



# The 2008 Asian Roundtable on Corporate Governance

## Conclusions and Key Findings Note

Shangri-La Hotel - Kowloon  
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In partnership with the Government of Japan

Co-hosted by:



1. While we have experienced convergence in corporate governance standards over the last decade, implementation and enforcement still require adaptation to local conditions. At its latest annual meeting, held in Hong Kong, China on 13-14 May 2008, the Asian Roundtable on Corporate Governance focused on ways to ensure effective implementation. The meeting was co-hosted by the Hong Kong Securities and Futures Commission, the Institute of Certified Public Accountants, the Chartered Secretaries, and the Institute of Directors, with the support of the Japanese government.

2. The meeting built on the work started at the Asian Roundtable meeting in Singapore last year, focused on how best to translate the policy objectives outlined in the 2003 *White Paper on Corporate Governance in Asia* into concrete improvements on the ground. To address the local context and effective implementation of international standards, the meeting focused on monitoring abusive related party transactions, which is one of the biggest corporate governance challenges in Asia. Senior officials, business leaders and scholars from Asia and OECD countries also engaged in an animated discussion on recent corporate governance developments and how to reach beyond box-ticking as well as dispelling major corporate governance “myths”.

3. The level of participation and the media coverage confirmed that the Asian Roundtable plays a pivotal role as a platform for the Asian corporate governance policy dialogue. Below are a few highlights:

- Participants decided to develop a **practical guide to monitoring abusive related party transactions**. To curb abusive related party transactions is a challenge in numerous emerging markets. And the document is expected to be of relevance and use also outside of Asia. A special task-force was established to develop a first draft, to be discussed in India at the end of this year, and presented to the OECD Steering Group on Corporate Governance spring 2009. The plan is to finalize the guide when the Asian Roundtable meets in the Philippines end June 2009.
- The quality of the meeting was also manifested by **high-level participation**. OECD countries were more active than ever. Securities regulators from Australia, France, Italy and Poland participated. The Chair of the OECD Steering Group played a significant role. Securities regulators and stock exchanges were actively engaged and committed. Business sector representatives included the CEO of the Tokyo Stock Exchange.
- The topics discussed attracted considerable **media attention**, including a live interview on CNBC by the Chair of the OECD Steering Group on Corporate Governance, an article in the Financial Times (see attachment) and local media.

### Session 1: Corporate Governance in Hong Kong “Beyond Box Ticking”

4. The discussion addressed Hong Kong’s experience in measuring, monitoring and enhancing the effectiveness of its corporate governance system going ‘beyond box ticking’. Participants discussed how various bodies in Hong Kong have sought to examine whether the corporate governance measures in place lead to effective adoption of good corporate governance practices, what drives changes in corporate

governance practices and what implementation measures are essential to ensure that there is compliance in substance not just in form. This session also provided the opportunity to discuss a wide range of interrelated issues applicable to many Asian jurisdictions, e.g. the challenges involving substance over form, regulatory burden, and the principles-based vs. rules-based approach.

5. The main drivers of recent corporate governance developments in Hong Kong (and arguably in other jurisdictions) are the convergence to global standards on financial reporting and regulatory reforms linked with multiple listings. One of the challenges in Hong Kong is a growing culture of compliance with increasing regulatory requirements, which have led to a ‘box-ticking’ approach. Some participants stressed the risk of such a regulatory burden while welcoming some on-going convergence with global standards, such as financial reporting.

6. Participants also discussed the *principles-based vs. rules-based approach*. The former was supported based on the understanding that market discipline works. Research in Hong Kong was presented, showing that a positive and statistical relationship exists between stock returns and the quality of corporate governance, although market reactions to changes in the quality of corporate governance can be variable. The study found that stock returns were less sensitive to an improvement in corporate governance practices and more responsive to deterioration.

### **Session 2: The Corporate Governance “Myth Busters”**

7. Participants debated corporate governance myths to consider the validity of some key concepts and the underlying assumptions. For example, (1) Do independent directors really add value? And (2) Do shareholders, including institutional investors, really care about corporate governance? As expected, the session generated a very lively and frank discussion.

