CG WATCH 2020

Future promise

Aligning governance and ESG in Asia

Special report - May 2021

Founding Sponsor of ACGA

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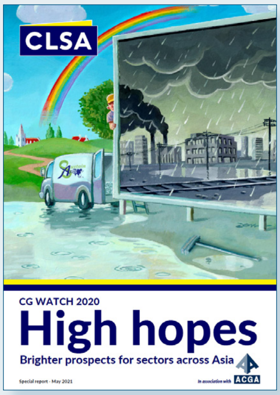


This report is published alongside CLSA's *High hopes* report that analyses governance scores from a sector perspective.

Contents

All prices quoted herein are as at close of business 11 May 2021, unless otherwise stated

Acknowledgements and disclaimer

ACGA would like to thank Asia Research & Engagement (ARE), our partner organisation in Singapore, for jointly designing and undertaking the detailed survey underlying the Listed Companies section in CG Watch 2020. The survey assesses 180 large-caps and 120 mid-caps across the 12 markets we cover in Asia-Pacific. The methodology and content of the company survey is jointly owned by ACGA and ARE.

ARE is a specialist firm that brings the voice of investors to address Asia's sustainable development challenges. It does this through structuring collaborative engagements and providing relevant research. ARE's collaborative engagements include Energy Transition and Sustainable Protein.

Future promise

A firmer CG foundation is needed for ESG progress

Environmental, social and governance strategies continue to offer visions of a better future, but how well businesses operate and govern themselves is central to supporting meaningful progress. The links between corporate governance (CG) mechanisms and ESG policy are unclear in Asian markets, limiting the potential of efforts by companies, investors and policymakers to make meaningful change, and we believe these issues need to be addressed in order to provide an effective governance foundation for ESG and sustainability in Asia. We make eight recommendations for how CG and ESG policy and practice could be better aligned.

A mid-pack reshuffle, with Taiwan and Japan the main gainers

Once again, most of the excitement in our latest CG Watch market ranking is not at the front or back of the pack, but in the middle. Taiwan has made a concerted effort over the past two years to enhance its CG ecosystem and moves from fifth to fourth. Japan has rebounded with a sustained effort across several of the stakeholder categories in our survey and rises from equal seventh with India in 2018 to equal fifth with Malaysia.

Australia maintains its lead with Hong Kong and Singapore in equal second, but each underperforms in its own way

At the front, Australia maintains a tight hold on first place, solidly ahead of Hong Kong and Singapore that rank equal second. Yet all is not perfect: Australia continues to underperform in Government & Public Governance and Regulators, as it did in 2016 and 2018. Hong Kong and Singapore exhibit weaknesses in their public and corporate governance systems that result in lower total scores than one might expect from the region's two international financial centres.

Malaysia and Thailand suffered from political change

Malaysia and Thailand are the only markets that place worse, each suffering the negative effects of politics on different aspects of their CG ecosystems. Yet both enjoy increases in scores in other areas, as the chart below shows.

No change in ranking at the bottom, but scores mostly higher - especially in Korea

At the back of the pack, there is no change in the order of markets. Korea remains ninth but on a much higher score. Indeed, it is now closer to the markets above than it has been for some time. China and the Philippines both gain in score, though not ranking. Indonesia places last again and is the only market to lose points overall. Yet even these lower ranked markets are strengthening their CG ecosystems in different ways. We hope this momentum continues.

Clear improvement across the region over the past two years

Market category heat map: 2020 vs 2018

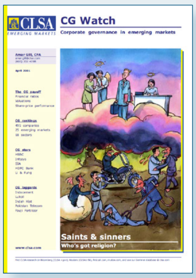
Increased 10 ppt or more | No change vs 2018 | Decreased within 10 ppt

Increased within 10 ppt | Decreased 10 ppt or more

	AU	HK	SG	TW	MY	JP	IN	TH	KR	CH	PH	ID	Average (%) increase vs 2018
1. Government & public governance													2.2
2. Regulators													1.4
3. CG rules													5.0
4. Listed companies													4.2
5. Investors													5.2
6. Auditors & audit regulators													2.8
7. Civil society & media													1.2

Note: Markets ordered from left to right in terms of their ranking. Source: ACGA

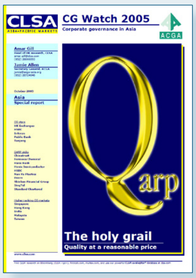
CG Watch through the years



Saints & sinners

April 2001

In our first edition we surveyed and ranked 495 stocks in 25 global emerging markets. High CG scorers generally outperform. South Africa, HK and Singapore score well, as do transport manufacturing, metals/mining and consumer.



The holy grail

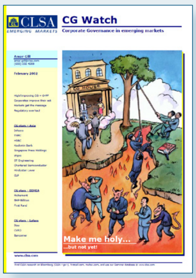
October 2005

QARP (Quality at a reasonable price) is a guide for stock selection in the quest for high-CG stock performance. The QARP basket of the largest 100 stocks in Asia ex-Japan beat the large-cap sample in the three years to 2004.

Dark shades of grey

September 2014

This year we rate 944 companies in our Asia-Pacific coverage. Japan has moved higher while Hong Kong and Singapore have slipped. Corporate scores have fallen, particularly in Korea. We have revamped our environmental & social scoring.



Make me holy . . .

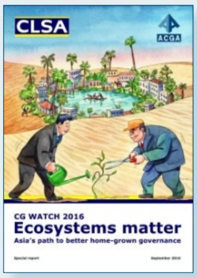
February 2002

Almost invariably, companies with high CG scores remained market outperformers, this year. The top-CG quartile outperformed the country index in nine out of 10 of the Asian markets under CLSA coverage.

On a wing and a prayer

September 2007

We include "clean and green" criteria in our corporate-governance scoring. Climate change is now a matter of corporate responsibility, with attendant economic risks. Yet, Asian firms are largely ignoring the issue.



Ecosystems matter

September 2016

Governance matters and ecosystems are key. No one stakeholder drives the process, it's the collective interaction that delivers outcomes. Australia heads our bottom-up survey and joins ACGA's top-down survey at No.1. Asia is improving.

Fakin' it

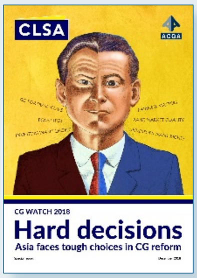
April 2003

Companies are smartening up their act, as stocks with high CG scores outperform. But much of the improvement is in form - commitment is not yet clear. Market regulations are moving up and it is time for shareholders in the region to organise.

Stray not into perdition

September 2010

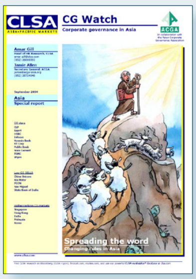
Corporate-governance standards have improved, but even the best Asian markets remain far from international best practice. Our CG Watch rankings may surprise investors this year even more than the 2007 reordering.



Hard decisions

December 2018

Regional markets face hard decisions in CG reform as mounting competition for IPOs raises pressure to lower standards. But there is still plenty of evidence of the push toward better CG. Australia maintains its lead, while Malaysia is the top-mover.



Spreading the word

September 2004

Our more rigorous CG survey of 10 markets in Asia ex-Japan finds improvements in many of the 450 stocks we cover, following new rules introduced in recent years. CG also emerges as an explanation for beta.

Tremors and cracks

September 2012

Cracks in Asian corporate governance have become more apparent since our last CG Watch. We provide CG and ESG ratings on 865 stocks. We rank the markets and indicate issues investors should watch for in the tremors of Asian investing.

ACGA

CLSA

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A firmer foundation

Effective governance is critical for the success of ESG and sustainability in Asia

For reasons well known to readers of CG Watch, environmental, social and governance (ESG) strategies and priorities have rapidly ascended to prominence in the thinking and business direction of the investment industry worldwide. This has significantly influenced the way in which investment firms now set priorities, market fund products, and allocate resources to governance activities such as voting and engagement. Sustainability concerns are high on the agenda of governments too as they grapple with the long-term risks of climate change, environmental degradation caused by urban expansion and resource usage, and the adverse social consequences that often follow. Banking and financial regulators meanwhile are acutely aware of the commercial potential of these seismic shifts and are competing to win the crown as the greenest capital market.

The rise of ESG is having a profound impact on company governance and operations

All of this is having a profound effect on how companies operate and are expected to govern themselves. It shapes what they measure and disclose, and how they interact with the outside world. After years of seeming disinterest, the Asia region now has a select group of companies that could rightly be considered ESG leaders, and there is a growing belief that taking sustainability seriously is the smart option from a business as well as national point of view.

Yet the connections between corporate governance and ESG are often unclear

While such high-level thoughts and ideas dominate much of the investment discourse on ESG, it is worth looking at whether the policy and organisational foundations required to underpin these developments are in place. Are current governance and management mechanisms in Asian markets sufficient to support meaningful approaches to ESG and sustainability by companies, investors and policymakers? Is there adequate discussion on how firms should evolve to become fit for purpose in this new world? Our view is that much of the focus remains fragmented and the connections between corporate governance and ESG policy are unclear. We believe these issues need to be addressed in order to provide an effective governance foundation for ESG and sustainability in Asia.

Here are eight suggestions for creating a firmer governance foundation:

1. Acclimatising CG codes

Asian CG codes were first developed 20 years ago and introduced the concept of the independent board

Codes of best practice for good corporate governance emerged in Asia around 20 years ago and have been in a state of development and improvement ever since. They were initially a response to the corporate dysfunction brought to light so dramatically by the Asian Financial Crisis of the late 1990s, including widespread and unsustainable foreign debt, egregious conflicts of interest with family company groups, and limited or non-existent checks and balances on controlling shareholders. The first codes had the task of building an entirely new corporate governance edifice overnight that had credibility in international financial markets. Not surprisingly, Asian governments took inspiration from existing norms and standards in western countries, which were seen at the time as setting the gold standard for good governance. This led to the wholesale adoption of independent directors, new board committees for audit (and later nomination and remuneration), a particular focus on risk management, faster and more expansive corporate financial, governance and business reporting.

Over the past decade CG codes have taken on more modern concerns

Over the past decade, these codes have continued to evolve. With governance basics already in place, the focus has been on incorporating a range of more modern concerns that followed the Global Financial Crisis of 2007/8. These include such things as greater board diversity (including gender diversity), lead independent directors, an emphasis on managing "stakeholder" concerns more effectively and, to varying degrees, high-level references to the importance of ESG and sustainability.

But codes are mostly silent on sustainability governance

Yet few CG codes of best practice in Asia address in any depth how board composition and governance might need to change to manage material ESG challenges, in particular the overarching issue of climate change. Will new committees be required? How will board composition and director skills need to change to cope with increased requirements for effective reporting and strategic decision-making around ESG/sustainability? What impact will all this have on director training needs? Is the traditional director nomination process, dominated by controlling owners and senior management, still fit for purpose?

A small group of Asian companies are leading the way on sustainability governance

Promisingly, some leading companies are already trying to answer these questions. A few have formed new sustainability committees at board and/or senior management level, such as CLP and CK Hutchison in Hong Kong and China Steel in Taiwan. A larger number are listening to the concerns of their major institutional shareholders as well as expert consultants and non-profits on the adverse impacts of climate risk to their businesses. Some Asian banks have voluntarily decided to stop financing new coal power plants. And reporting in line with the framework outlined in 2017 by the Task Force on Climate-Related Financial Disclosures (TCFD) is starting to take hold in sectors such as energy, banking, insurance, transportation, and consumer goods. Regulators do not need to start with a blank sheet if they decide to make their CG codes more climate-relevant.

Figure 1

UPSCALE: a seven-point checklist for boards

Understand	Become literate and competent on ESG issues, including climate change.
Prioritise	Make crafting and executing a thorough ESG strategy a mission-critical priority.
Step up	Disclose board-level responsibility and accountability for ESG performance as well as complete and meaningful ESG disclosure. Consider the need for a sustainability committee at board or senior management level.
Communicate	Create mechanisms for stakeholders to provide feedback on ESG plans, performance and disclosure. Consider non-binding shareholder advisory votes on major ESG decisions.
Align	Inspire every part of your organisation to work towards achieving ESG objectives.
Link	Establish clear and meaningful ESG targets that are tied to external realities, such as resource scarcity and national greenhouse-gas emission reduction pledges.
Embed	Cultivate a culture that values and commits to achieving ESG objectives across all elements of your organisation, including value chain and service providers.

Source: ACGA

2. Linking ESG reporting guidance and CG Codes

Voluntary CSR guidelines first appeared in Asia in the 2000s

The forerunners to today's regional ESG reporting guidelines, which are typically implemented through the "comply or explain" mechanism, were some voluntary corporate social responsibility (CSR) guidelines released in the mid to late 2000s in China, Indonesia and Malaysia. Taiwan then published its CSR Best Practice Principles in 2010.

CSR later morphed into "ESG" and more substantive reporting guidance appeared

As CSR morphed into ESG in the early to mid-2010s, the region saw more focussed but still mostly voluntary guidance on sustainability reporting appearing in Singapore, Thailand, India and Hong Kong. Taiwan enhanced its commitment considerably in 2014 following a national tainted food scandal when it mandated listed companies in the food, finance and chemicals sectors, as well as those with the largest share capitalisations, to produce reports in line with the Global Reporting Initiative (GRI) standard. In the same year Japan published its landmark Ito Review on "Competitiveness and Incentives for Sustainable Growth", which emphasised the need for higher quality "corporate disclosure towards sustainable growth" and, as part of this, better ESG disclosure. Notably, the Ito Review warned that Japanese companies tended to focus on environmental and social disclosure to the detriment of good reporting on corporate governance.

