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Asian Corporate Governance Association (ACGA)

# "Best Practices and Excellence in Corporate Governance"

Presentation by:

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# Agenda

1. Definition, principles and history of corporate governance
2. Asian uniformity: convergence around common standards
3. Asian complexity: divergence due to history & culture
4. What do institutional investors in Asia want?
5. CBRC new guidelines on corporate governance
6. Conclusion: Some key questions

# Purpose of ACGA

- Formed in late 1999 to facilitate long-term systemic improvements in corporate governance in Asia and provide an independent voice on evolving policy, regulatory and best-practice issues.
- ACGA carries out research on corporate governance in Asia, engages with regulators and listed companies, and works with investors and companies to raise standards. A practical, hands-on focus.
- Incorporated in Hong Kong as a non-profit membership association and funded by more than 100 companies from Asia and around the world (mostly institutional investors). Other members include Asian listed companies, brokers, insurance, audit and law firms, and universities.
- For more details, see our website: [www.acga-asia.org](http://www.acga-asia.org)

# 1. What is corporate governance?

Sir Adrian Cadbury:

"The system by which companies are directed and controlled."

- Key distinction between directing a company and managing that same company. Managers cannot supervise themselves. They need to be accountable to directors and shareholders.

*(Sir Adrian Cadbury was a former chairman of Cadbury-Schweppes and chairman of The Committee on the Financial Aspects of Corporate Governance, which produced the seminal "Cadbury Report" in the UK in December 1992.)*



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# A performance definition

Mr. Teh Kok Peng:

> "Corporate governance is the enhancement of corporate performance through supervision, monitoring of management performance and ensuring the accountability of management to shareholders and stakeholders."

*(Mr. Teh Kok Peng, President, GIC Special Investments, Singapore. From a speech to ACGA's first annual conference, Hong Kong, November 1, 2001.)*



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# Common global principles and practices

| | OECD Principles | USA | UK | Germany* | Hong Kong | China# |
|---|---|---|---|---|---|---|
| **Directors should be accountable to shareholders** | Yes | Yes | Yes | Yes (and to employees) | Yes | Yes |
| **Board independence and supervision of management** | Yes | Yes | Yes | Yes | Yes | Yes |
| **Independent board committees (eg, audit, nomination)** | Yes (OECD recommend) | Yes | Yes | Yes | Yes | Yes |

*Answers refer to the Supervisory Board in Germany.

#In China, there is also a "board of supervisors" that formally supervises directors and senior managers.

# Brief history of corporate governance

Over the past 30 years, financial markets in the US, Europe and Asia have undergone significant corporate governance reform:

- **1970s:** Financial misreporting and corporate collapses in the United States led to "independent" outside directors and audit committees.
- **1980s:** Corporate collapses in the United Kingdom led to the "Cadbury Report", which sets basic guidelines on board independence. It has been hugely influential and widely copied.
- **1997:** The Asian Financial Crisis led to sweeping regulatory change in the region and adoption of many international standards.
- **2002:** The Enron fraud in the US led to reform of the external auditor's role, greater accountability for financial reports, greater board oversight, and stronger internal controls.
- **2007:** The Global Financial Crisis led to much criticism of "Western" CG, but also spurred further reform in board oversight, board diversity, the role of shareholders, regulation of risk.

# 2. Asian uniformity:
## Boards before the Asian Financial Crisis of 1997-98

| Country | CG Code on board governance? | Independent directors required? | Audit committees required? |
|---|---|---|---|
| **China** | No | No | No |
| **Hong Kong** | Minuscule | No | No |
| **India** | No | No | No |
| **Indonesia** | No | No | No |
| **Japan** | No | No | No |
| **Korea** | No | No | No |
| **Malaysia** | No | No | No |
| **Philippines** | No | No | No |
| **Singapore** | No | No | No |
| **Taiwan** | No | No | No |
| **Thailand** | No | No | No |

