



The 2007 Asian Roundtable *on* Corporate Governance

SYNTHESIS NOTE

**Singapore
27-28 June 2007**

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DRAFT Conclusions and Key Findings Note

The Asian Roundtable on Corporate Governance¹ met in Singapore on 27 and 28 June 2007. It was hosted by the Singapore Exchange Limited (SGX) and Singapore Institute of Directors (SID), and supported by the Japanese government. The discussion among senior officials, business leaders and scholars from Asia and OECD countries addressed: a showcase session on corporate governance since the 1997 financial crisis in Asia; current reforms in Singapore; Methodology for Assessing the Implementation of the OECD Principles on Corporate Governance (“OECD Methodology”); shareholder activism, proxy voting and related party transactions.

KEY ISSUES AND NEXT STEPS

- ◆ In terms of future work, the Roundtable decided to review related party transactions in Asia, which would benefit from experiences in OECD countries, and to form a Task Force on Related Party Transactions. The objective of the Task Force would be to (i) document and map relevant policy frameworks and practices across different jurisdictions and (ii) propose policy options to the benefit of policymakers and market players in order to facilitate good practices. The OECD Methodology will be very useful in guiding the group. Also, given the importance of this issue in other regions, the output developed in Asia could become a very important tool around the world.
- ◆ Related party transactions will be the key issue on the 2008 agenda of the Asian Roundtable. It was also suggested that cutting edge issues such as regulatory impact assessments as well as private equity, hedge funds and corporate governance could be considered. The OECD will also be forming a small “advisory team” of Roundtable participants to consult with in preparation for the next meeting as well as the future work programme.
- ◆ The 1997 financial crisis in Asia was a catalyst for significant corporate governance reforms and today good corporate governance is seen as an on-going effort that produces long-term benefits for business and society as a whole. The OECD survey, *Asia: Overview of Corporate Governance Frameworks in 2007* shows how much progress was achieved in the legal and regulatory framework since the 2003 *White Paper*. However, Asian decision-makers indicated in their *Singapore Declaration* that they see implementation and enforcement as an un-finished agenda and demonstrated their commitment to improve corporate governance “in practice”.

1. The Asian Roundtable was established in 1999 and serves as a high-level regional forum for a structured policy dialogue on corporate governance. It also provides participants with direct access to the global policy dialogue that the OECD supports. The Roundtable economies include Bangladesh, China, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Singapore, Chinese Taipei, Thailand and Viet Nam.

- ◆ Roundtable participants see dialogue with the OECD as an important tool in the process of improving national corporate governance practices and frameworks. This dialogue is now even more important since the May 2007 OECD Council meeting at Ministerial level that adopted a Resolution on Enhanced Engagement, calling upon the OECD to strengthen cooperation with China, India and Indonesia as well as South East Asia. The Asian economies will continue to use the Roundtable platform for assessing similarities and differences amongst themselves, other regions and OECD countries. The next meeting of the Roundtable will take place in Hong Kong, China in May 2008.

Showcase Session: Corporate Governance, ten years since the Asian financial crisis

This session provided an opportunity to take stock of corporate governance developments since the Asian financial crisis in 1997 that firmly placed the issue onto the international policy agenda. As confidence in the health of corporations and the financial markets was shaken, substantial efforts went into attracting investment by improving corporate governance frameworks in the region.

Ten years since the financial crisis, the Roundtable has developed a cross-country survey comparing the corporate governance frameworks of 13 Asian economies, using the OECD Principles of Corporate Governance as a benchmark. The survey and discussion confirm that most Asian jurisdictions have substantially revamped their laws, regulations and other corporate governance norms. Participants to the Roundtable are pleased with these achievements, which would not have been possible without their dedication and efforts. Now it is important to ensure that the lessons learned will not be lost.

Today, all Roundtable economies have national corporate governance codes and many have institutions promoting good corporate governance. Shareholders now have the statutory right to participate in key corporate governance decisions. Roundtable economies allow either shareholders' derivative suits or class action suits. In most jurisdictions, laws and regulations stipulate sanctions for insider trading and require disclosure of material related-party transactions. Consolidated financial reporting as well as quarterly reporting is required for listed companies in most economies. Annual reports are to include essential non-financial information such as information on corporate governance, management's discussion and analysis and ownership structures. Boards in virtually all economies are required to include directors independent of senior management and controlling shareholders and to have an audit committee.