2015 was a turning point for reporting standards

Reporting standards began to evolve even more rapidly from 2015. In that year Hong Kong upgraded its voluntary ESG reporting guidelines to "comply or explain" and Bursa Malaysia said listed companies would need to disclose their management of material "economic, environmental and social" (EES) risks and opportunities in their annual reports. The following year, Singapore enhanced its sustainability reporting guide by putting it on a "comply or explain" basis, while India expanded its mandatory requirement for "business responsibility reporting" (BRR) from the top-100 listed firms by market cap to the top 500. India is in the process of extending this to the top 1,000 firms by 2021 and is producing a new and extremely detailed template for companies to follow.

ESG reporting standards are broadening and deepening . . .

Taiwan meanwhile has broadened its rule on GRI-aligned reporting to around 225 of the largest listed companies and accounting for around 80% of Taiwan Stock Exchange (TWSE) market cap. But many companies do it voluntarily: The total tally is now 486, of which 368 are listed on the TWSE and another 118 on the smaller company Taipei Exchange. In 2019, the Philippines joined the club and issued mandatory sustainability reporting guidelines for listed companies on the "economic, environmental and social" aspects of their organisations, while Hong Kong upgraded its 2015 guidelines in the same year and added a new environmental KPI on climate change and a requirement to report according to a set of social KPIs. In 2020 Japan released a non-mandatory but detailed handbook on ESG disclosure for listed companies, while there are expectations that China and Korea will release their own guidelines in the relatively near future.

. . . and now include a high-level focus on governance

In addition to these policy developments, a positive change in recent years has been the recognition of the importance of governance in the ESG reporting process. Many guidelines now start with a requirement that companies should make statements about board oversight of material ESG risks and opportunities, and how decisions are made on these issues. While this development is to be welcomed, most guidance documents tend not to go into a lot of detail about how board oversight and decision-making should be implemented in practice. This is understandable since these guidelines are primarily focussed on reporting, not governance. A simple solution, such as that adopted several years ago in Singapore, is to refer the reader back to the CG code. The original 2016 Singapore sustainability reporting guide accordingly starts with a statement on Board Responsibility:

> "Under the Code of Corporate Governance issued on 2 May 2012, the Board is collectively responsible for the long term success of the issuer. It provides strategic direction and specifically considers sustainability issues as part of its strategic formulation. Consistent with its role, the Board should determine the

> ESG factors identified as material to the business and see to it that they are monitored and managed. The Board's close interaction with management will enable the Board to satisfy itself on the way sustainability governance is structured and functioning through the various levels of management. The Board has ultimate responsibility for the issuer's sustainability reporting. If any question is raised regarding the issuer's sustainability reporting, the Board should make sure it is addressed." (Note: A largely similar statement is in the revised sustainability reporting guide of February 2020.)

The new Singapore CG Code has less direct language on ESG and sustainability

Unfortunately, the simple and direct language on ESG in the 2012 Singapore CG Code has been replaced with more general references to sustainability and "sustainable business performance" in the current Singapore CG Code of 2018. Moreover, the section in the 2012 Code that outlined the board's role has been relegated in the 2018 version to an accompanying document called the Practice Guidance, which is voluntary. In the process, the specific language in the 2012 Code stating that a board should "consider sustainability issues, e.g. environmental and social factors, as part of its strategic formulation" has become "ensure transparency and accountability to key stakeholder groups". The only reference to sustainability in this part of the Practice Guidance is a stipulation that one of the board's primary roles is to "provide entrepreneurial leadership, and set strategic objectives, which should include appropriate focus on value creation, innovation and sustainability". SGX believes that these changes elevate the importance of stakeholders relative to shareholders. While we agree that boards need to consider a broader range of interest groups today, we mourn the loss of the more direct and plain language of the earlier Code.

CG codes should emphasise clearly the board's oversight role in ESG reporting

Our recommendation is that ESG and sustainability reporting guidelines should link directly to CG codes as a basic reference document and the latter should clearly emphasise the principle of board involvement in ESG reporting as well as sustainability strategy and governance. As the primary corporate governance guidance document in most markets, the CG code should take the lead here and be fully aligned with any ESG policy documents. This does not mean that CG codes themselves must provide extensive practical guidance on how boards should oversee ESG reporting. Such detailed recommendations could be put in a supplementary document, as Hong Kong Exchanges and Clearing (HKEX) did in March 2020 when it released a document called "Leadership Role and Accountability in ESG: Guide for Board and Directors". The CG code should however lay down the basic principles of board oversight of ESG reporting and the minimum standards expected of companies. This would be a step up from the rather brief references to governance in current ESG reporting guidelines. A legitimate question that companies may ask is, 'If board oversight of ESG reporting is so fundamental, why is it not mentioned in the CG code?'

The Malaysian CG code is more aligned than most on sustainability—and is getting stronger

One CG code in Asia that has been more aligned than most in recent years is the Malaysian Code on Corporate Governance (MCCG) of 2017. It states quite unequivocally that a key role of the board is to "ensure that the strategic plan of the company supports long-term value creation and includes strategies on economic, environmental and social considerations underpinning sustainability". MCCG was revised in late April 2021 and now places even more emphasis on ESG, which is "increasingly material to the ability of companies to create durable and sustainable value and maintain confidence of their stakeholders". If companies are to be resilient, boards need to "anticipate and address material ESG risks and opportunities".

Taiwan is starting to draw closer links between CG and ESG reporting

Another market that is starting to think about these issues is Taiwan. In late August 2020 the Financial Supervisory Commission (FSC), its peak financial regulator, announced a new plan for corporate governance titled, "Corporate Governance 3.0 - Sustainable Development Roadmap". This was described as a "bid to enhance the sustainable development of companies" and to "establish a comprehensive Environmental, Social and Corporate Governance (ESG) ecosystem, strengthening the international competitiveness of Taiwan's capital markets". This will be the third CG roadmap that Taiwan has developed since 2013 and it puts a strong focus on sustainability reporting.

The Thai CG Code is the most aligned with ESG and sustainability in historical terms

Meanwhile, the most aligned code historically has been the Thai Code, which has its own principle on the subject containing a range of sub-principles and guidance. The responsibilities are also nested throughout the code. Principle 5 on "Nurture Innovation and Responsible Business" states: "The board should prioritise and promote innovation that creates value for the company and its shareholders together with benefits for its customers, other stakeholders, society, and the environment, in support of sustainable growth of the company."

3. Supporting ESG reporting

The quality of ESG reporting in Asia is improving, but numerous challenges remain

That listed companies need support on ESG reporting seems incontestable. This is a new and complex area and getting it right is not easy. ACGA has been studying ESG reporting in Asia through CG Watch since 2016. We later put our research on a more structured basis with a new survey developed jointly with Asia Research & Engagement (ARE), our partner organisation in Singapore. In both 2018 and 2020 our survey assessed 180 large-cap listed companies and 120 mid-caps in total across 12 markets. Some recurring patterns have been evident:

- Increasing numbers of ESG, sustainability and "integrated reports" are being produced around the region, with voluminous amounts of data on environmental and social factors, yet the role of the board in this process is often murky. How much actual oversight is there? Given that the existence of sustainability or even CSR/ESG committees within Asian boards is still quite new, the reasonable conclusion to draw is that most boards are not yet actively engaged.
- To what extent do companies utilise new information on material ESG risks and think deeply about the potential impact on their operations and business models? How will they address emerging competitive or regulatory threats? While large-cap companies are broadly getting better at this, our reviews have found many that continue to score poorly. Some ignore obvious material risks.
- There is still much to be done on the issue of climate risk disclosure. Our 2020 survey found that less than half of the 180 large caps assessed around the region disclosed concrete steps to address the physical risks of climate change. A further 20% acknowledge the risk but do not explain how they are responding to it. And a third of companies ignore it entirely.
- A common complaint about ESG reporting in Asia is that the prevalent and often standalone GRI-style report is designed more for a multi-stakeholder than investor audience. This is where the standards developed by the Sustainability Accounting Standards Board (SASB) come in: the goal is to encourage companies to focus their reporting on ESG issues that are of most financial relevance to investors. The aim is that this should complement, not replace, GRI reporting.

- And then there is the issue of targets. If gathering and publishing data is a challenge, writing a sensible target is even harder. This explains the uniformly low scores for targets across our 12 markets in the ACGA/ARE company survey - less than 15% of the 180 large companies scored top marks for having targets linked to most of their material issue areas.

One solution for assisting companies is to create an informal forum on ESG reporting, as in Japan

Given the wide range of reporting standards available, many companies feel confused as to the right way forward and seem resistant to change, often pressuring regulators to keep standards to a minimum. A practical solution could be to take a leaf out of Japan's book and set up an informal forum on sustainability reporting comprising representatives from companies, investors and policymakers. The Ministry of Economy, Trade and Industry (METI) in Japan initially formed a study group on TCFD in August 2018 and published guidance later that same year. In May 2019 a group of leaders from business and academia created the TCFD Consortium and held an inaugural summit meeting. Further meetings have been held since and, as of late October 2020, the Consortium boasted support from 294 organisations, including major listed companies in Japan, banks, life insurers, investment managers, universities and professional service firms. A number of foreign institutional investors are members, as is the Keidanren, the country's largest business federation.

Another model comes from Australia, where investor bodies have drafted guidance for companies

Another model is found in Australia where the country's two leading investor associations, the Australian Council of Superannuation Investors (ACSI), which represents pension funds, and the Financial Services Council (FSC), which represents investment managers, jointly published a set of ESG reporting guidelines for companies in 2011 and revised them in 2015. As the introduction to the 2015 edition states:

> "Investors need accurate, timely and comparable information to identify and manage exposure to ESG investment risks. Such information assists investment managers to decide the selection and holding of stocks in their portfolios, and in their investable universe. This information also prompts investment managers, broker analysts and asset owners (principally superannuation funds) to constructively engage with companies on these matters.
>
> "Companies need consistency in the information required by institutional investors, and for reporting obligations not to impose undue costs, competitive disadvantages or other commercial burdens.
>
> "Recognising both perspectives, ACSI and the FSC have jointly updated this Guide to highlight the types of information needed by our member organisations to understand, price, analyse and manage ESG investment risks."

Australia grounds its reporting obligation in company law

This guide and subsequent surveys of ESG reporting among the ASX200 carried out annually by ASCI is one reason Australia has a high level of sustainability reporting without a detailed set of guidelines from the stock exchange or financial regulator. Other factors include a stipulation in the Corporations Act requiring disclosure of material business risks that could affect a company's future prospects in the "operating and financial review" (OFR), which is Australia's version of a management discussion and analysis (MD&A) section in the annual report. This is interpreted to include climate change and other broad ESG risks. The Australian Securities & Investments Commission (ASIC) produced a statement on climate risk disclosure in September 2018 and later updated its guidance on recommended ESG reporting in the OFR and prospectuses. Completing the circle is the ASX CG Principles, which state that: "A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks."

Australia takes a more systemic approach to encouraging ESG reporting

One potential lesson from the Australian system is that a combination of company law, securities commission guidance, stock exchange CG policy, and practical recommendations from institutional investors all help to produce a compelling framework for listed company reporting. This "ecosystem" approach may prove more effective and durable than the fragmented approach found in much of Asia.

4. Nudging ESG assurance

Most ESG reports in Asia are not independently assured. Does this matter?

In contrast to financial statements, most ESG reports in the region are not audited or even reviewed by independent third parties. Regulators have taken a hands-off approach to date, encouraging listed companies to consider assurance but not making it mandatory. The Singapore Exchange's sustainability reporting guide offers a succinct rationale for assurance and recommends phasing it in:

> "Independent assurance increases stakeholder confidence in the accuracy and completeness of the sustainability information disclosed. An issuer whose sustainability reporting has already matured after several annual exercises would want to undertake external assurance by independent professional bodies to add credibility to the information disclosed and analysis undertaken. An issuer new to sustainability reporting may wish to start with internal assurance before progressing to external assurance for its benefits. The issuer should also consider whether it would be worthwhile to undertake independent external assurance on selected important aspects of its report even in its initial years, expanding coverage in succeeding years."

Institutional investors are often sceptical of ESG assurance

Yet many institutional investors and investment analysts remain ambivalent about assurance. One issue is the difficulty of putting the outcomes in context: Since only a minority of ESG reports are assured, there is little room for a comparative analysis of results. Another is that the scope of assurance is often extremely limited: Companies choose which parts of their reports are assured and typically select metrics in which they have a high degree of confidence or processes where they know they perform well. Like giving oneself a gold star after looking up all the answers! Since assurance is voluntary, companies do not need to release poor assurance reports and, indeed, it is hard to find one that is qualified. And there is the issue of materiality: can assurers attest that companies have truly focussed on the most material ESG risks facing their businesses?

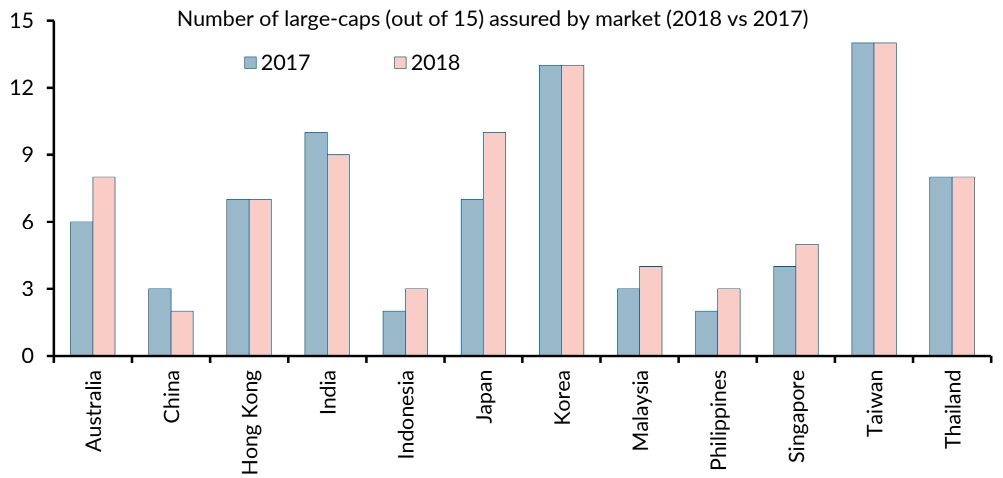
Original ACGA research has found the extent and scope of assurance to be limited

Research carried out by ACGA over the past year confirms many of the above concerns. Having reviewed 180 large-cap sustainability reports across 12 Asia-Pacific markets for financial years starting in 2017 and 2018 (ie, the same companies we assessed for CG Watch 2018), we found only two jurisdictions where the vast majority of reports were assured: Korea and Taiwan. In five markets—Australia, Hong Kong, India, Japan and Thailand—around a half to two-thirds of reports were assured. In the remainder, a third or less were assured.