8. Despite remaining concerns, participants stressed that independent directors have started to gain some ground and to challenge controlling shareholders in Asia. The discussion also evolved around the importance of “3Cs” of independent directors: i.e. competency, character, and commitment. Merely tightening the definition of independence does not mean that directors are independent minded or can ensure efficient boards.

9. Participants discussed shareholder behaviour, noting that most institutional investors usually choose to sell their shares rather than pay the costs involved in challenging management. This may be an economically optimal decision for individual investors but not for shareholders as a whole. Activist hedge funds can sometimes be the exception but generally speaking, shareholder activists still face difficulties in obtaining co-operation and commitment from other shareholders.

10. The discussion pointed out the need to look at the corporate governance system as a whole and its complementarities. In essence, participants agreed that there is no single silver bullet that fixes everything. For instance, an approach that may be effective in a country with a strong judicial system cannot work in a country with weak courts. A wide range of fundamentals should be considered in order to effectively improve corporate governance in any jurisdiction.

### **Session 3: Break Out Sessions on “Related Party Transactions”**

11. The *OECD Principles of Corporate Governance* stress how important it is for the market to know whether a company is being run in the interests of all its investors, and not only in the interest of controlling entities. To this end, it is essential for the corporate governance framework to require timely, comprehensive and public disclosure of material related party transactions. This includes whether they have been executed at arm’s length on normal market terms.

12. In a number of Asian jurisdictions, the disclosure of related party transactions is already a legal requirement and/ or part of accounting standards. Disclosure requirements can include the nature of the relationship where control exists and the nature/ amount of transactions with related parties, either individually or on a grouped basis. Transactions involving the controlling shareholders (or their close family, relations etc) either directly or indirectly, are potentially the most difficult types of transactions to identify. In this respect, it is vital to understand whether the definition of related party is sufficiently broad (and not exceedingly broad) to capture the kinds of transactions that present a risk for potential abuse, if it is not easily avoided and effectively enforced.

13. Roundtable participants split up into smaller groups to discuss: public disclosure; approval by boards and shareholders, and fiduciary duties of boards and shareholder's redress. The basis for the discussion was an issues paper and background papers on China, India and Indonesia as the three Asian Enhanced Engagement countries. Moderators presented key outcomes in the following three sessions.

#### **Sessions 4: Related Party Transactions: Public Disclosure in Asia**

14. The discussion began with a presentation of the French experience. In France, related party transactions are disclosed in annual and semi-annual reports, and audited. Disclosure includes a declaration of personal transactions by directors and their relatives with shares in the company. In addition, listed companies are required to annually disclose information on corporate governance and internal control procedures. The chairman of the board of directors is required to make an annual report to shareholders on "how the board prepares and organises its work and on the internal control procedures implemented by the company".

15. Participants stressed that related party transactions are at the forefront of transparency issues. Most Asian jurisdictions have a basic legal and regulatory framework in place to monitor related party transactions with no significant difference in the definition. Some participants suggested that further expansion of the definition might be considered to mitigate abusive related party transactions while taking regulatory costs into consideration.

16. With respect to the threshold for disclosure of related party transactions, participants debated whether all transactions should be disclosed, if a threshold should be set what the minimum amount should be, and how recurrent related party transactions should be treated. The concept of control and materiality seems critical to consider, not only with regard to the nature of the relationship but also the amount of the transaction. Participants stressed that further discussion on (1) the thresholds (2) improving the function of external auditors as providers of material information and (3) enforcement of disclosure is critical.

#### **Session 5: Related Party Transactions: Approval by Boards and Shareholders in Asia**

17. Prior to discussing the topic, Japan raised some issues that remain corporate governance challenges. In particular, it was noted that Japanese boards still has a limited number of independent directors and most executives consider that non-executive directors lack company-specific knowledge. It was also highlighted that stock exchanges can play a greater role in promoting good corporate governance, particularly to improve disclosure and enforcement. For example, if directors could receive material information prior to board/committee meetings, this could help them exercise their functions more effectively.