# The convergence towards international standards: Formal board structures after the Asian Financial Crisis

| Country | CG Code on board governance? | Independent directors required? | Audit committees required? |
|---|---|---|---|
| **China** | 2002 | Yes | Yes |
| **Hong Kong** | 1993/2004/2012 | Yes | Yes |
| **India** | 1999 | Yes | Yes |
| **Indonesia** | 2001 | Yes | Yes |
| **Japan** | Still no consensus | Still optional | Still optional |
| **Korea** | 1999/2003 | Yes | Yes (large firms) |
| **Malaysia** | 2000/2007/2012 | Yes | Yes |
| **Philippines** | 2002/2009 | Yes | Yes |
| **Singapore** | 2001/2005/2012 | Yes | Yes |
| **Taiwan** | 2002/2011 | For IPOs and larger firms | Soon mandatory for larger firms |
| **Thailand** | 1999/2006 | Yes | Yes |



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# 3. Asian complexity
## Legal and regulatory variation

| | Historic basis of company law | Board structure | Minimum # of INEDs |
|---|---|---|---|
| **China** | German | Dual (two boards) + Party C'tee | One-third |
| **Hong Kong** | English | Single | One-third |
| **India** | English | Single | 33-50% |
| **Indonesia** | Dutch | Two-tier | 30% |
| **Japan** | German | Dual (two "boards") | One INED or ISA[α] |
| **Korea** | German/ Japanese | Single or quasi dual | 25-50% |
| **Malaysia** | English | Single | Majority* |
| **Philippines** | American | Single | Two/20% |
| **Singapore** | English | Single | One third to majority* |
| **Taiwan** | German/ Japanese | Single or quasi dual | Two for certain companies |
| **Thailand** | French / mixed | Single | Three/one-third |

*Majority suggested only if the chairman is non-independent. Not a mandatory rule.

α "ISA" refers to an independent statutory auditor (kansayaku).

Source: ACGA research

# Asian complexity

## Corporate ownership and cultural variation

| | Dominant form of corporate ownership | State control of large caps? | Strength of family business culture |
|---|---|---|---|
| **China** | Concentrated | Extensive | Emerging |
| **Hong Kong** | Concentrated | Minimal | Strong |
| **India** | Concentrated | Some | Strong |
| **Indonesia** | Concentrated | Some | Strong |
| **Japan** | Dispersed, but control by management | Some | Weaker, but strong groups |
| **Korea** | Dispersed, but control by families | Some | Strong |
| **Malaysia** | Concentrated | Some | Strong |
| **Philippines** | Concentrated | Some | Strong |
| **Singapore** | Concentrated | Extensive | Strong among non-state firms |
| **Taiwan** | Dispersed, but control by families | Some | Strong |
| **Thailand** | Concentrated | Some | Strong |

Source: ACGA research

# Parallel tracks:
## CG reform in Asia is moving on two tracks

1. International rules dominate in areas where common standards are politically acceptable and implementable. For example:
   - Accounting and financial reporting standards
   - Shareholder meetings / voting
   - Regulation of external auditors

2. Local practices continue to dominate where common standards are more controversial and/or regulatory and shareholder influence is limited. For example:
   - Functioning of boards and board committees (as opposed to their formal structures, as seen earlier)
   - Dialogue with shareholders
   - Decisions on related-party transactions
   - Capital-raising exercises

The challenge for listed companies is to assess if their internal governance practices are effective and optimal.



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# 4. Key issues for institutional investors in Asia

**Quantitative**

- Financial reporting that is detailed and has integrity. No surprises.
- Immediate disclosure of material events.
- Clarity and controls on related-party transactions—*the* CG issue.
- Strong shareholder rights (eg, approval of major transactions).
- Fair systems of capital raising (ie, no excessive dilution).
- Transparent shareholder meetings, including voting by poll.
- Clarity on executive compensation policies.
- A policy/strategy on sustainability and disclosure of material risks.

**Qualitative**

- Independent and well-balanced boards.
- Meaningful "non-financial reporting" on internal governance.
- Open shareholder communications.



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# 5. CBRC New Guidelines on Corporate Governance

**China Banking Regulatory Commission (CBRC) new guidelines on corporate governance for commercial banks**

- Released late July 2013 after extensive earlier consultation
- Nine chapters, 136 articles
- Key emphasis on the following :
  - Sound organisation structure;
  - Clear functional delineations;
  - Scientific development strategies;
  - Good valuation principles and social responsibility;
  - Effective risk management and internal control;
  - Sensible framework for incentive and control; and
  - Sound information disclosure systems

N.B. The information set out here is for reference only and not intended to be formal advice – please consult your professional advisers !