Korea and Taiwan are leading the way in the number of ESG reports assured

Figure 2

Large-cap ESG assurance in Asia-Pacific, 2017-2018



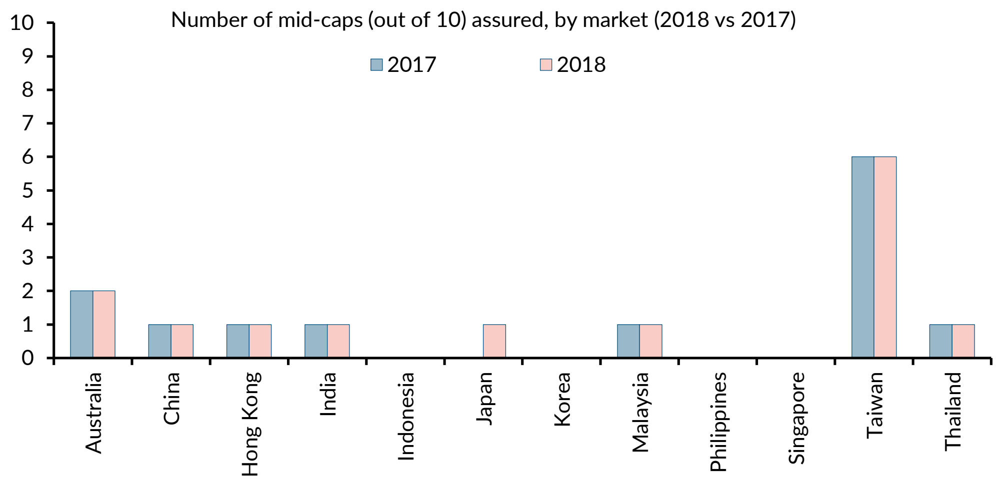
Source: ACGA

The extent of assurance among mid-cap ESG reports is minimal

We have also reviewed assurance in the ESG reports for the same 120 mid-cap companies that we looked at for CG Watch 2018. With the exception of Taiwan again, very few mid-cap companies have their reports assured.

Figure 3

Mid-cap ESG assurance in Asia-Pacific, 2017-2018



Source: ACGA

Assurance often covers only a limited set of data points

As for the scope of coverage, assurance engagements vary considerably. A typical worst-case example is a report that addresses only a few data points, such as verification of CO_2 emissions and other pollutants. Better examples are where assurance is broadened to cover a wider set of key metrics and look at how companies are managing corruption and governance. But overall, most assurance is limited in scope.

Auditing standards need to evolve further to enhance the assurance process

Assuring the way in which companies assess the ESG risks that are most material to their businesses is more challenging; and part of the problem is the auditing standards themselves. Auditors typically say that the international standard for assuring non-financial information (ISAE 3000) is not really fit for purpose for assuring ESG reports. This standard was last revised in 2013, although the international audit standard-setting body, the IAASB, has recently produced new guidance on interpreting and applying ISAE 3000. Whether this solves all the problems remains to be seen. Meanwhile, the main competing standard, AA1000, does have an explicit focus on materiality and is the standard used by consulting firms and, more recently, some audit firms.

There is little discussion in Asia on how to move forward on ESG assurance

Our observation in Asia is that there is little or no discussion among policymakers, companies, shareholders and assurers as to the right way forward on this issue. The current self-selection system does have the advantage of allowing progressive companies to differentiate themselves. However, with ESG information becoming ever more important to companies and investors, the idea that assurance will remain voluntary indefinitely does not seem credible or likely.

Encouraging more independent reviews could be beneficial for investors

We would propose two ideas for nudging this process forward. First, encourage the content of ESG reports to be independently reviewed for their breadth and depth of coverage, with recommendations made as to how they could improve and be made more useful for investors in particular. This does not envisage assuring all the data points, rather taking a more selective approach to addressing issues that are most material to a company's business.

Some investors are starting to call for auditors to include TCFD reporting in their financial audits

Secondly, if an ESG risk is material enough to have a major financial or business impact, it should be discussed in the annual report and assessed alongside the financial statements. The obvious candidate is climate change. Indeed, some global institutional investors are starting to call for auditors to look at climate risk disclosure, in particular TCFD reporting, when auditing the financial statements.

Governments could move this process forward through public fora or hearings

Since no one wants to see another new exercise in box-ticking and the production of documentation for its own sake, one way to start would be for governments to invite interested parties to a public discussion or series of hearings on different aspects of ESG reporting and assurance. Written consultations have their place, but not enough use is made of public fora in our view.

5. Aligning stewardship and CG codes

"Stewardship codes" for investors have swept the region in the past decade

Since the UK adopted in 2010 its first formal "stewardship code" for institutional investors, a reaction to perceived failings to hold banks properly to account in the run up to the Global Financial Crisis, most jurisdictions in Asia have followed suit. The content and structure of most Asian stewardship codes are similar to the UK Code, namely that investors should develop and publicise stewardship policies, manage conflicts of interest, monitor investee companies, engage constructively with them on governance and ESG issues, have a policy on voting and disclosure of voting, and report periodically on these activities. The two elements of the UK code that have proved somewhat troublesome in Asia are notions of collective engagement and the escalation of stewardship, which outlines steps for more active intervention in companies. (Hong Kong and Thailand are exceptions here, as are Japan and Malaysia to a lesser extent.)

Yet CG codes have surprisingly little to say on the new world of stewardship

Despite a broad consensus that investor stewardship has a critical role to play in encouraging better governance among listed companies and probing whether or not they are considering ESG risks and opportunities, the typical CG code in the region has little to say on the subject. Many codes touch upon relations with shareholders and offer a few best practice ideas for running shareholder meetings. But these are established policies that have been in place for 10-15 years.

CG codes should provide explicit support

In line with our arguments on sustainability governance and ESG reporting, it would make sense for CG codes to provide explicit support for the concept of investor stewardship and some guidance as to how companies and their institutional shareholders should engage with each other. While the average stewardship code empowers domestic and foreign investors to act as stewards of listed companies - and implicitly condemns apathy and non-action - it often seems as if directors have yet to get the memo. The volume of engagement between institutions and companies has significantly increased across the region over the past five years, yet ACGA members still report on how frustrating and time-consuming it often is to secure meetings to discuss ESG and governance issues. If investors are mandated by regulators to act, how can companies refuse to meet? If institutional shareholders are truly stewards of companies, how can directors not talk to them?

Japan is one of the few markets to make a clear connection between governance and stewardship

Japan has been one of the few markets to draw a direct link between its CG code and stewardship. In March 2018 it published its "Guidelines for Investor and Company Engagement" in tandem with a revised CG code. According to the Financial Services Agency (FSA), the peak financial regulator, the Guidelines are "intended to be a supplemental document to the Stewardship Code and the Corporate Governance Code". They are brief at only four pages long, but provide a number of agenda items that investors and companies can focus on in their engagement meetings. What is refreshing is that these items all speak to current challenges in corporate governance in Japan, such as cross-shareholdings, CEO succession planning, the cost of capital and capital efficiency, management remuneration, and the appointment of independent directors and "statutory auditors" (known as Kansayaku) with knowledge of finance and accounting among other necessary skills to do their jobs properly. It is in fact quite rare to learn something about corporate governance in a country from reading its CG policy documents.

6. A focus on investor governance

The internal governance of investment institutions is creeping onto the agenda

An issue likely to attract more attention in the future is the internal governance of institutional investors. Most stewardship codes do not address this directly, but as noted earlier, touch briefly upon management of commercial conflicts of interest. The UK 2012 stewardship code offers just two sentences and a short paragraph that states the problem and urges investors to adopt a policy to manage conflicts. In contrast, its new and heavily rewritten stewardship code of 2020 puts fund governance front and centre (Principle 2 of 12), although the language remains terse.

Asian stewardship codes make brief references to managing conflicts of interest

The comparable language on conflicts of interest in most Asian stewardship codes is a little more descriptive, but still rather generic and abstract. Only the new SEBI code from India in early 2020 and the Thai SEC code from 2017 make an attempt to provide some broad practical suggestions, albeit brief ones. The Japanese code meanwhile states that, "Asset managers should establish and disclose governance structures, such as an independent board of directors or third party committees for decision-making or oversight of voting, in order to secure the interests of clients and beneficiaries and prevent conflicts of interest."

Australia has had a governance code for pension funds since 2017

Australia is the market with the clearest guidance for investors on the importance of fund governance. The first document came from the Australian Institute of Superannuation Trustees (AIST), a representative body for industry pension funds and their directors, in April 2017. Called the "AIST Governance Code", it was voluntary for the first financial year (July 2017 to June 2018), then became mandatory for registered funds from July 2018 onwards. The first two principles speak about "laying solid foundations for management and oversight" and "structuring the board to add value". In other words, a direct focus on the mechanics of fund governance, board leadership and culture.

Australia's stewardship code for investment managers emphasises the importance of internal governance

The second document was a stewardship code for investment managers published in July 2017 by the Financial Services Council (FSC), an industry body. This was called the "Principles of Internal Governance and Asset Stewardship" and took effect from January 2018. The rationale for the focus on internal governance was that, "While stewardship is often focused on the corporate governance of entities that the Asset Manager is invested in, effective internal governance and stewardship requires the Asset Manager to also have robust internal governance practices to ensure they always act responsibly, act in clients' interests and treat clients fairly." The Principles do not specify how an investment manager should establish its governance structure, but asks for disclosure on 12 topics ranging from ethical conduct and personal trading to managing conflicts of interest, risk management and compliance, brokerage and commissions, whistleblowing and so on. Unlike the AIST Governance Code, it does not delve into board and management organisation or leadership.

The two Australian codes are a useful reference

While the structure of the Australian pension industry is quite different from most Asian markets, there is much of relevance in the AIST code for major asset owners in this region. Investment managers in Asia could also find the FSC principles a useful starting point.

7. Improving investor reporting

The quality of stewardship reporting by investors varies widely, even among leading markets

An important part of the stewardship process for domestic institutional investors is reporting publicly on their policies and practices. Not surprisingly, the level and quality of such reporting varies widely around the region. As this year's CG Watch market survey shows, the best performing markets in this regard are Australia, India and Japan. Not too far behind are Korea, Taiwan and Thailand. Further back are Hong Kong and Malaysia. While China, Indonesia, the Philippines and Singapore are barely off the starting grid.

More may be going on than meets the eye, but there is value in reporting publicly

The good news is that more is going on than appears from publicly available documents. However, there is a fundamental value in investors disclosing to the market what they intend to do and what they have done. This is not just about virtue signalling and good PR. Investors can shape the debate about corporate governance and sustainability through their words and actions, including attending AGMs and asking pertinent questions of directors and auditors. Such efforts could help to inform current and future investee companies of what they expect. Public reports also boost the credibility and accountability of the organisation publishing them - as long as they are genuine efforts to report on tangible work done, not marketing spin.

Is it time to collate best practice examples?

One way that official entities responsible for stewardship codes could encourage better reporting is to review the reports that have been published and collate a series of best practice examples. Taiwan is already doing this. Such an approach has been used to good effect by some regulators on listed company CG reporting.

8. Aligning policy aspirations

Regulatory agencies in some markets send conflicting signals on ESG

The thematic disconnect one finds between CG codes, ESG reporting guidelines and stewardship codes is mirrored at the policy level in some markets, where the priorities of different regulatory agencies around ESG and sustainability can vary considerably. Although central banks, financial regulators and stock exchanges in some markets are broadly aligned in their high-level messaging - think Malaysia, Taiwan and Thailand - there is an imbalance of emphasis in others. Hong Kong offers a good example. Since late 2018 government agencies have released a series of major policy papers: A position paper from the Securities and Futures Commission (SFC) in September 2018 titled a "Strategic Framework for Green Finance"; a landmark paper on an ESG strategy for Hong Kong in November 2018 from the Financial Services Development Council (FSDC), a government-appointed think tank; and another paper from the FSDC in July 2020 on how the city could become "the global ESG investment hub for Asia". During this same period, the Hong Kong Monetary Authority (HKMA) steadily increased its commitment to green finance. It announced a three-phase approach to promoting green and sustainable banking at a forum in May 2019, then followed this with circulars outlining its plans in greater detail. In May 2020, for example, it released a self-assessment framework for banks called the "Common Assessment Framework on Green and Sustainable Banking", which was intended to set a "greenness baseline" for regulated institutions. Then in June 2020 it published a "White Paper on Green and Sustainable Banking".

In 2018 the SFC in Hong Kong placed a big bet on TCFD

The intended audience for most of these policy papers included banks, other financial institutions, and the broader listed company sector. Indeed, in its 2018 Strategic Framework, the SFC repeatedly emphasised the value and importance of TCFD disclosure among other things. "The SFC has signed up as a supporter of the TCFD recommendations. The SFC is working with HKEX to consider enhancing listed companies' disclosure of environmental (including climate change-related) information, aiming to align with the TCFD recommendations." The HKMA also became a supporter of TCFD.

