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Asian Corporate Governance Association (ACGA)

“Fostering Constructive Engagement between Companies and Investors”

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The Council of Experts Concerning the Follow-up of
Japan’s Stewardship and CG Codes
June 1, 2016

Agenda

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1. Core principles of corporate governance
2. Why we set up ACGA
3. The evolution of engagement: From formality to substance

Jamie Allen

1. Addressing conflicts of interest
2. Encouraging passive investors to engage

Appendices

1. A history of “comply or explain”
2. Trends in investor stewardship in Asia

Core Principles of Corporate Governance

1. Transparency
2. Accountability
3. Fair treatment of shareholders / stakeholders
4. Board independence / strategic role
5. Ethics and integrity

We believe these principles strengthen, not weaken, companies, capital markets and national economies over time.

Why we set up ACGA

- Founded in 1999 as a response to the Asian Financial Crisis of 1997-98.
- An independent, non-profit membership association dedicated to facilitating systemic and long-term improvements in corporate governance in Asia through independent research, advocacy and educational initiatives.
- We work with key constituencies—regulators, listed companies, institutional investors, accounting auditors and others—to bring about tangible improvements in governance practices.
- ACGA's growing membership base reflects increasing interest in corporate governance in Asia and globally—111 organisations; 1,200 individual contact persons receiving our material; and a global AUM of more than US\$24 trillion among our investor members.

The evolution of engagement: From formality to meaning

- Under company law, shareholders elect directors and, therefore, directors are accountable to shareholders as owners.
 - This formal legal framework, however, has not produced meaningful dialogue in most countries.
- Solution 1: The introduction of corporate governance codes and “Comply or Explain” – Designed to give companies choice and to explain their governance policies to shareholders/stakeholders.
 - This has led to an improvement in communication and relations generally, but still much box-ticking.
- Solution 2: Stewardship codes – Puts the onus on shareholders to play an active role. While directors are the primary stewards of a company, these codes recognise that shareholders also have an important stewardship role.
 - The goal is meaningful corporate communication (reports, websites, social media) and constructive dialogue.

Constructive dialogue and engagement

A new role for both company boards and management teams:

- Directors and executives need to be more open to engagement with shareholders and critical stakeholders.
- Delegation of communication to the investor relations function will continue, but cannot be the only avenue.
- Dialogue is an opportunity to gain new insights and independent views.

A new role for institutional investors:

- Dialogue with directors and senior management puts more onus on shareholders to understand the strategic challenges facing a company.
- New Government Pension Investment Fund survey indicates some companies complaining about investors who are seeking meetings to meet performance targets. Engagement must be meaningful.
- Governance recommendations also need to be carefully targetted and relevant to each company/sector—not just standardised best practices.
- CG / ESG specialists and portfolio managers need to present an integrated message to companies.

Addressing conflicts of interest - 1

Q: How can asset managers mitigate conflicts of interest over shareholder voting in Japan?

Possible solutions:

- 1. Independent committee to review voting:** An interesting idea, but the composition of the committee would influence its effectiveness. And from a practical perspective, would such people have the time during proxy season to review the vast number of voting decisions made by asset managers?
 - A materiality threshold or risk-based approach needed to ensure the committee focuses only on the most serious conflict-of-interest situations.
- 2. Disclosure of voting records:** Useful, but of limited value if only in aggregate form (ie, total votes For, Against, Abstain on all AGMs in a year).
 - A better solution would be company-level voting disclosure.

Addressing conflicts of interest - 2

3. **Clear voting policy:** Develop an internal guideline that has market credibility and allows asset managers to vote based on what is best for their clients and beneficiaries. This gives the asset manager a consistent standard on which to base voting decisions and should reduce arbitrary pressure from a parent.
 - This approach could be augmented by requiring asset managers to explain why they have voted for parent-company clients in conflict-of-interest situations.
4. **Parent-level disclosure:** Perhaps the FSA should require parent financial institutions to explain how they allow asset management subsidiaries to play their fiduciary role without interference?