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# CBRC New Guidelines

**Key common themes compared with CG-1 "Corporate Governance of Locally Incorporated Authorized Institutions" issued by HKMA (revised 2012)**

- Independent and well-balanced boards
- Time commitment of directors and training
- Specialised committees (audit committee, remuneration committee, nomination committee and risk management committee)
- Performance evaluation
- Risk management and internal control
- Internal and external audit
- Information disclosure
- Regulatory supervision

**Key difference in approach**

CBRC guidelines are more prescriptive and CG-1 more principle-based.



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# CBRC New Guidelines – Comparison 1

| Board matters | CBRC guidelines | HKMA CG-1 |
|---|---|---|
| **Board meetings** | Once a quarter | Preferably monthly, but not less than once every quarter |
| **Board composition** | One shareholder to nominate no more than one-third. | One-third or three directors to be INEDs |
| **Supervisory board** | Required by Company Law | Not applicable |
| **INED maximum term** | Six years | No specific limit |
| **Training** | Should attend training to know rights and obligations | Induction course and ongoing training |
| **Time commitment** | Attend 2/3 of meetings, INED 15(25) working days and no INED on two banks | Sufficient time and effort to fulfil responsibilities effectively |



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# CBRC New Guidelines – Comparison 2

| Board Committees | CBRC guidelines | HKMA CG-1 |
|---|---|---|
| **Nomination Committee** | In principle, INED should be person in charge | Chaired by Board Chairman or INED, majority INEDs. |
| **Audit Committee** | In principle, INED should be person in charge, appropriate proportion of INEDs | Comprise NEDs with majority (and Chair) as INEDs |
| **Risk Management Committee (RMC)** | Personal in charge to have risk management experience | All or majority NEDs with technical expertise |
| **Remuneration Committee** | In principle, INED should be person in charge | Comprise INEDS; if EDs there, then majority INEDs |
| **Other Committees** | Strategic and related-party transaction control committees | Executive, credit, asset and liability, and corporate governance committees |

# CBRC New Guidelines – Comparison 3

| Other relevant issues | CBRC guidelines | HKMA CG-1 |
| --- | --- | --- |
| **Board performance evaluation** | Comprehensive evaluation systems for board and supervisory board | Regular assessment of board effectiveness and individual director contribution |
| **Risk management and internal control** | Chief Risk Officer to report directly to board and RMC | Adequate risk management systems of eight internal risks |
| **Internal audit (IA) and external audit** | Chief Audit Officer and IA personnel appointed by board | IA directly reports to board. Board selects external auditors and approves appointment of Head of IA |
| **Information disclosure** | Financial, risks, CG and material disclosure | Banking (Disclosure) Rules and transparency |

# CBRC New Guidelines – Comparison 4

| Other relevant issues | CBRC guidelines | HKMA CG-1 |
|---|---|---|
| **Senior management & staff performance evaluation** | Establish evaluation indicators system for remuneration and subject to IA/external audit | Set performance objectives for key senior management and monitor performance on a continuing basis |
| **Reporting of legal/ regulatory violations** | Encourage employees to report violations | Policy for staff to channel to board concerns/violations |
| **Regulatory supervision** | CBRC including inspection and performance of directors/supervisors | HKMA annual supervisory review and approve directors/CE under fit and proper test |
| **Other aspects** | Corporate social responsibility and shareholders meeting | Less specific emphasis |



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# 6. Conclusion: Some key questions

- What does your bank understand by "corporate governance"?
- Do you seek to comply with regulations only or do you try to adopt "best practices" that may not yet be mandatory?
- Have you evaluated your bank's CG performance?
- How do your shareholders view your CG performance?
- How do you communicate the views of shareholders and other stakeholders to your board and/or senior management?
- Is your corporate governance culture optimal in the context of your long-term business strategy?
- Is your board composition optimal and sufficiently diverse given your long-term business strategy?
- Do you treat all your shareholders fairly?
- Are your ESG/sustainability policies aligned with your CG practices?



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