This was not reciprocated by HKEX in its revised ESG reporting guide in 2019

Yet HKEX, which sets reporting standards on ESG for listed companies, is clearly more ambivalent about raising the bar too high. In a mid-2019 consultation paper on a revision to its ESG Reporting Guide, the issue of international standards was given limited bandwidth: TCFD and other standards such as CDP, SASB and GRI were briefly explained in the paper but never made it by name into the text of the revised Guide, published in December 2019. Although a new environmental KPI on climate risk disclosure was included, it merely stated that companies should provide a "Description of the significant climate-related issues which have impacted, and those which may impact, the issuer, and the actions taken to manage them."

HKEX now includes TCFD in supplementary educational documents only

A couple of months later, the Exchange amended a Frequently Asked Questions document on its website to include positive references to TCFD and other international standards. Then in March 2020 it produced its supplementary guidance on the "Leadership Role and Accountability in ESG: Guide for Board and Directors", which includes multiple references to TCFD. These documents are located in a part of the website that contains a series of practical guidance documents on ESG for directors and report preparers, including one on how to report according to the new environmental KPIs. While the Exchange is to be applauded for developing such guidance, these are supplementary educational materials and pack a much smaller policy punch than the Guide itself. One cannot help but conclude that the Exchange, as a commercial entity, is reticent to push its clients too hard. Yet Hong Kong is supposed to be an international financial centre and should surely be aiming higher.

Making connections

The investor consensus is that sound governance forms the basis for effective company management of ESG

Asian capital markets are moving quickly to adopt new policies on green finance and sustainability. ESG reporting is front of mind for many stock exchanges and large listed companies, while institutional investors are increasingly integrating ESG factors into their investment process. At the same time, there is a strong consensus among investors that sound governance must form the basis for effective company strategies and action on issues like climate change and other sustainable development challenges and opportunities. How can companies make decisions, implement those decisions, and sustain any strategic focus without an effective governance and management structure in place? Form often precedes function - or at least offers companies new and better ways of doing things. For example, in place of instinctive and conservative decision-making on climate change strategy by an individual controlling shareholder, it could make sense to form a sustainability committee that has a greater capacity to think independently about the options and make more forward-looking and informed decisions. To move this process forward, we believe that policymakers should clarify and strengthen the connections between the new world of ESG and sustainability policy and the established systems of corporate governance. Today's fragmented approach sends mixed signals to the market, arguably impedes improvement in sustainability governance within companies, and leaves a lot to luck and chance.

Markets overview

Small differences in overall market scores hide some big variations in stakeholder category performance. Politics undermines corporate governance in Southeast Asia. Overall, we see an improving trend in scores.

Once again, the excitement in the latest CG Watch race is not at the front or back of the pack, but in the middle. Taiwan has made a concerted effort over the past two years to enhance its CG ecosystem and moves from 5th to 4th, edging ever closer to Hong Kong and Singapore. Japan has rebounded with a sustained effort across several of the stakeholder categories in our survey and rises from equal 7th with India to equal 5th with Malaysia. At the top of the ranking, Singapore's score is now so close to Hong Kong that both rank equal 2nd.

Among the decliners, it is no surprise to see Malaysia falling from 4th to equal 5th, nor Thailand dropping from 6th to 8th. Both countries have suffered badly from political upheaval, cronyism and corruption during 2020. Malaysia is the saddest case, since its direction of travel two years ago was widely seen as one of the region's bright spots.

Australia ranks 1st with an 11ppt lead

The rankings of the remaining markets are unchanged. Australia is 1st with a commanding 11-percentage point lead. India stays at 7th and Korea at 9th, albeit both with improved scores. Indeed, India is still hot on the heels of Japan, while Korea wins the prize this time for most-improved market in percentage-point terms. China holds down 10th place and the Philippines at 11th, both on slightly higher scores. Indonesia is 12th with little difference in score.

Tight total scores mask some big variations in category performance

Figure 4

CG Watch 2020 market rankings and scores

Market	Total (%)	Macro market highlights
1. Australia	74.7	Banking commission spurs enforcement, still no federal ICAC
=2. Hong Kong	63.5	New audit regulator, enforcement remains strong, ICAC disappoints
=2. Singapore	63.2	Enforcement firming, rules improve, company disclosure disappoints
4. Taiwan	62.2	Big CG reform push on multiple fronts, rules still complicated
=5. Malaysia	59.5	Political turmoil erodes government scores, other areas hold steady
=5. Japan	59.3	Ahead on climate change reporting, behind on company CG disclosure
7. India	58.2	New audit regulator, civil society surges, public governance disappoints
8. Thailand	56.6	Political turmoil erodes government scores, rules strong, investors improve
9. Korea	52.9	Public governance strengthens, CG disclosure improves, regulatory opacity
10. China	43.0	Forging its own governance path, still waiting for ESG reporting guidelines
11. Philippines	39.0	Stronger regulatory focus on CG, investors and civil society disappoint
12. Indonesia	33.6	CG reform continues to struggle, some stronger rules, new e-voting system

Note 1: Total market scores are not an average of the seven category percentage scores. They are instead an aggregate of all the points received for the 119 questions in our survey, then converted to a percentage and rounded to one decimal point. Total points for each market out of 595 was as follows: Australia (441); Hong Kong (378); Singapore (376); Taiwan (370); Malaysia (354); Japan (353); India (346); Thailand (337); Korea (315); China (256); the Philippines (232); and Indonesia (200).

Note 2: Since the score differences between Hong Kong/Singapore and Malaysia/Japan as less than 0.5 ppt each, we have ranked them equally.

Source: ACGA

As the analysis in this chapter shows, total scores and rankings hide significant differences in market performance across the six "stakeholder" categories in our survey and the one thematic category on CG Rules. There is variation both within and between markets. Australia is still weaker than one might expect in Government & Public Governance, while Taiwan outperformed Hong Kong in this category following concerted government efforts to align the island's regulatory regime to its commitment to CG policy, focus more on bank governance, and raise standards of state enterprise governance and disclosure. Despite being international financial centres, Hong Kong and Singapore continued their lukewarm performances in the Investors category, being comfortably beaten by Australia, Japan, India, Korea and Malaysia. Meanwhile, Japan rated lower for corporate disclosure in the Listed Companies section than its overall ranking would predict.

The following table shows changes in market rankings and the categories that most hold back each market.

Singapore, Taiwan and Japan have moved up the rankings, while Malaysia and Thailand have declined

Figure 5

Changes in market rankings / Underperforming categories

Blue = Rising market   Red = Falling market

2018		2020		Underperforming categories 2020
1.	Australia	1.	Australia	Government & Public Governance; Regulators
2.	Hong Kong	=2.	Hong Kong	Investors; Listed Companies
3.	Singapore	=2.	Singapore	Investors; Listed Companies
4.	Malaysia	4.	Taiwan	Investors; CG Rules
5.	Taiwan	=5.	Malaysia	Government & Public Governance; Civil Society
6.	Thailand	=5.	Japan	Listed Companies
=7.	Japan	7.	India	Government & Public Governance; Investors
=7.	India	8.	Thailand	Government & Public Governance; Civil Society
9.	Korea	9.	Korea	Civil Society; CG Rules
10.	China	10.	China	Investors; Civil Society
11.	Philippines	11.	Philippines	Investors; Civil Society
12.	Indonesia	12.	Indonesia	Investors; Regulators

Source: ACGA

The impact of politics

Politics can have a profound effect on corporate governance, but it is not always easy to see

The impact of politics on corporate governance is challenging to assess. In markets where there is a large state enterprise sector and plenty of opportunity to appoint people to the boards of such companies, as in Malaysia, a change of government and ideology can have a direct and quite sudden impact on corporate governance and organisational leadership. In places with a smaller listed SOE sector, such as Thailand, the impact is likely to be more subtle and will likely play out through changes in government capital market policy, the degree of commitment to anti-corruption efforts, the behaviour of the judiciary, and the extent of press freedom. These issues are explored in more detail in the respective market chapters for Malaysia and Thailand.

CG Watch examines public governance as it relates to corporate governance and capital market regulation

Our focus in CG Watch is on public governance as it relates to corporate governance and capital markets. We examine how government CG and capital market policy may be changing, the level of political support for financial regulators, and the independence of funding for securities commissions. We also look at progress made in the fight against public- and private-sector corruption, how the judiciary handles company and securities law cases, and whether the government is committed to improving state enterprise transparency and accountability. If we see evidence that political appointments or interference in the judiciary is affecting its independence generally, and on company and securities law cases specifically, and is leading to greater corruption in the judicial process, then we will view that as a negative for corporate governance. The market scores and ranking in CG Watch 2020 are based on our review of a two-year period ending in mid-November 2020.

Political unrest in Hong Kong has not stopped CG and ESG reform

This raises the question of where Hong Kong stands in terms of its Government & Public Governance score. Having been rocked by months of protest in the second half of 2019, followed by Beijing's imposition of a national security law in May 2020, one might imagine the score to have plummeted. In fact, it increased slightly and for reasons unrelated to either of these two events. One is technical: Scores for a small number of Hong Kong questions were adjusted following changes in our scoring methodology and to ensure consistency of scoring against other markets. A second factor is that the political unrest did not appear to affect the ability of the financial regulator to do its job, either at the policy or enforcement level. Reform of CG rules continued, new ESG reporting guidelines were introduced, and regulators went ahead in crafting new guidance on green finance. Moreover, the most negative CG policy development in Hong Kong in recent years, the introduction of "weighted voting rights" (WVR) or dual-class shares, predated the unrest by a year.

But complacency is not in order

These comments are not intended to suggest complacency. International investment funds continue to flow to Hong Kong but could be affected in future by further political changes in the city, a perception that the rule of law has weakened materially, continued geopolitical tensions, or a noticeable decline in information flows. Moreover, it is worth emphasising that Hong Kong has underperformed in aspects of our Government & Public Governance category for some time, in particular the lack of a clear strategy from government on its vision for corporate governance and how Hong Kong should differentiate its capital market from Shanghai and Shenzhen. Its answer to becoming more competitive was to introduce WVR - a challenge to which Shanghai quickly responded. As we argue in our "Future promise" chapter, there is much more Hong Kong could be doing to boost its competitive position as the international financial centre of China.

Auditors is the highest scoring category, followed by CG Rules. The Investor category remains lowest

Category scores

The specific scores for each of the 12 markets in our seven survey categories are as follows. Note that Regulators comprises two sub-categories:

Figure 6

Market scores by category, 2020

(%)	AU	CH	HK	IN	ID	JP	KR	MY	PH	SG	TW	TH	Regional average
1. Government & public governance	68	29	65	45	31	60	60	32	28	60	68	35	48
2. Regulators	65	52	69	53	24	62	53	53	27	63	66	51	53
- Funding, capacity, reform	*62*	*42*	*62*	*51*	*31*	*58*	*45*	*53*	*27*	*56*	*62*	*47*	*50*
- Enforcement	*68*	*64*	*76*	*56*	*16*	*66*	*62*	*54*	*26*	*70*	*70*	*56*	*57*
3. CG rules	82	63	75	69	35	58	56	77	45	75	66	76	65
4. Listed companies	79	51	59	65	38	44	48	66	55	60	63	60	57
5. Investors	66	18	34	44	19	60	44	43	21	39	38	38	39
6. Auditors & audit regulators	86	43	81	54	59	77	70	86	60	81	76	76	71
7. Civil society & media	80	22	60	78	38	62	36	44	36	64	62	49	53
Total	**74.7**	**43.0**	**63.5**	**58.2**	**33.6**	**59.3**	**52.9**	**59.5**	**39.0**	**63.2**	**62.2**	**56.6**	**55**

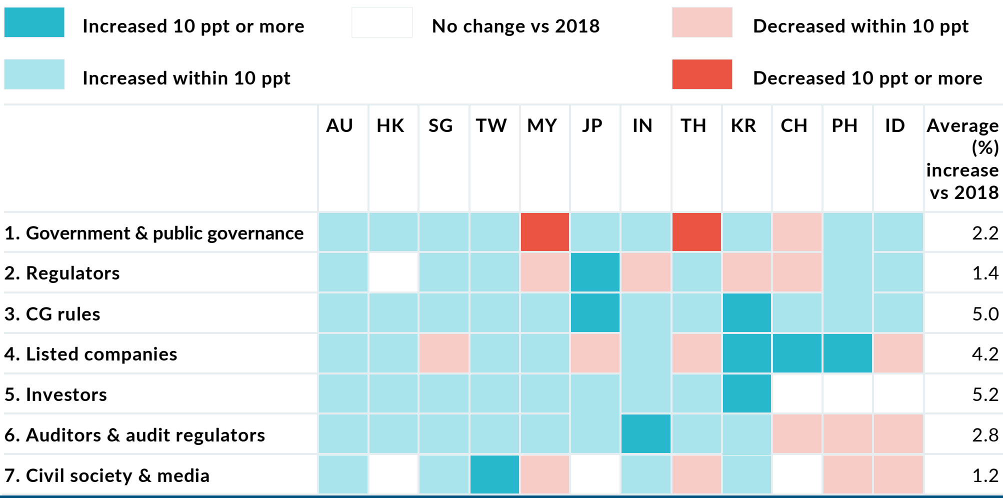
Source: ACGA

Before delving into an analysis of the main changes in each category, which markets have improved or declined, we would like to show a "heat map" of the category scores compared to 2018. As the figure below shows, scores have risen in most categories and in most markets. The biggest increases, in terms of markets and number of categories, came in Japan and Korea. A few other markets also saw a large improvement in one category. The biggest decreases came in Malaysia and Thailand. A deep turquoise shade means the score in 2020 improved by 10 percentage points (ppt) or more over 2018, while a light turquoise means it rose less than 10ppt. A white shade stands for no change in score. A red shade indicates it has declined by 10ppt or more, while a light red means it fell by less than 10ppt.