ACGA Member Practice

Total number of ACGA investor members	75
Number (percentage) that have a voting policy	63 (84%)
Number (percentage) that disclose voting records down to the company level	48 (64%)

Example:

PROXY VOTING PROCEDURES AND PRINCIPLES

The following summarizes the internal operating procedures for voting proxies of portfolio companies held by the American Funds. These Proxy Voting Procedures and Principles ("Principles"), which have been in effect in substantially their current form for many years, are disclosed in accordance with a U.S. Securities and Exchange Commission requirement that all investment companies (mutual funds) make public how they conduct their proxy voting process.

Abbott Laboratories

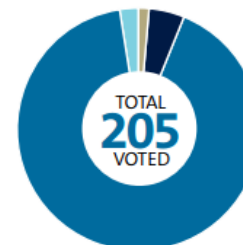
Ticker	Security ID:	Meeting Date	Meeting Status			
ABT	CUSIP 002824100	04/24/2015	Voted			
Meeting Type	Country of Trade	Proponent	Mgmt Rec	Vote Cast	For/Agnt	Mgmt
Annual Issue No.	United States Description					
1.1	Elect Robert J. Alpern	Mgmt	For	For	For	
1.2	Elect Roxanne S. Austin	Mgmt	For	For	For	
1.3	Elect Sally E. Blount	Mgmt	For	For	For	
1.4	Elect W. James Farrell	Mgmt	For	For	For	
1.5	Elect Edward M. Liddy	Mgmt	For	For	For	
1.6	Elect Nancy McKinstry	Mgmt	For	For	For	
1.7	Elect Phebe N. Novakovic	Mgmt	For	For	For	
1.8	Elect William A. Osborn	Mgmt	For	For	For	
1.9	Elect Samuel C. Scott III	Mgmt	For	For	For	

AMP CAPITAL BLUE CHIP FUND

Proxy Voting Disclosure
Financial Year 2014-2015

AMP CAPITAL 

VOTING
AMP CAPITAL
BLUE CHIP FUND



Number of resolutions:

- Abstain **3** (2%)
- Against **10** (5%)
- For **187** (91%)
- Not authorised to vote* **5** (2%)

* This includes votes at AMP Limited meetings and stock issues in which AMP Capital participated.