At the same time, Roundtable participants realise that improving corporate governance practices and policy framework is an on-going process. Participants confirmed their strong commitment to further improve corporate governance in Asia. Going a step further, the discussion provided an opportunity to identify challenges and set the future reform agenda. While different jurisdictions may adopt different approaches, participants want to give priority to action in the following areas:

- Implementation and enforcement remain an unfinished agenda. Roundtable participants are committed to give priority to effective implementation and credible enforcement. The Roundtable will monitor developments and evaluate progress in Asia.
- While rules and regulations are improving, participants agreed that there is still a need to "fill the gaps" in specific areas, such as transparency of related party transactions and improving incentives for shareholders' derivative/class action suits. The Roundtable will serve as a platform for an in-depth exchange of international experiences in specific areas.

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- Roundtable economies committed to review if present and future regulations are effective and bring the intended results by assessing regulatory impact. Participants also agreed to continue to actively engage the private sector by supporting private sector initiatives for better corporate governance, such as corporate governance codes, director training and investor education.

Session 1 – Current reforms in Singapore

Singapore presented major developments in corporate governance during the past decade. A significant change since the 1997 financial crisis in Asia was the move away from a merit-based to a disclosure-based approach. That implies that instead of prescribing detailed rules, the regulator issues recommended guidelines and practices. There is also greater emphasis on public consultation in rulemaking that seeks to raise transparency and also better gauge acceptability to the market. The aim is to offer the market flexibility but with responsibility. Participants noted that companies are increasingly aware that their corporate governance practices are subject to greater public scrutiny, which has reinforced market discipline. To effectively implement this new system, Singapore started a comprehensive reform of its legal and regulatory framework to include stronger legal obligations to disclose and ensure higher quality and standards of disclosure. It has taken some time for investors to get used to the new system and also for companies to understand the importance of disclosure and what they need to do differently.

The SGX has also recently changed the structure of its second tier listed companies, moving away from the present exchange regulated structure to a sponsor supervised set-up. Listed companies are to be regulated by and accountable to sponsors from the industry rather than directly by SGX, which will supervise the quality of the sponsors and continue enforcing listing requirements. When the companies mature, they can progress to the main board. Some participants expressed concern about the inherent conflicts of interest with sponsors deciding on the company's listing and also being a vehicle to uphold standards.

Participants also engaged in a discussion on the role of independent directors, an issue that has recently received considerable media attention in Singapore. The public debate, animated by scandals, demonstrates increasing awareness by the public that independent directors have an important role to play in improving corporate governance but also that there is still a lack of clarity on what is the exact function of an independent director. Several cases were presented where directors were expected to represent minority shareholder interests. It was reiterated that any board director, independent or not, is legally bound to act in the interest of the company as a whole. At the same time, the independent director has a special role in exercising objective independent judgment, particularly in areas where the interests of management, the shareholders and company diverge, such as executive remuneration or succession planning, among others.

There was a discussion about how independent directors are selected, trained, and remunerated in Singapore. The SID has set up a register and issued a reference statement of good practice on the role, duties and responsibilities of independent directors as well as training. Certification of directors is not yet on the agenda in Singapore and participants debated whether this may actually be counterproductive, i.e. directors assuming that just because they pass a course qualifies them for directorship. Participants stressed the need to focus on outcomes and not only process. The nominating committee has a key role to play. Appropriate remuneration is important to reward directors enough to motivate them to do their job well without overpaying them, which could diminish their independence.

Session 2 – Moving away from box ticking

Participants discussed the OECD Methodology and how to apply it in the real world, including examples in Thailand and India. The OECD Methodology is an instrument for public policy as a way to analyse systems, how efficient they are and if the right incentives are in place. It was emphasised that no matter what the legal and regulatory framework is, what really matters is how it is being lived and actually used. That is why the OECD Principles focus on outcomes, rather than only looking at the law on the books but actually at what is being done, even if there are different ways for implementation depending on the economy, corporate structure and legal framework. Participants stressed the importance of not only looking at how individual principles are being implemented but also at how they tie together and if they are consistent, i.e. the coherence of the system as a whole. Also, each principle may have more or less importance in any given economy, which is one of the reasons why the OECD Methodology does not provide ratings of countries, which can often be a box-ticking exercise, which can be misleading by simply adding together different judgments. Rather the OECD Methodology can help policy-makers understand how countries measure up against the Principles in a consistent manner despite different legal traditions and market structures.