Clear improvement across the region over the past two years

Figure 7

Market category heat map: 2020 vs 2018



Note: Markets ordered from left to right in terms of their ranking. Source: ACGA

There are three possible explanations for these improved scores

There are three possible reasons for the general increase in scores:

- The score was incorrect in 2018 and has since been adjusted.
- Our more granular scoring methodology in 2020 has resulted in a general uplift in scores.
- There has been a genuine improvement in market performance.

Some scores have been corrected . . .

Our view is that all three reasons play some part in the higher scores in 2020. We have adjusted scores upwards where errors were made in 2018, although the number of questions affected is small. We highlight these corrections in our market chapters.

. . . markets have benefited from changes in our scoring system

As for methodology, this clearly had an inflationary impact in categories where most markets saw an increase in score and, more importantly, the average score increase stood out. Average score increases were highest in three categories: Investors (+5.2%); CG Rules (+5.0%); and Listed Companies (+4.2%). Whereas individual market scores fell in five of the seven categories in our survey, they all went up in CG Rules and either increased or stayed the same in Investors. Listed Companies includes four markets whose scores fell, but this was more than offset by significant increases in three markets and smaller increases in five others.

Tangible reforms have also led to improved scores

This is not the end of the story. Substantive improvements have been made in CG and ESG rules across the region over the past two years, in particular standards for sustainability reporting, updated CG codes of best practice, new or revised stewardship codes, tighter definitions for independent directors, and executive remuneration disclosure. Real changes are also evident in the voting and engagement practices of institutional investors, as well as the quality of corporate disclosure around climate change and sustainability issues. Civil society groups are becoming more active. Financial regulators continue to sharpen their enforcement tools. And audit regulation is becoming more sophisticated and transparent. In short, there is a good story to tell alongside the methodological one.

Category scores and themes

The comparative market scores for 2020 for each category and high-level themes emerging are as follows:

1. Government & public governance

Scores for the top six markets all improved

Australia and Taiwan top the scoring at 68%, with Hong Kong not too far behind at 65%. Japan, Singapore and Korea achieved the same score of 60%. The top six markets all improved in score, with the biggest change seen in Korea. India's score also rose, as did those for Indonesia and the Philippines. Thailand and Malaysia both declined significantly, due to the political upheavals discussed above, while China's score was marginally lower than in 2018.

Yet most governments still do not have a clear strategy on corporate governance

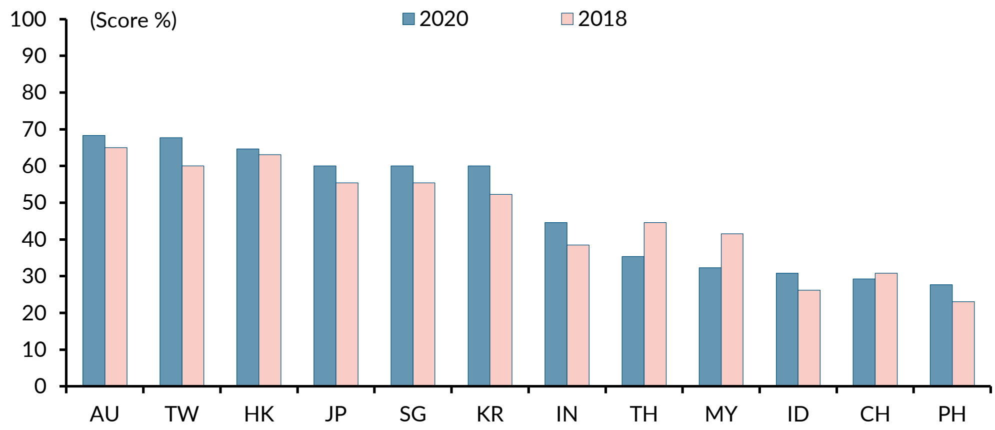
Scores improved for a range of reasons, including more political support for regulatory enforcement, better funding for regulators, or an enhanced focus on bank governance. Yet we continue to believe that most governments do not have a clear strategy for developing corporate governance and building on it as a source of competitive advantage in their capital markets. Taiwan, Korea, and to a lesser extent Japan, are exceptions here. While most Asian governments are excited about the possibilities of ESG and green finance, official policy towards CG is often contradictory. This is evident either in policies that directly undermine aspects of CG, such as dual-class shares, or in non-action on thorny issues of shareholder rights.

The fight against corruption is not improving in most markets

Another area of concern is the fight against corruption. Scores in nine out of 12 markets either stayed the same or declined in our question on the existence and powers of an independent commission against corruption.

Figure 8

Government & public governance: scores by market, 2020 vs 2018



Source: ACGA

Japan and Singapore saw the biggest increases in score

2.1 Regulators: Funding, capacity building and regulatory reform

The picture here is broadly one of two groups: The top five markets and the bottom two all improved in score, while the remainder fell. The biggest increases were seen in Japan and Singapore, while the biggest decreases were seen in Malaysia, India and Korea.

Funding is strong or improving in six markets

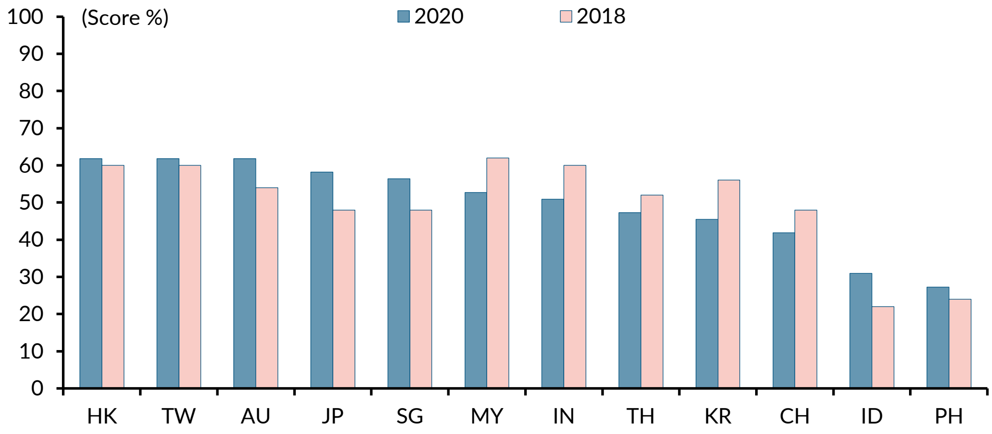
Hong Kong, Korea and Thailand have always done well on our question about the funding of securities commissions, while scores improved in Australia, Japan and Taiwan. One of the reasons these markets do relatively well is that they publish detailed figures on their main regulator's operating income and expenses, the size of budgets is increasing over time, and it appears they have sufficient resources to do their jobs. Other markets, such as Singapore, publish minimal budgetary information. It would have scored even higher for this category if more data were available.

Yet assessing the sufficiency of regulatory resources remains difficult

Nevertheless, we continue to have doubts about the sufficiency of regulatory funding in many markets - even some of the better scoring ones. The fact is that there is no agreed formula for calculating what a securities commission's budget should be given the scope of its responsibilities, the size of the domestic securities market, the number of regulated entities, living costs and so on. The picture is even more opaque at the stock exchange level, both because these organisations are for-profit entities for the most part and disclose even less information on budgets and resources than securities commissions.

Figure 9

Regulators - Funding, capacity building and regulatory reform: scores by market, 2020 vs 2018



Source: ACGA

2.2 Regulators: Enforcement

Enforcement is a higher scoring category than regulatory funding, reform

In line with the results of previous CG Watch surveys, scores for enforcement are generally higher than for regulatory funding, capacity building and reform - with the average for the 12 markets being precisely seven percentage points higher. It is also worth noting that while the regional average score for the former sub-category did not improve in 2020, it increased by four percentage points for enforcement.

Regulators often have more latitude to do their enforcement job

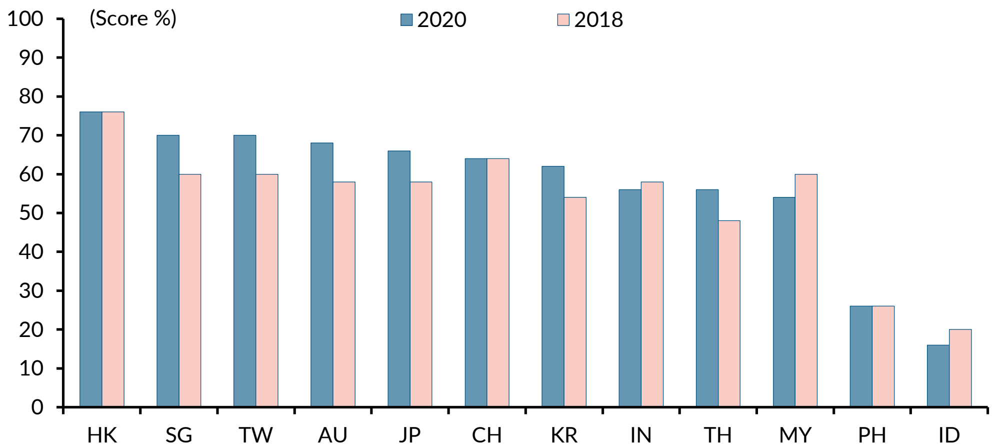
Our interpretation of these results is similar to the point we made in CG Watch 2018: While securities commissions and stock exchanges may struggle to win extra funding and carry out reform in the face of entrenched opposition from vested interests, it is harder to object to regulators playing a disciplinary role - especially if the market has suffered a few corporate scandals and members of the public have lost money.

Six markets are improving in their enforcement scores

Perhaps most pleasing about these results is that, in addition to Hong Kong's high score, another six markets have shown improvements in score and are catching up to Hong Kong. China, meanwhile, continues to hold its own.

Figure 10

Regulators - enforcement: Scores by market, 2020 vs 2018



Source: ACGA

The CG Rules category assesses rules on paper, not in practice

3. CG Rules

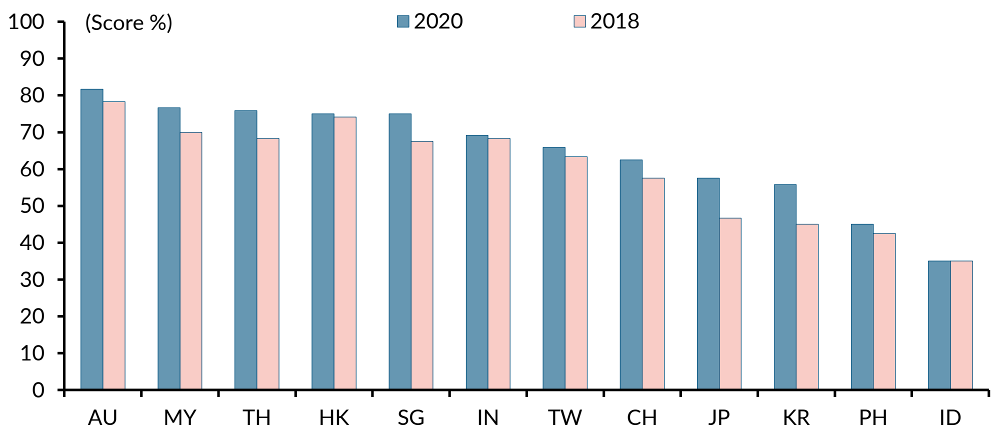
This is one of the higher scoring categories in our survey and, as noted above, has benefited from the more granular scoring methodology we are using. It is important to note that this category assesses rules on paper, not the implementation or enforcement of those rules. Australia continues to lead the way followed by Malaysia and Thailand, which despite their political challenges have long had a solid set of laws and regulations. Hong Kong and Singapore are slightly behind.

A score of 70% is considered a "good" performance for rules

We would argue that a score of 70% or more represents a good outcome in this category, meaning that the above five markets are doing well, and India, at 69%, is almost there. Taiwan at 66% and China at 63% still have a little way to go. The remaining markets have more work to do. It is worth highlighting, however, that while Japan and Korea are both below 60%, their scores have increased significantly compared to 2018. This is a combination of our new methodology, some score corrections, and a number of rule improvements.

Figure 11

CG Rules: Scores by market, 2020 vs 2018



Source: ACGA

Our company scores are drawn from a joint ACGA/ARE survey

4. Listed companies

This part of our survey is based on scoring undertaken through a separate underlying survey devised and carried out in conjunction with Asia Research & Engagement (ARE), our partner organisation based in Singapore. The survey assesses 15 large caps per market selected from the top 50 and a further 10 mid-caps per market.

The ranking of markets differs from other categories

What is striking about the figure below is that, with the exception of Australia, the ranking of markets by total score differs noticeably from the Government & Public Governance, Regulators and CG Rules sections. Hence, Malaysia, India and Taiwan rank above other markets and on increased scores. Singapore and Thailand lost points in 2020. Hong Kong ranks in the bottom half of the pack and Japan comes second last.

