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# Asian Corporate Governance Association (ACGA)

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## “A Preview of CG Watch 2005”

Presentation by  
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at the  
OECD 2005 Asian Corporate Governance Roundtable  
September 8, 2005, Bali

# Agenda

1. Methodology of “CG Watch 2005”
2. Country issues
3. Areas of strength/progress

# CG Watch 2005

- 10 markets: China, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand
- More than 400 companies: top 30-50 companies covered by CLSA for its institutional clients in each of the 10 markets
- ACGA works with CLSA on the country rankings:
  - Develop scoring methodology and template of questions (which CLSA comments on)
  - Work closely with CLSA research heads in each market to answer the template
  - Ensure consistency of approach across the 10 markets

# 1. Methodology

Improved country scoring template:

1. Questions sharpened, more precise
2. New questions added, some deleted (total increased from 63 in 2004 to 78 in 2005)

3. An additional level of scoring:

<u>2004:</u>	<u>2005:</u>	<u>Points:</u>
Yes	Yes	1
No	No	Zero
Somewhat	Somewhat	0.5
	Marginally	0.25

- A lot of answers in the grey zone. Need to refine scoring to take this into account.

# Question categories and changes

1. CG Rules and Regulations: (19 questions)  
New focus on audit committees, pre-emption rights, shareholder meetings and rule implementation.
2. Enforcement (public + private): (18 questions)  
New focus on insider trading, disclosure of enforcement action by regulator, exercise of voting rights by investors.
3. Political and Regulatory Environment: (10 questions)  
More focus on actual autonomy of regulator, availability of information on laws & regulations, range of legal remedies.
4. IGAAP (Accounting and Auditing): (13 questions)  
Focus on practices as well as rules; information on standards.
5. CG Culture: (18 questions)  
New focus on large-caps (vs the rest), mid caps, split between chairman and CEO, internal controls, voluntary voting by poll.

## 2. Country issues

Country <sup>1</sup>	2000	2001	2002	2003 <sup>2</sup>	2004 <sup>3</sup>
Singapore	7.5	7.4	7.4	7.7	7.5
Hong Kong	7.1	6.8	7.2	7.3	6.7
India	5.6	5.4	5.9	6.6	6.2
Malaysia	3.2	3.7	4.7	5.5	6.0
Korea	5.2	3.8	4.7	5.5	5.8
Taiwan	5.7	5.3	5.8	5.8	5.5
Thailand	2.8	3.7	3.8	4.6	5.3
Philippines	2.9	3.3	3.6	3.7	5.0
China	3.6	3.4	3.9	4.3	4.8
Indonesia	2.9	3.2	2.9	3.2	4.0

1. Ranked in descending order according to 2004 score. Scores out of 10.
2. First year in which ACGA collaborated with CLSA.
3. Introduced more rigorous scoring methodology in 2004.

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

# Some general remarks

- Most country scores in 2005 trending downwards. Why?
- It is not due to a decline in objective corporate governance standards or less effort on the part of regulators.
- Rather, a result of factors such as:
  - Even more rigorous methodology in 2005 than 2004.
  - Certain weaknesses in the detail of laws and regulations have become more apparent.
  - Gap between national accounting policies and practices.
  - Some major CG best practices not gaining traction among listed companies.

# Rules and regulations: Issues

- Quarterly reporting: mandatory, but not always sufficient.
- Audit committees: mandatory, but not always implemented.
- Audit committees: questions as to whether they are functioning independently and effectively.
- Securities laws not deterring insider trading and market manipulation.
- Pre-emption rights of investors not firmly protected.



# Enforcement: Issues

- Perception in many markets that regulators do not treat companies equally.
- Limited disclosure by regulators of their enforcement track records (although some countries are impressive).
- Limited regulatory track record against insider trading.
- Limited voting by institutional investors (although on the rise).

# Political and regulatory environment: Issues

- Are securities regulators sufficiently autonomous from government?
- Lingering questions over regulatory structure, especially with regard to stock exchanges.
- Unavailability of laws and regulations in English in some markets.
- Ineffective access to courts—high costs, limited legal remedies.

# CG Culture: Issues

- Does the average listed company believe corporate governance is of value? (“No” or “marginally” in most markets.)
- Are large caps following the spirit of CG rules? (50-50)
- How many companies have truly independent chairmen? (Very few)
- Is disclosure of internal controls by listed companies sufficient? (“No” or “marginally”)

### 3. Areas of strength: Rules

- Considerable improvement in financial reporting standards in most markets.
- Rules on disclosure of “material transactions” and substantial ownership generally good.
- Voting by poll moving onto the agenda, if not yet a rule in most markets. Voluntary voting by poll in some markets (notably Hong Kong).
- Legislative improvements planned in some countries (eg, China is planning to amend its Company Law).

# Areas of strength: Enforcement

- Recognition that regulators are investing more effort in enforcement. Increase in investigations, prosecutions, settlements.
- Increased supervision of intermediaries (eg, brokers, advisors) and IPOs (ie, quality of prospectus disclosure).
- Anecdotally, some increase in institutional investor voting (although no statistics available).

## Areas of strength: Political/regulatory

- Stock exchanges have become extremely useful sources of information on listed companies. Most now provide extensive online databases of issuer reports, announcements and notices—although not necessarily in English!
- The degree of media freedom to report on corporate governance issues does appear to be on the rise.

## Areas of strength: CG culture

- In addition to the large caps, a small group of mid-caps is gaining a reputation for good governance.
- Remuneration of independent directors is on the rise.
- Improvement in internal controls and the practice of risk management.
- Some brave companies are starting to appoint independent chairmen!

# Some recommendations


- Review problematic rules and procedures with market participants (eg, pre-emption rights, voting systems, shareholder meetings). Ask the market what it thinks is important. Hard for market discipline to function on an unlevel playing field.
- If mandatory rules are sound (eg, audit c'tees), ensure they are: A) implemented; and then B) properly implemented!
- Improve disclosure of enforcement track record. Better enforcement = higher trust in the stock market.
- Ensure all major laws and regulations are translated and easily accessible.
- Ask companies and investors to rate the value of different best practices/CG rules. What works? What doesn't?




# ACGA 5<sup>th</sup> Annual Conference: Oct 14, 2005

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