The key empirical question posed by the OECD Methodology is: assuming that one wishes to make a judgement about the extent to which the outcome oriented Principles have been implemented in a jurisdiction, what observable features are most important in forming that judgement? In assessing the implementation of individual principles, the OECD Methodology provides “essential criteria” that must be fulfilled for the principle to be fully implemented. The criteria, like the Principles themselves, emphasise outcomes whether they are achieved through laws, codes or market incentives. Equal weight is given to actual practices since what matters most is that the outcome advocated by the principle is achieved. Whether the chosen method is effective and efficient is also dealt with in the Methodology via chapter I of the OECD Principles: *ensuring the basis for an effective corporate governance framework*. The criteria therefore also provide concrete details about what observable items might constitute the required outcome. The end goal is to understand policy and assist policy-makers with reform efforts and priorities.

Thailand shared its experience with the World Bank’s 2003 Corporate Governance ROSC (Review of Standards and Codes), using the OECD Principles as a benchmark. The process of going through the assessment significantly helped increase awareness and focus reforms. Thailand commented that the OECD Methodology will make this review process easier in the future, as it specifies more clear criteria for each of the OECD Principles. Thailand plans to propose doing an updated self-assessment using the OECD Methodology.

India remarked that using the OECD Methodology as a tool for a self assessment would be extremely beneficial to stimulate an active policy debate within the country and to raise understanding using a common international language. This would also allow regulators to fill regulatory gaps, map corporate governance practices and provide a tool for advocacy in order to raise the level of corporate governance practices.

Australia commented on the benefits of its experience with an independent assessment, the FSAP (Financial Sector Assessment Programme), notably to look beyond the law at the quality of information. The result was less detailed statements and greater focus on accuracy as well as quality in order to make statements more streamlined and easier to understand. An independent assessment can be a useful tool for policy-making in order to avoid knee-jerk reactions.

The discussion also brought out some important points about how to best use the OECD Methodology in Asia, in order to keep track of implementation and enforcement in key areas. This would also provide the basis for mapping practices and sharing of experiences in order to enlarge the menu of options, globally. It can also be used for thematic reviews of priorities areas, such as related party transactions.

Sessions 3 – Shareholder activism and proxy voting

The discussion highlighted the relative passiveness of investors in Asia, with examples from Korea of frequently dormant institutional investors such as public funds. Academic work was presented demonstrating that these funds can have a major impact and improve corporate governance in companies where it is particularly weak. Shareholder activism has the potential to positively impact stock prices.

Participants also discussed different ways that shareholders can be active, whether through public campaigns (such as naming and shaming, press, court battles) or behind the scenes in discussions with management, the board, among others. The Malaysian experience was discussed, where efforts are focused on supporting minority shareholders in becoming more engaged. It was pointed out that there are a growing number of others investor groups in Asia as well as more cooperation between investors through several informal networks. This “investor engagement” is often behind the scenes but appears to be on the rise. An example a new fund in Korea, focused on mid size companies, has experienced encouraging results from its efforts to improve corporate governance and bring higher returns to investors.

Still, there is much progress to be achieved, not only to increase shareholder activism but at a minimum by shareholders voting their shares. Studies show that only about 30% of minority shares are being voted in most markets. Improving the functioning of proxy voting systems is critical. Participants referred to a recent survey sighting concerns including: lack of independent audit of vote results, lack of publication of vote results, insufficient information on which to vote; no confirmation that vote has been received; and the prevalence of voting by show of hands rather than by ballot/poll.

Session 4 – Related party transactions

To introduce the issue, recent academic work was presented on tunneling assets from Chinese listed companies to the state. The findings indicate that related party transactions between firms and their state owners can result in massive expropriation of the firm’s minority shareholders. The study suggests that expropriation is concentrated to firms with the highest state ownership and controlled by local government SOEs, and in provinces where local government bureaucrats are less likely to be prosecuted for misappropriation of state funds. The economic value of this loss is significant to the company and its shareholders.

Roundtable participants then split up into smaller groups to discuss the following three areas: (i) Actual practices and identify most difficult kinds of transactions (ii) How to enhance disclosure and improve the approval process of transactions, role of the public and private sectors (iii) From the perspective of enforceability, determine thresholds for approval (board and/or shareholders) and disclosure (to the public and/or regulator). Moderators reported on the conclusions from each group, which can be summarised as follows.

Most Asian jurisdictions have a basic legal and regulatory framework in place to control related party transactions but as can be expected, practices vary from one economy to another². There is often a gap between regulations and practices, particularly with respect to disclosure. Detecting a related transaction is problematic in most jurisdictions. Participants highlighted that the complex ownership structure of Asian companies creates particular challenges for detecting related party transactions. Groups of companies and conglomerates with major shareholders who have access to insider information often expropriate minority shareholders. Some of the most difficult transactions to identify include those that occur between a listed company and another company in a group that can lead to transfer pricing and expropriation. In economies with a large state-owned enterprise sector, identifying and disclosing related transactions is particularly difficult and costly. Even in the case of large related transactions, it may be tough to identify whether the transactions are abusive, especially if there is no market price.