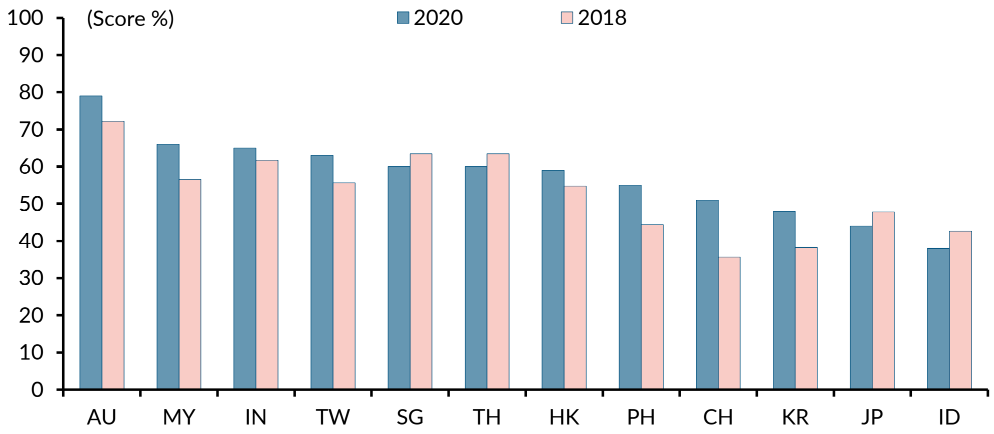
We see some genuine improvement in corporate reporting, but still a lot of boilerplate

Our survey assesses a range of governance areas, including corporate reporting on key financial metrics, governance and ESG/sustainability, as well disclosure on board practices such as training, board evaluation, remuneration policy, and so on. While our view is that disclosure is broadly improving in real terms - eight of the 12 markets saw an increased score compared to 2018 and there is evidence of objectively better company reports - the regional average of 57% indicates there is a great deal of room for improvement. The best companies are producing excellent and informative reports. Unfortunately, the volume of boilerplate and generic disclosure remains high.

The best companies are producing excellent and informative reports

Figure 12

Listed companies: Scores by market, 2020 vs 2018



Source: ACGA, ARE

5. Investors

Only two markets stand out for Investors . . .

Our lowest scoring category again, as a quick glance at the figure below will indicate. Only two markets stand out - Australia and Japan.

. . . but nine markets show improved scores

Despite the low overall scores, however, the good news is that the majority of markets have increased their scores relative to 2018 - something we believe is largely due to genuine improvements, not scoring methodology. Moreover, three markets retained the same score and none declined.

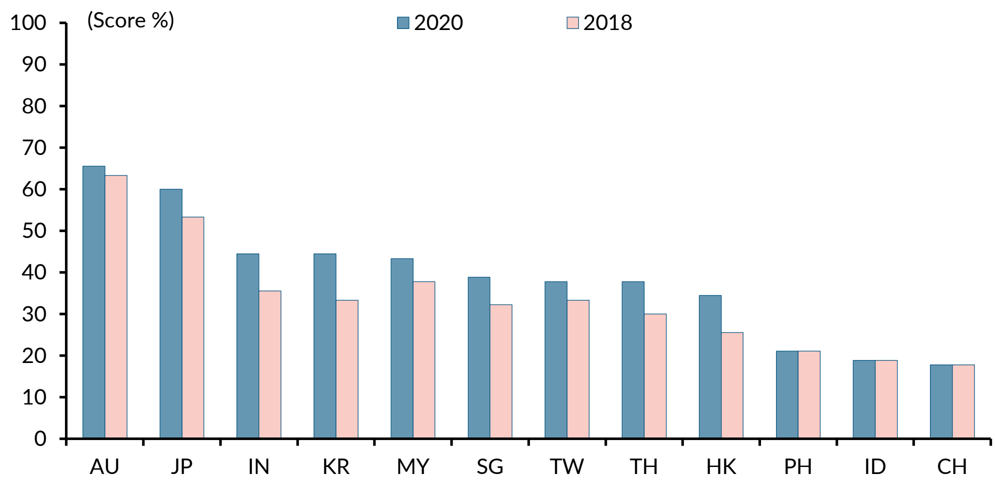
Stewardship codes and the management of ESG is driving higher scores

The primary reason for this consistent result is the pressure both domestic and foreign institutional investors are under to implement "stewardship codes", which in practice means developing new policies on CG/ESG, voting more actively at AGMs and EGMs (including voting against management resolutions and disclosing how they have voted on company resolutions), communicating more often with companies about the latter's CG and ESG performance and organising "engagement" meetings, and producing reports on what they have achieved. In short, institutions need to show they are serious about "responsible investment", that they have plans in place to manage ESG risks in their portfolios, and they have a capacity to engage with companies on environmental, social, and governance issues. (It should be noted that our assessment of Asian markets in this regard includes the behaviour of both domestic and foreign investors.)

Our lowest scoring category

Figure 13

Investors: Scores by market, 2020 vs 2018



Source: ACGA

6. Auditors & audit regulators

All markets have signed up to international standards of accounting and auditing

This is the highest scoring category in our survey because we assess a range of standards and practices that all markets follow or at least sign up to, namely international standards on accounting and auditing, the creation of independent audit regulators (often called "audit oversight boards" or AOBs), the drive for higher quality audits of listed-company financials, and a more transparent and accountable auditing process.

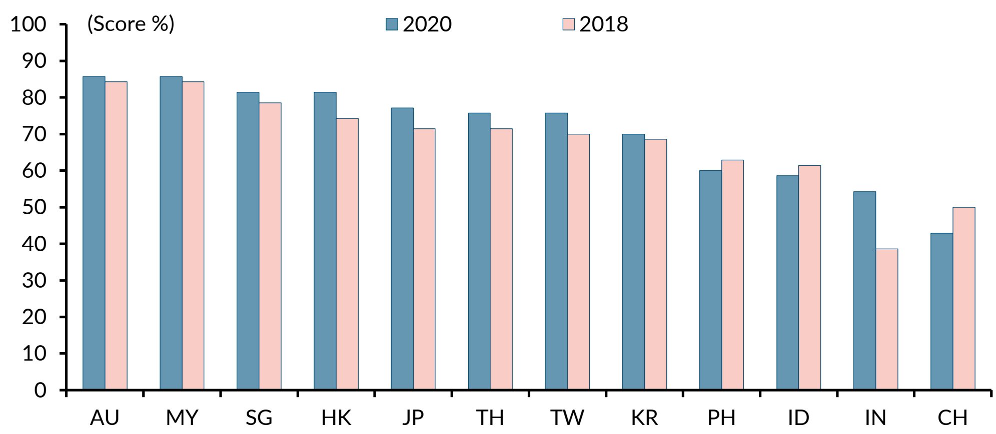
Hong Kong and India finally have independent audit regulators

The main news in this category since our last CG Watch report is the arrival, after an interminable wait, of independent AOBs in Hong Kong and India. This accounted for a large part of the increased scores in both markets. But the figure below also shows a clear improvement in the scores for Japan, Thailand and Taiwan.

Clear improvement in the scores for Japan, Thailand and Taiwan

Figure 14

Auditors & audit regulators: scores by market, 2020 vs 2018



Source: ACGA

There is a wide disparity in civil society scores in Asia-Pacific

7. Civil society & media

The main visual feature of this part of our survey is the wide disparity between the highest and lowest ranking markets. It is not a great surprise that Australia and India do well, given the vibrancy of their non-profit sectors, well-established professional institutes and industry bodies, and their open media. Singapore, Japan, Taiwan and Hong Kong also have quite robust civil societies, with non-governmental groups playing an important role in promoting CG and ESG, undertaking training, and contributing to regulatory consultations and government committees.

Taiwan enjoyed the biggest increase in score

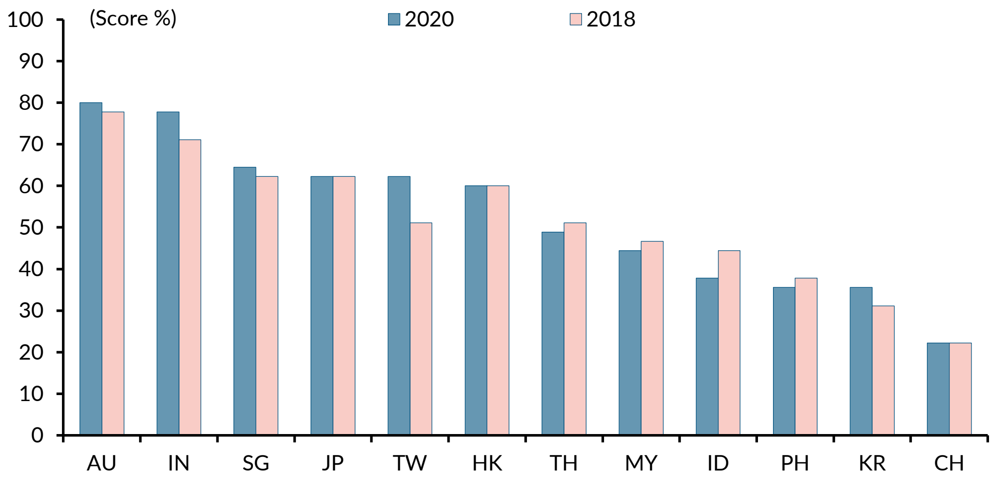
Taiwan is the market with the biggest increase in score here. Unfortunately, we see some deterioration in Malaysia and Thailand for reasons given above, while Indonesia and the Philippines have also slipped. Although ranked low, Korea is improving. China's score remains unchanged.

Media scores largely deteriorated

As for the media, we have serious concerns about its current trajectory around the region. No market saw an increase in score for our question on how active and impartial media is in its coverage of CG events, while five markets saw their scores fall. The picture was even worse in terms of how skilled media coverage is of CG issues, with seven markets seeing a drop in score.

Figure 15

Civil society & media: Scores by market, 2020 vs 2018



Source: ACGA

Contrasting the performance of key stakeholders and areas in Asian CG in 2020

Legend:

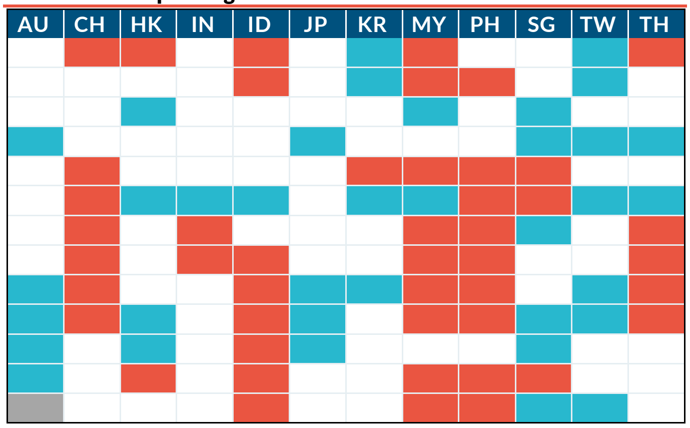
0-1 | 2-3 | 4-5

ACGA Asian CG ecosystem "heat maps"

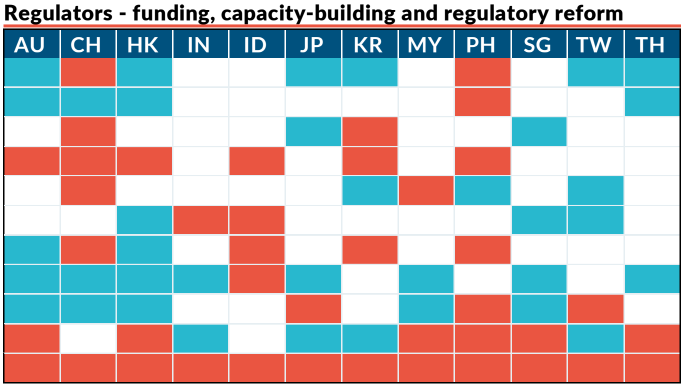
Converting the score for each question to a colour highlights the strengths and weaknesses of the different stakeholder groups and thematic areas that make up the Asian CG ecosystem. Turquoise represents high scores, red is for low scores, and white for moderate scores.

The highest scoring categories are Auditors & Audit Regulators and CG Rules. The lowest scoring are Investors and Government & Public Governance. It is also possible to see that in some categories, such as Regulators - enforcement or CG Rules, the red cells are concentrated vertically (ie, under certain markets), whereas in Investors all markets have a sea of red.