ASX CODE	COMPANY NAME	MEETING DATE	RECORD DATE	MEETING TYPE	PROPOSER	PROPOSAL NO	TYPE OF PROPOSAL	VOTE	PROPOSAL DETAIL
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	2	Director Election	For	RE-ELECTION OF MR HK MCCANN AS A VOTING DIRECTOR
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	3	Director Election	For	RE-ELECTION OF MS DJ GRADY AS A VOTING DIRECTOR
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	4	Director Election	For	ELECTION OF MR GR BANKS AS A VOTING DIRECTOR
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	5	Director Election	For	ELECTION OF MRS PA CROSS AS A VOTING DIRECTOR
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	6	Director Election	For	ELECTION OF MS NM WAKEFIELD EVANS AS A VOTING DIRECTOR
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	7	Executive Remuneration - Approve the remuneration report	For	TO ADOPT THE REMUNERATION REPORT OF MACQUARIE FOR THE YEAR ENDED 31 MARCH 2014
MQG	MACQUARIE GROUP LTD	24-Jul-14	22-Jul-14	Annual General Meeting	Management	8	Executive Remuneration - Approve incentive plan	For	APPROVAL OF EXECUTIVE VOTING DIRECTOR'S PARTICIPATION IN THE MACQUARIE GROUP EMPLOYEE RETAINED EQUITY PLAN (MEREPE)
WPL	WOODSIDE PETROLEUM LTD	1-Aug-14	30-Jul-14	Ordinary General Meeting	Management	1	Capital restructure	Against	BUY-BACK OF SHELL'S SHARES IN THE COMPANY
TCL	TRANSURBAN GROUP	9-Oct-14	7-Oct-14	Annual General Meeting	Management	2.a	Director Election	For	TO RE-ELECT A DIRECTOR OF THL AND TIL-NEIL CHATFIELD
TCL	TRANSURBAN GROUP	9-Oct-14	7-Oct-14	Annual General Meeting	Management	2.b	Director Election	For	TO RE-ELECT A DIRECTOR OF THL AND TIL-ROBERT EDGAR
TCL	TRANSURBAN GROUP	9-Oct-14	7-Oct-14	Annual General Meeting	Management	3	Executive Remuneration - Approve the remuneration report	For	ADOPTION OF REMUNERATION REPORT (THL AND TIL ONLY)
TCL	TRANSURBAN GROUP	9-Oct-14	7-Oct-14	Annual General Meeting	Management	4	Executive Remuneration - Issue of options/ZEPs	For	GRANT OF PERFORMANCE AWARDS TO THE CEO (THL, TIL AND THT)
TLS	TELSTRA CORPORATION LTD	14-Oct-14	10-Oct-14	Annual General Meeting	Management	3.a	Director Election	For	ELECTION OF DIRECTOR: MR PETER HEARL
TLS	TELSTRA CORPORATION LTD	14-Oct-14	10-Oct-14	Annual General Meeting	Management	3.b	Director Election	For	RE-ELECTION OF DIRECTOR: MR JOHN MULLEN
TLS	TELSTRA CORPORATION LTD	14-Oct-14	10-Oct-14	Annual General Meeting	Management	3.c	Director Election	For	RE-ELECTION OF DIRECTOR: MS CATHERINE LIVINGSTONE AO
TLS	TELSTRA CORPORATION LTD	14-Oct-14	10-Oct-14	Annual General Meeting	Management	4	Executive Remuneration - Issue of options/ZEPs	For	GRANT OF PERFORMANCE RIGHTS
TLS	TELSTRA CORPORATION LTD	14-Oct-14	10-Oct-14	Annual General Meeting	Management	5	Executive Remuneration - Approve the remuneration report	For	REMUNERATION REPORT
CSL	CSL LTD	15-Oct-14	13-Oct-14	Annual General Meeting	Management	2.a	Director Election	For	TO RE-ELECT PROFESSOR JOHN SHINE AS A DIRECTOR
CSL	CSL LTD	15-Oct-14	13-Oct-14	Annual General Meeting	Management	2.b	Director Election	For	TO RE-ELECT MS CHRISTINE O'REILLY AS A DIRECTOR
CSL	CSL LTD	15-Oct-14	13-Oct-14	Annual General Meeting	Management	2.c	Director Election	For	TO RE-ELECT MR BRUCE BROOK AS A DIRECTOR
CSL	CSL LTD	15-Oct-14	13-Oct-14	Annual General Meeting	Management	3	Executive Remuneration - Approve the remuneration report	For	ADOPTION OF THE REMUNERATION REPORT
CSL	CSL LTD	15-Oct-14	13-Oct-14	Annual General Meeting	Management	4	Executive Remuneration - Issue of options/ZEPs	For	GRANT OF PERFORMANCE OPTIONS AND PERFORMANCE RIGHTS TO MR PAUL PERREAULT, THE MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER

Market Rules / Practices on Institutional Voting

Market	Disclose voting policy?	Disclose voting records?	Disclose voting to company level?
United States	✓	✓	✓
Australia	✓	✓	✓
India	✓	✓	✓
Korea	✓	✓	×
Malaysia	✓	✓	×
Thailand	✓ (Follow industry standard)	✓ (Industry aggregate)	×

Encouraging passive investors to engage

Incorrect to say that passive investors have no role in CG:

1. Passive investors cannot sell, hence engagement is one of the few ways to deal with governance problems in companies.
2. Passive investors are long-term shareholders by definition (and often with long-term liabilities), hence have an incentive to enhance the value of their holdings.
3. Numerous asset owners around the world are passive investors, yet have voting policies, actively vote shares, and increasingly engage.
4. Given large holdings, passive investors must be selective in choosing companies to engage with.