Abusive related party transactions are a global challenge, the lack of transparency when insiders deliberately fail to disclose such deals to shareholders is widespread. Participants suggested that there is a need to measure the size of the problem as well as how to distinguish between fair and abusive transactions. Looking at cases in Thailand, Korea and Indonesia, the abusive transactions are sometimes hidden behind fair ones. The nature of the relationship between two parties to the transaction is key, and whether it is at arms length or related. A key question then is whether the relationship lead in fact to changed conditions for the parties.

Participants stressed that boards can do more to enhance transparency of related transactions, particularly the quality of information received from management.³ The audit committee's role is crucial in identifying these transactions, also to ensure that proper accounting and auditing standards (particularly IAS 24) are implemented. Independent directors have an important function in reducing information asymmetry to ensure that all shareholders, particularly minority shareholders, have accurate information. However, in many groups of companies, directors are nominated by the parent firm, which makes their "independent" judgement questionable. More probing and critical questions from independent directors and advisors to management and those proposing the transaction could make a critical contribution. Participants suggested developing an "alert list" or "guidelines for boards" with a clearly defined procedure and benchmark. This could include: the name of the related party, the nature of the relationship with the related party, the nature of the transactions, the amount of the transaction and that the board ought to be aware of the market price.

Participants highlighted that enhanced and complementary interaction between the public and private sector is essential to improve monitoring and enforcement of related transactions. While regulators focus on enforcing the legal and regulatory framework according to the letter and spirit of the law, the private sector can be called upon to develop practical guidelines and procedures for disclosure. It could be beneficial to develop a policy at company-level on controlling related party transactions so that all players understand their respective roles and obligations, this could be more rigorous than the law and listing requirements. The role of the media in exposing abusive related transactions was highlighted, as well as that of gatekeepers. Also, educating investors so that they can ask the right questions of the board could be helpful.

2. Hong Kong, China is currently rewriting its company law, specifically reviewing provisions dealing with related party transactions. HK and Singapore are considering creating listing rules on related transactions. The role of the board of directors and in particular whether or not fiduciary duties of directors should be statutory or voluntary is being considered.

3. Senior executives with decision-making authority could be called upon to disclose related or interested parties in the annual report, to be signed off by the CFO and CEO.

The capacity of regulators to detect and sanction non-compliance with disclosure and/or approval rules is another key issue to consider. It is important that the law provide a proper mechanism for investors to take action if they feel that directors are acting against their interest and the interest of the company, for example through derivative action. However, this assumes that jurisdictions have an effective and efficient judicial system in place. Also, a full menu of remedies could be developed to enhance enforcement, including criminal, civil, and administrative sanctions. Sanctions can be a choice or mix of financial and non-financial tools (e.g. reputation, disciplinary actions). Administrative fines appear to be used actively, for example by Korea, Thailand and Malaysia.

Participants debated whether all related transactions should be disclosed or if there should be a threshold, based on materiality or significance of a transaction. It was suggested that when defining the threshold, flexibility should be kept in mind so that there is no way to circumvent the requirement by breaking up a major transaction into smaller ones. It was suggested that this can be calculated according to a ratio (i.e. compared to the size of a company, its assets, profits, etc) rather than a percentage that may be easier to get around. Participants discussed the benefits and costs of prohibiting certain types of related transaction, such as personal loans as well as guarantees to directors, senior officers, controlling shareholders and other insiders. In some countries, like China, loans to companies belonging to one group are not yet prohibited. This issue warrants more study.

Related activities

Participants went around the room to present relevant upcoming events/initiatives in Asia, this includes:

- The OECD-Asia Network on Corporate Governance of State-Owned Enterprises⁴, which is developing a Policy Brief on Corporate Governance of State-Owned Enterprises in Asia, using the OECD Guidelines on Corporate Governance of SOEs as a reference. The Network is planning to meet in India, spring 2008.
- The OECD/World Bank Global Corporate Governance Forum is developing a toolkit to support director training.
- The Asian Corporate Governance Association is planning on an Asian Business Dialogue on Corporate Governance in November “Strengthening Companies and Capital Markets through Corporate Governance.”
- The International Corporate Governance Network will have their next meeting in Seoul, Korea in June 2008.

4. In 2006, the Asian Roundtable launched the “Asia Network on Corporate Governance of State-Owned Enterprises” in order to reach the appropriate audience and to address the specific policy challenges of SOEs. The Network’s objective is to raise awareness and promote use of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, which were adopted in 2005 as the first international benchmark in this area.