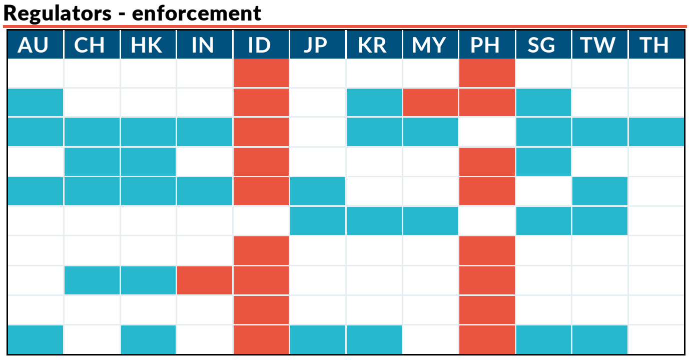
Government & public governance



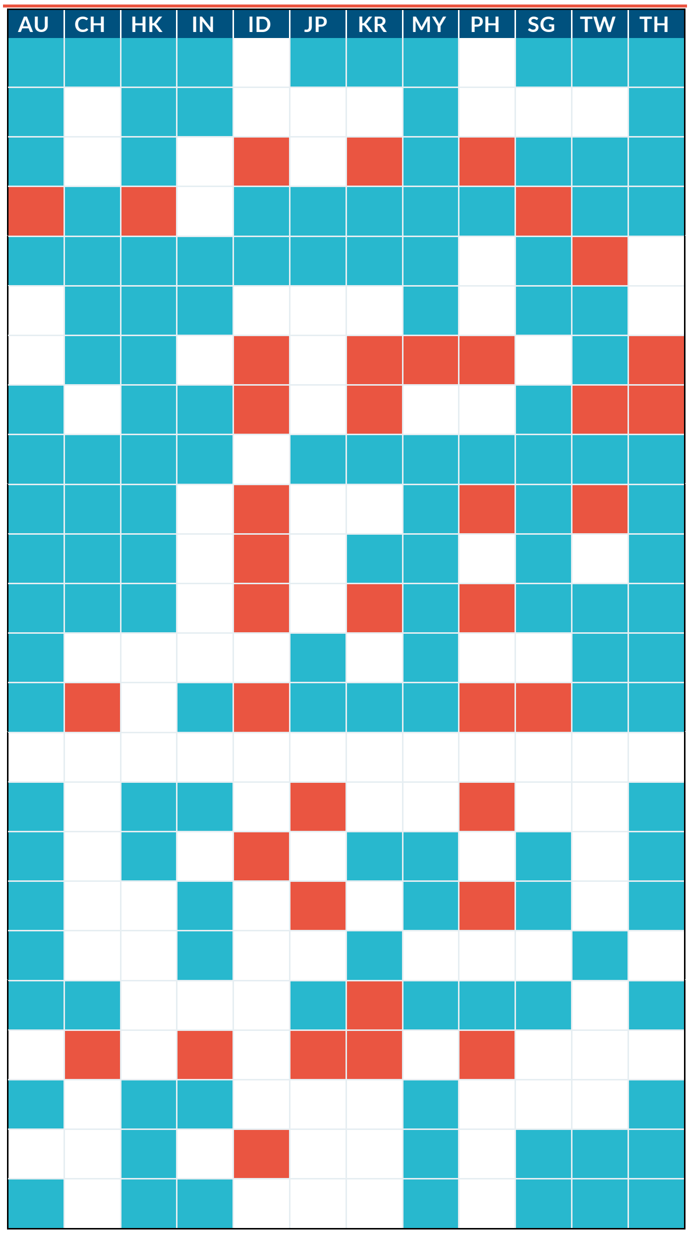
Regulators - funding, capacity-building and regulatory reform



Regulators - enforcement

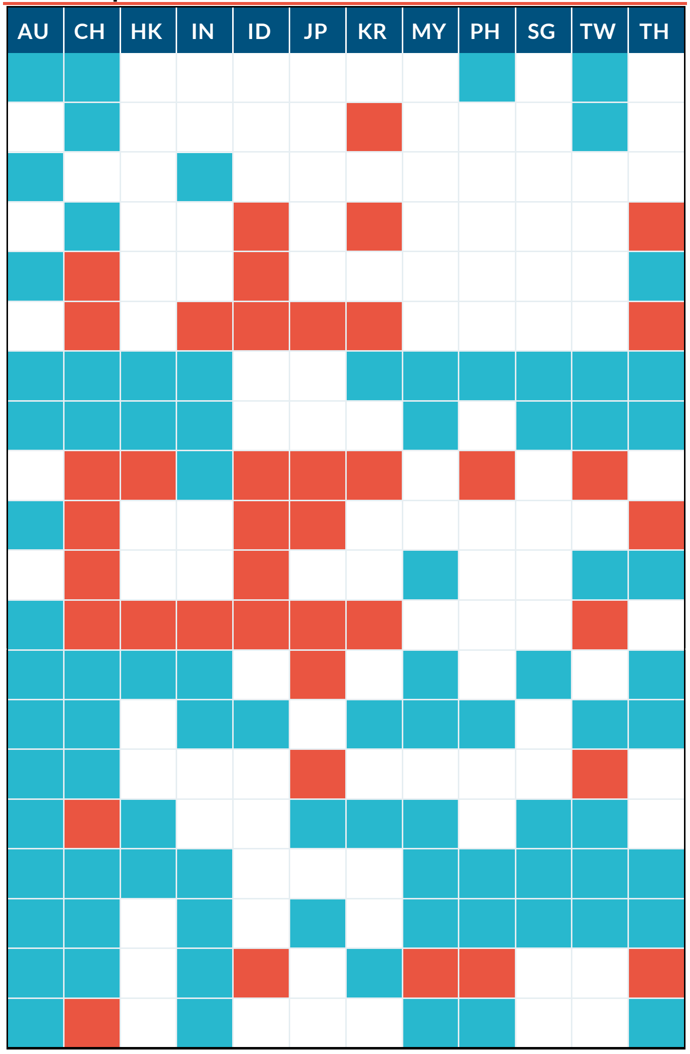


CG rules

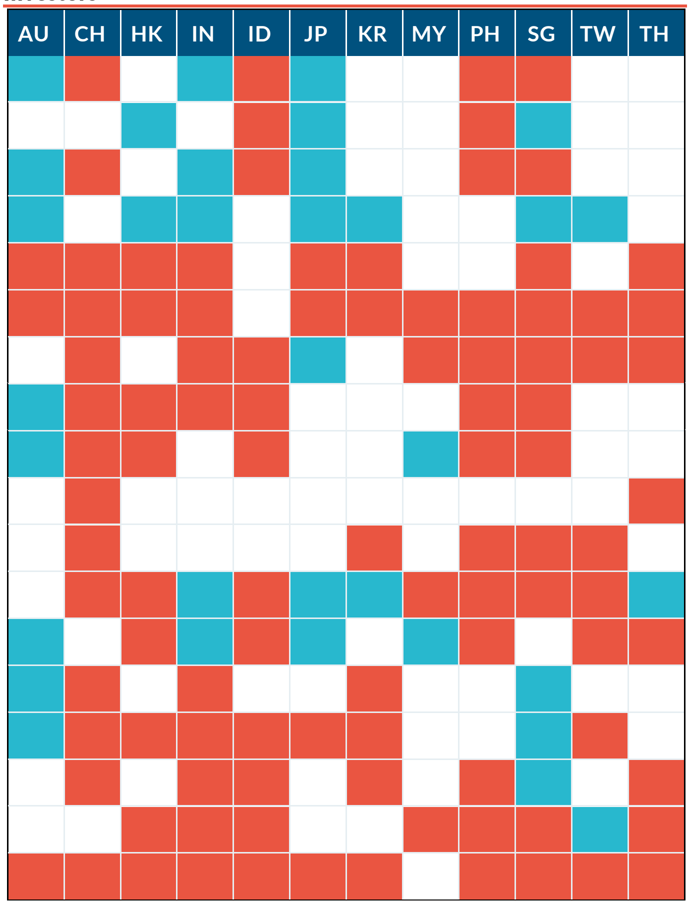


Note: Q1.13 is not scored for Australia. Source: ACGA

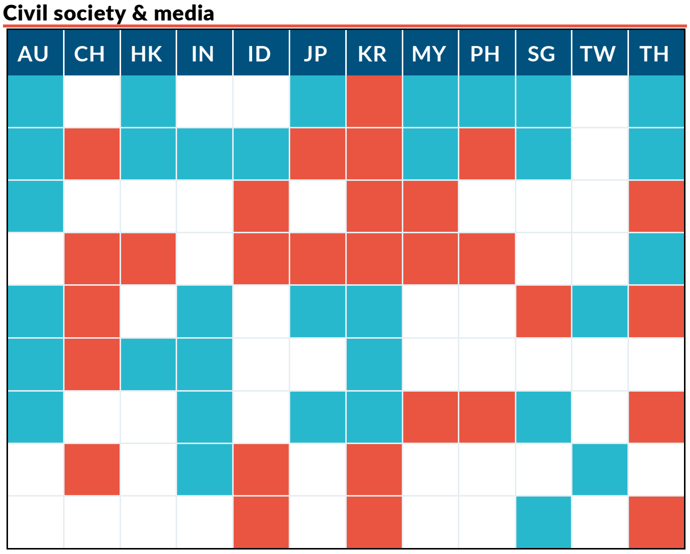
Listed companies



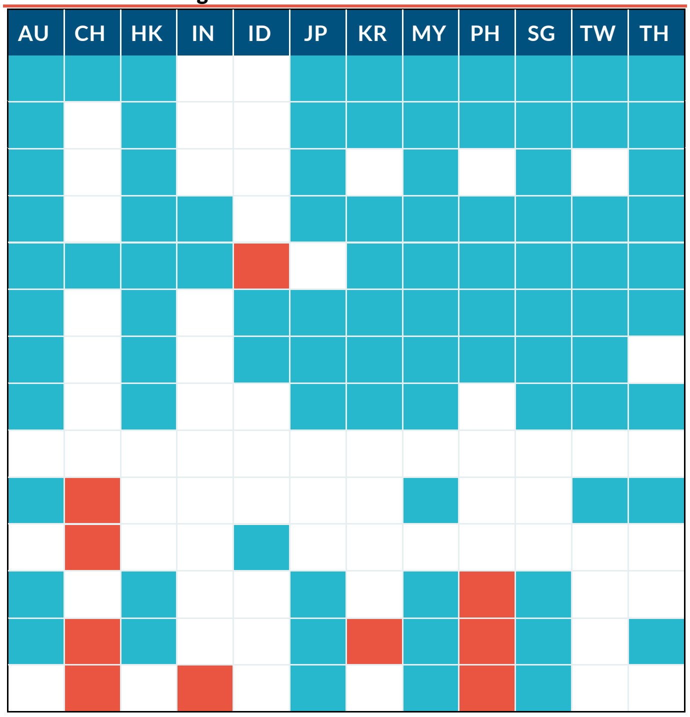
Investors



Civil society & media



Auditors & audit regulators



Source: ACGA; (ACGA & ARE for Listed Companies)

We introduced a significantly restructured survey and improved scoring system in 2018

Scoring methodology

Recapping 2018

In CG Watch 2018, we introduced a significantly revamped survey structure and scoring methodology, moving from our earlier five-category thematic system (CG Rules & Practices; Enforcement; Political & Regulatory Environment; Accounting & Auditing; and CG Culture) to our current seven-category "CG stakeholder ecosystem". The basic rationale for the change was to allow for more precise analysis of developments in corporate governance around the region and to compare progress across the 12 markets in the different stakeholder groups. Our previous survey did not provide for this because it aggregated the work of different stakeholders in the same category. For example, Enforcement included both "public" (ie, regulatory actions) and "private" (ie, the exercise of shareholder rights). It was not possible to directly compare, say, the effectiveness of regulatory investigations and sanctions between markets.

Our 2018 survey also increased the number of questions from 95 to 121 and introduced a small but important change in our scoring system: we replaced our traditional five-point system (Yes-1; No-0; Marginally-0.25; Somewhat-0.5; Largely-0.75) with a more rigorous six-point system (0, 1, 2, 3, 4, 5). This allowed for a more nuanced range of scores and removed the middle score of 0.5 points, which had tended to result in a neutral-bias on many questions. The new system forced a choice between 2/5 and 3/5 where market performance was average.

The structure of our 2020 survey has not changed, but our research and scoring methodology has become more granular

2020 improvements

We made no changes to the seven-category structure of our market survey in CG Watch 2020, nor to the six-point scoring system. Our basic list of questions has remained the same, although we removed a few (especially in Listed Companies) and revised others to make the scope and/or intent of the question clearer. The total number of questions in this survey has fallen slightly to 119 from 121 in 2018.

Each question now has a more detailed list of between four and six sub-components that guide our research

The main improvement in this survey, however, has been the introduction of a more granular and objective scoring methodology. Each question now has a more detailed list of between four and six sub-components that guide our research and against which we assign positive or negative scores. Our aim is to produce a more consistent and precise approach to scoring across markets.

We started working on CG Watch 2020 in Q1 2020, initially revising and improving our market and company surveys. Research on individual markets began in Q2 2020, drawing both on work ACGA had done previously for our Asia Regional Briefing newsletter (for members) as well as new material gathered and interviews carried out specifically for CG Watch. As a team we met on a regular basis in Q3 and Q4 2020 to compare scores and iron out issues with our new scoring methodology. The end of the process was a series of detailed discussions - spanning more than three weeks over mid-October 2020 to mid-November 2020 - when we finalised the scores for each question across the 12 markets.

Our aim is always to be as accurate as possible regarding local market rules and conditions, and to be fair in how we judge markets on a comparative basis. While some questions are binary and objective, many require the application of judgment on the part of ACGA.

We judge each market by the same criteria

A perennial challenge in our market scoring is that regulators and others often feel we have not properly recognised progress being made in their market. This is because regulators measure progress against their own starting point, not an objective regional benchmark. Our response is that we judge each market by the same criteria and, while we recognise and give points for effort, we are also seeking to score markets in terms of actual progress (not future potential) and the objective or current status of their CG regulatory system and environment. We take responsibility for any errors made and will correct them in subsequent issues of CG Watch.

The content of our seven categories summarised

Survey structure and content

A summary of the content of the seven categories in our market survey follows:

1. **Government & Public Governance:** An overview of government CG policy, political support for regulators, bank governance, regulatory independence, progress on civil service ethics, and the independence and expertise of the judiciary and anti-corruption commissions.

2. **Regulators:** This category is organised into two sub-categories: "Funding, Capacity Building, Regulatory Reform"; and "Enforcement". The former looks at regulatory resources, institutional development, and efforts made to improve CG regulation and standards. The latter at regulatory powers, enforcement outcomes, and the quality of disclosure on enforcement actions and trends.

3. **CG Rules:** Examines key rules on: The content of corporate disclosure (financial, CG, ESG) and reporting frequency; major features of securities law designed to ensure a fair and transparent market (ie, substantial ownership disclosure, insider trading, related-party transactions, share pledging, director trading); soft-law codes on CG and stewardship; the definition of independent director; and shareholder rights around voting, capital raising, and AGMs. The intent of this section is to provide a "pure" rules-on-paper comparative score. The implementation of rules is assessed in other categories.

4. **Listed Companies:** An in-depth examination of corporate disclosure and governance practices among 15 large caps, selected to represent a diverse range of sectors, ownership types, and market cap size; and a more general examination of 10 mid caps, selected along similar lines. (See below for a more detailed explanation of our listed companies survey.)