Appendix 1: The emergence of “Comply or Explain”

- **United Kingdom, early 1990s:** Corporate collapses, concerns over auditing and executive pay led to the “Cadbury Report”, a seminal document on the “financial aspects of corporate governance”, published in December 1992. Hugely influential and widely copied.
- The Cadbury Report produced a short Code of Best Practice, which companies were expected to follow or “give reasons for any areas of non-compliance”. The London Stock Exchange created a continuing listing obligation to this effect (ie, a disclosure obligation).
- Cadbury argued that “compliance with a voluntary code coupled with disclosure, will prove more effective than a statutory code. It is directed at establishing best practice, at encouraging pressure from shareholders to hasten its widespread adoption, and at allowing some flexibility in implementation”.

(Underlining added)

Implementation of “Comply or Explain”

Cadbury envisages four essential actors in any “comply or explain” regime:

- 1. Listed company boards:** They can choose to comply with the best practices in the Code or explain why they do not. But they should do so in spirit and substance, not form.
 - 2. Regulators:** They must ensure that the Code’s disclosure obligation is taken seriously by companies and take enforcement action under the Listing Rules if it is not (eg, a reprimand).
 - 3. Shareholders:** Since they elect directors, shareholders have a responsibility as owners to hold boards accountable in their implementation of the Code.
 - 4. Auditors:** They are formally appointed by shareholders and must ensure the financial reports of companies are true and fair, and that their audit is done with professional objectivity. Cadbury also envisaged auditors would review board compliance with the Code.
- These four parts are interconnected. Drop any one or more and the system loses integrity and cohesion.

Early challenges

- **Hampel Committee, January 1998:** Formed in late 1995 to review the implementation of the Cadbury Committee's recommendations and those of a subsequent committee addressing remuneration—the Greenbury Committee.
- Hampel reported that companies often felt shareholders or their advisers treated the Codes as “sets of prescriptive rules”, which led to box-ticking.
- Hampel also criticised some companies for taking the “easier option” of box-ticking, rather than “the diligent pursuit of corporate governance objectives”.
- And, presciently, he argued against lower standards for smaller companies—a controversial issue still today.

“Any distinction by size would be arbitrary; more importantly, we consider that high standards of governance are as important for smaller listed companies as for larger ones.”

CG Codes in Asia-Pacific

Market	CG Code adoption	Amendment	“Comply or explain”?
Australia	2003	2007, 2010, 2014	Yes
China	2002	-	No (mandatory)
Hong Kong	2004	2012	Yes
India	1999	2014	Yes
Indonesia	2001	2006, 2015	No / Yes
Japan	2015	-	Yes
Korea	1999	2003, 2016?	No (voluntary) / Yes?
Malaysia	2000	2007, 2012	Yes
Philippines	2002	2009	No (mandatory)
Singapore	2001	2005, 2012	Yes
Taiwan	2002	2011, 2015	Yes
Thailand	1999	2002, 2006, 2012	Yes

CG Codes in selected European countries

Market	CG Code adoption	Amendment	Code compliance: Mandatory or Comply/ explain?
Germany	2002	2003 to 2015 (11 revisions)	Both
Belgium	2004	2009	Both
Spain	2006	2013, 2015	Voluntary/Comply or explain
Finland	2004	2008, 2010	Mandatory
France	2003	2007 to 2015 (5 revisions)	Voluntary/Comply or explain
Italy	2006	2010 to 2015 (4 revisions)	Voluntary/Comply or explain
Netherlands	2003	2008	Both
UK	1998	2003 to 2016 (6 revisions)	Both
Sweden	2005	2008, 2010, 2015	Mandatory

Source: AMF, France

How does Asia measure up?

- Although the Cadbury Report (and later the “UK Combined Code”) has had a profound impact on Asian CG Codes—some largely copying it and/or the OECD Principles—the performance of the four actors has much room for improvement:
 - **Company** explanations often verge on the formulaic (“boilerplate”).
 - **Regulators** rarely take enforcement action for poor disclosure.
 - **Shareholder** ability to hold boards accountable is limited.
 - **Audit** quality hard to assess, lack of professional scepticism.
- This has implications for Korea: Governance reform needs to ensure that the right cultural incentives and institutional structures are in place if the amended CG Code is to achieve its objectives.
- It is worth noting that even in the UK, these processes are far from perfect. A 2013 review found that many companies struggled to articulate why they deviated from some aspects of the Code.