18. Participants noted that since it is difficult to set a threshold for disclosure to the board of recurring transactions, this issue should be discussed further. It was also suggested that guidelines should be developed on what transactions need to be approved by the board. While all jurisdictions have regulations on approval mechanisms, though there is still room for improvement, the key challenge is

enforcement. It was suggested that securities regulators should obtain increased capacity to investigate and sanction in this area. Also, whistle-blower protection mechanisms could be established. Participants discussed whether directors should be required to disclose their interests and abstain from voting, just like interested shareholders are required in most jurisdictions.

19. Participants then discussed a Korean case study of an abusive related party transaction, its implications as well as the role of independent directors and/or regulator. A key conclusion is that an effective monitoring mechanism was necessary and that the mindset of directors is critical.

### **Session 6: Related Party Transactions: Fiduciary Duties of Boards and Shareholder's Redress in Asia**

20. The discussion highlighted that the legal provisions dealing with related party transactions in most Asian jurisdictions are generally sound. However, without the proper behavior, attitude and commitment, the law will have little impact. Participants stressed that the focus should not only be on improving regulations, but also changing the mindset of shareholders, board members, practitioners, policy-makers and regulators. The law needs to be clear and principles-based. However, it also needs to provide adequate detail in the form of specific guidelines/interpretations. In order to improve understanding of fiduciary duties and change directors' behavior, appropriate penalties or sanctions and effective enforcement mechanisms are also essential.

21. With regard to shareholders' redress, participants observed little legal action in Asia because litigation is so expensive, time-consuming and with a heavy burden of proof. It was stressed that such barriers should be lowered. In order to improve enforcement, regulators and stock exchanges would need to have additional investigatory power and ability to apply sanctions. Moreover, alternative mediation channels could be considered for settling disputes. Shareholders need to be educated and awareness of shareholders rights should be raised.

22. Participants suggested that disclosure can be an effective tool for monitoring by shareholders, as well as access to relevant information. However, reporting requirements should not distract managers from their main objective which is to create shareholder value.

### **Session 7: Concluding Session– Implementing the OECD Principles of Corporate Governance: New OECD Work and the Way Ahead**

23. The discussion covered how best to implement the OECD Principles in a rapidly evolving environment. Recent initiatives by the OECD Steering Group on Corporate Governance were presented, notably to systematically monitor and analyse implementation issues and interpret the Principles in new situations, such as “alternative investors” (e.g. private equity, activist hedge funds and sovereign wealth funds). The OECD is now examining policy issues that include: controlling conflicts of interest, ensuring a transparent takeover market and co-operation between shareholders. Complementing this policy work, the OECD has also been developing a practical guide on the use of regulatory impact assessment techniques in the area of corporate governance.

24. Australia shared a recent study on shareholder participation and engagement to explore where improvements could be made. They also started discussion on non-binding shareholder votes, such as regarding remuneration, generally believed to be an effective tool. Another issue that is being explored is “clarifying corporate offences.” As existing laws may not clearly state what is expected of directors, directors are often said to be overly cautious when making business decisions.

25. The concluding remarks focused on OECD's Asian Network on Corporate Governance of SOEs and the Global Network on Corporate Governance of SOEs. The Asian Network is expected to finalise its

own White Paper on Corporate Governance of SOEs later this year. The Global Network will hold its second meeting in 2009. Participants reiterated the importance of improving corporate governance of SOEs in Asia. They also welcomed a new initiative launched by APEC on corporate governance, which uses the OECD Principles and OECD Guidelines on Corporate Governance of SOEs as key references.

26. Moving ahead, in addition to the focus on related party transactions, participants noted an interest in exploring the following issues in 2009: the role of stock exchanges in promoting better corporate governance, regulatory impact assessments, the market for corporate control and acting in concert.