

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