What “comply or explain” is not

- There seems to be a view that “comply or explain” means either ‘comply and simply state that you have complied’ or ‘do not comply and provide an explanation as to why you have not’.
- However, companies need to provide some explanation to shareholders even when they do comply. How are they implementing the principles and guidelines in a Code, and what have been the results of this action?
- Hence, “comply or explain” should really be written: “comply and explain, or do not comply and explain”.

Appendix 2: Stewardship Codes

- UK “Stewardship Code” (2010, 2012)
- Netherlands “Best Practices for Engaged Share Ownership” (2011)
- Japan “Stewardship Code” (2014)
- Malaysia “Code for Institutional Investors” (2014)
- Hong Kong “Principles of Responsible Ownership” (2016)
- Taiwan “Stewardship Principles for Institutional Investors” (2016)

Coming up in Asia:

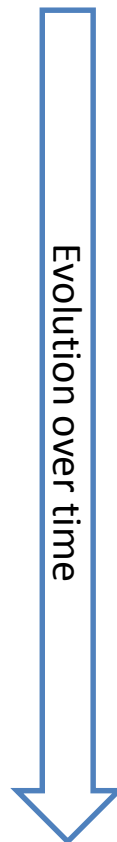
- Singapore
- Thailand
- Korea

“Stewardship” before stewardship codes

- **1980s/1990s:** State pension funds in the US began to develop policies and strategies on corporate governance. Voting shares, highlighting poor performers (CalPERS).
- **1990s/2000s:** Pension funds and asset managers in the UK started to follow suit, with voting/CG policies and active voting.
- **2000s:** Superannuation (pension) funds in Australia became actively involved in corporate governance issues and voting.
- **2005:** National Pension Service in Korea revised its voting policies.
- **Mid-2000s:** ACGA members actively voting in this region.
- **2010:** Employees Provident Fund, Malaysia, published its internal CG Principles and Voting Guidelines.

Global investor approaches to Asian companies: past 10+ years

	Comment
“Passive”	Only invest in companies, passive as shareholder
“Automatic voters”	Some shareholder responsibilities, institutions starting to vote, but somewhat automatically
“Informed voters”	Investors who take a focussed and risk-based approach as shareholder (e.g. voting on all or selected parts of their shareholdings)
“Light touch engagement”	Investors starting to exercise their rights and responsibilities as shareholders (e.g. undertake or participate in letter campaigns or conference calls with companies)
“Active owners” (Stewards)	Act as owners of the company (e.g. building long term relationship, engagement strategy, advising etc.)



Modern “stewardship” – Post 2010 / GFC

- Institutional investors (pension funds and investment managers) are under increasing pressure to act as “stewards” of the capital they invest and of the assets they invest in (through holding the board to account).
- What does this mean in practice?
 - Investors need to take “environmental, social, and governance” (ESG) factors into account when investing.
 - They need explicitly to engage in “purposeful dialogue” with company management/directors.
- The Global Financial Crisis (GFC) has led to enormous pressure on institutional investors to be better stewards. Great criticism that many of them ignored CG and ESG factors before the GFC, leading to large investment losses.

Key Questions & Issues

1. Directors are the primary stewards of a company. How should shareholders exercise their “stewardship” function most effectively? What is the right relationship between the two groups?
2. Investor stewardship comprises two parts: stewardship of the capital with which they have been entrusted (the “fiduciary duty” concept); and stewardship over the companies in which they invest (the “ownership concept”). Both are critical. Yet most of the discussion and focus is on the latter.
3. How do institutions manage and disclose the conflicts of interest they face?
4. How do state pension/investment institutions manage the political interference they face?
5. Should pension funds (“asset owners”) drive stewardship, with investment funds (“asset managers”) playing a secondary role?

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