5. **Investors:** An assessment of the governance, engagement and advocacy initiatives of both domestic and foreign institutional investors (asset owners and managers) in each market, as well as retail investors and related associations.

6. **Auditors & Audit Regulators:** Rating the quality of accounting and auditing standards and practices, the preparedness of listed companies for their annual audit, and the scope and effectiveness of independent audit regulation.

7. **Civil Society & Media:** A review of the extent of director and company secretarial training, the participation of non-profit groups and professional/business associations in CG/ESG research and awareness-raising, and the role of the media.

The scoring for the Listed Companies category is based on an extensive survey developed in collaboration with ARE

Listed companies survey

A new feature of CG Watch which commenced in 2018 is a detailed survey underlying our Listed Companies section. Developed in collaboration with Asia Research & Engagement (ARE), Singapore, the survey aims to be as objective as possible and is focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or for financial years starting in 2019). Through 16 high-level questions on large caps (accompanied by 51 sub-questions) and four high-level questions on mid caps (25 sub-questions), our objective is to build a systematic picture of the quality of governance practices and corporate disclosure among leading companies in the region.

Companies were chosen in a structured and representative manner

Companies were chosen in a structured and representative manner. For large caps, we selected the top 50 companies by market cap for each of the 12 markets, then narrowed the selection down to 15 per market. The proportion of sectors and ownership structures was mapped for each of the top 50 company lists and, as far as possible, was replicated in the final selection of the 15. For example, if a market had six property companies in the top 50, comprising 12% of the total, we would select two property companies in the final 15, representing 13% of the total.

The second level of selection reflected the proportion of different ownership styles in the top 50, namely state ownership, private (family), private (dispersed), and multinational corporations. If 60% of the top 50 companies in a market were SOEs, we ensured that nine of our 15 large caps had state owners.

For the mid caps, we chose 10 companies per market to reflect predominantly sector composition. For most markets, the mid caps were selected from the top 101 to 350 companies by market cap. However, we had to adjust this range to take account of company size in large and small markets. In markets such as China and Japan with several thousand listed companies, the mid-cap cut-off point would not be the 101st largest company. Conversely, in the Philippines the 101st largest company would be a small cap by regional standards. We adjusted the selection ranges accordingly.

After we developed the survey, ACGA took the lead in researching Australia, China, Hong Kong, India, Japan, the Philippines and Taiwan. ARE took the lead on Indonesia, Korea, Malaysia, Singapore and Thailand. We compared notes at multiple stages during the process and worked together at the end to ensure scoring consistency across the region. The survey was also designed to reduce inconsistencies in the evaluation and scoring process.

Our company survey produced more than 9,000 data points for the 180 large caps reviewed

In total, our company survey produced more than 9,000 data points for the 180 large caps reviewed and 3,000 data points for the 120 mid caps. This information was aggregated to produce scores for the 20 high-level questions in the Listed Companies section for each market and formed the basis for our analysis of how companies were performing on topics ranging from financial reporting to board governance and diversity, and from director and executive remuneration policies to ESG and sustainability reporting.

While there are many new features in the content of our 2020 survey that make it significantly different from our 2018 version, one important innovation is the use of SASB materiality indicators as a basis for assessing company sustainability management and reporting practices.

Another major innovation in CG Watch 2020 was a series of surveys on specific aspects of the CG ecosystem in Asia

Other surveys

Historically, the scoring in our market survey has been based on original and independent ACGA research. That is to say, CG Watch is not a survey sent out to market participants and responses duly collated. This approach has remained unchanged for this survey, with some significant additions.

To strengthen the comparative data used in the scoring of CG Watch 2020, we carried out new cross-regional research on topics relating to regulators, companies, investors and auditors. One of these involved a survey of ACGA institutional investor members on their voting and engagement in the region—the first time we have included such data in CG Watch. The full list of regional research topics was as follows:

1. **Covid-19 and e-AGMs**: We studied how regulators reacted to the pandemic in 2020 and allowed flexibility in financial reporting and AGM deadlines, provided new guidance on electronic AGMs (hybrid or virtual) and in some cases amended company law to allow for virtual meetings. We also looked at the extent to which the top 50 companies in each market adapted to electronic-meeting technology or stuck with physical AGMs - a choice that was largely driven by the policy decisions of regulators. This information was then incorporated under the Regulators and Listed Companies sections for each market.

We undertook two sub-surveys, one on domestic institutional investors and one on ACGA's global investor membership base

2. **Investor voting and engagement:** We undertook two sub-surveys, one on domestic institutional investors and the other involving ACGA's global investor membership base. The first involved desk research to assess the level of stewardship among the top five asset owners and top 10 asset managers in most markets. We sought information on policies on CG/ESG and voting, the disclosure of voting records and portfolio company engagement.

   The second survey, which is discussed in detail in the overview chapter titled "ACGA Member Survey on Voting and Engagement 2020", asked our members 17 questions on such things as their level of investment in Asia-Pacific, the extent to which they vote against management resolutions in AGMs, their individual company engagements, and whether they apply their global voting and CG policies to the region or adapt them in any way.

   The results of these two surveys were incorporated in the scoring for the 13 high-level questions on institutional investors in the Investors category as well as the commentary in each market chapter.

3. **Auditing standards:** We hired an outside expert to carry out a review of auditing standards and inspection regimes across the 12 markets, looking at how quickly and comprehensively markets adopt new International Standards on Auditing (ISAs) and the new 2018 IESBA Code of Ethics, as well as the integrity of CPA and audit engagement inspection regimes. The results were incorporated into the scoring for the relevant questions in Auditors & Audit Regulators and the commentary for each market chapter.

Acknowledgements

The research on each market in CG Watch 2020 was led by an individual ACGA team member with support from one or more others. Research sources included a wide range of printed and online materials from governments, regulators, companies, investors, accounting firms, law firms, civil society groups and the media. Numerous one-on-one interviews were also undertaken in each market, mostly by telephone or Zoom due to travel restrictions, with follow-up as necessary through written exchanges.

In total, 18 people worked directly on CG Watch 2020 in a research and writing capacity. In addition to the author names already recognised in the market chapters, we would like to acknowledge the support of the following individuals who contributed in multiple different ways:

- **At ACGA:** Sumika Hashimoto, Vivian Yau, Bilal Khan, Helen Wong, Padma Venkat, Mikky Li, Ida Chan, Edwin Chiu, Joseph Ding and Melissa Brown. Special thanks to Padma, Mikky and Ida for diligently coordinating our first global member survey.
- **At Asia Research & Engagement (ARE), Singapore:** Jeehee Moon and Joyce Khoh, for supporting our listed company survey and market research. Special thanks to Jeehee for superbly managing the company survey process.
- **Christina Ng** for her research on auditing standards and inspection regimes across the region.
- **At CLSA:** Seungjoo (SJ) Ro, Miriam Zhou, Liz Patterson, Ellen Lo, Richard Watt and Tom Telford for moral and practical support on production, including our special joint Preview Report published for the ACGA 2020 Annual Conference in November 2020. Special thanks to SJ and Liz for their patience in waiting for ACGA to complete the full report! Thanks also to Marylene Guernier and Jingting Peng for coordinating the launch of CG Watch 2020 in May 2021.

We would further like to express our appreciation to the ACGA Council, led by Anthony Muh, Chair, and Steven Watson, Vice Chair, for their moral support and patience during the longer than normal writing period for this report. Our gratitude, too, to all ACGA members for their forbearance.

We would finally like to acknowledge, anonymously, the many ACGA members, friends and contacts who provided insights and information during the compiling of this report, as well as the many individuals whom we interviewed from regulatory agencies, companies, investment/financial institutions, auditing firms and many other organisations. Some we are able to thank by name, including: Bob Broadfoot of the Political & Economic Risk Consultancy, Hong Kong; Dr Jon Quah, Anti-Corruption Consultant, Singapore; Tatsuya Imade of Japan Shareholder Services, Tokyo; Nick Smith of CLSA Japan, Tokyo; Professor Woochan Kim of Korea University and Solidarity for Economic Reform, Seoul; Professor Jhinyoung Shin of Yonsei University and the Korea Corporate Governance Service, Seoul; Associate Professor Mak Yuen Teen of NUS Business School, Singapore; and Rob Edwards on behalf of the Association of Global Custodians - Asia Committee.

The ACGA Secretariat

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Mikky Li
Ida Chan
Neesha Wolf
Vivian Yau
Jane Moir

First ACGA Member Survey on Voting & Engagement 2020

What kind of engagement is going on between global institutional investors and the Asia-Pacific listed companies in which they invest? How active are they in voting their shares? Do they vote against management? As part of our research for CG Watch 2020, we surveyed our global investor members in September 2020 to establish where they invest, where and how they vote, and how much they engage. Overall, the results were positive.

What we found

The survey provides solid data for the first time

Over the years ACGA has built up a general sense of what is going on around the region in terms of investor voting, meeting attendance and listed company engagement. We decided it was time to go beyond the company announcements and anecdotal evidence to create a more tangible picture. By quizzing our institutional members we have been able to confirm much of what we previously understood and learn some new things.

Attending AGMs in person is rare, as is collective engagement . . .

It came as no shock to learn that AGM attendance is low. Nor that collective engagement is rare. But investors are using their votes in an informed way and voting against at least one management resolution in a large proportion of AGMs. And individual engagement turned out to be a more interesting story than expected, which indicates that investors are taking their stewardship responsibilities seriously.

. . . but voting and individual engagement is extensive, and many funds are adapting their CG/ESG policies to Asia-Pacific

Our key takeaways:

- Voting at AGMs: Most investors say they generally vote all their shares across markets, and more importantly, reject resolutions that do not satisfy their CG or ESG policies.
- Individual vs collective engagement: Market-wide, investors engage individually at a fairly consistent rate (on average 21% of their portfolio across markets), but not collectively (on average only 3% of their portfolio across markets).
- Adapting CG/ESG policies: We are happy to see most respondents say they tailor their global CG/ESG policies to suit local regulations or policies in Asian markets.
- Attendance at AGMs: Our investor members are keen to engage with investee companies but not at AGMs. Even before COVID-19 travel restrictions kicked in, participating at AGMs was underwhelming: 62% did not attend any AGMs in 2019 or 2020. On a more positive note, 20% of respondents took advantage of virtual AGM modes in 2020.

Who took part

Almost half our investor members took part in the survey

Almost half our investor membership—45 out of 92 members—responded to an online survey we organised in September 2020. The total AUM of the respondents at the time US$26.5tn.

Structure of the survey

There were 16 questions across five major areas:

- **Demographics (Questions 1-3, 11)**: Investors could either choose to identify themselves or participate anonymously. Most chose to identify themselves. We asked which markets they invested in and to provide a ballpark figure on how many publicly listed companies they invested in per market.
- **Voting at AGMs (Questions 8-10)**: We asked what percentage of AGMs they voted in each year (out of their total portfolio) and the number of meetings in 2020 where they voted against at least one management resolution. Respondents had the option to elaborate on the type of resolutions they typically voted against around the region (we did not ask for specific examples by market).
- Company engagement (Questions 12-13): Investors were asked whether they engage with their portfolio companies individually or collectively, and the total number of such engagements over 2019 and 2020.
- Policy adaptation (Questions 14-16): We wanted to find out if members tailored their global CG/ESG voting or stewardship policies to suit local rules and governance practices.
- Attendance at AGMs (Questions 4-7): We asked if members attended any AGMs in the 10 years to 2020 and particularly in the previous two years. We wanted to find out if attendance had gone up or down with the advent of virtual AGMs in 2020.

The findings in full

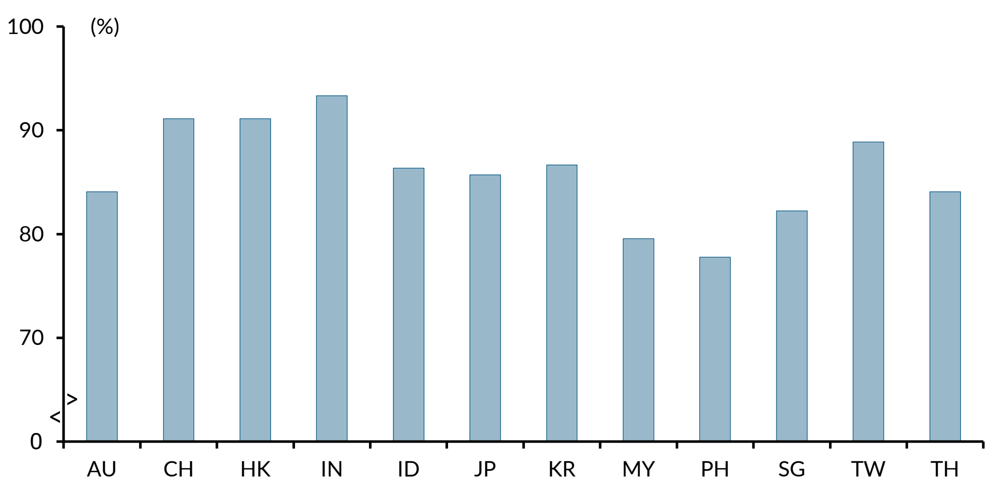
Demographics

More than 90% of respondents invest in India, China and HK

As a percentage of total respondents, India, China and Hong Kong were the top three markets for investment among our 45 survey participants. As the figure below shows, more than 90% of respondents invest in these markets. Taiwan is just behind at 89%, while Australia, Indonesia, Japan, Korea and Thailand all come in at slightly above or below 85%. The rest of Southeast Asia hovers close to 80%. Even the smallest market, the Philippines, still attracts a sizeable 78% of respondents.

Figure 16

Percentage of respondents investing in each Asia-Pacific market, 2020



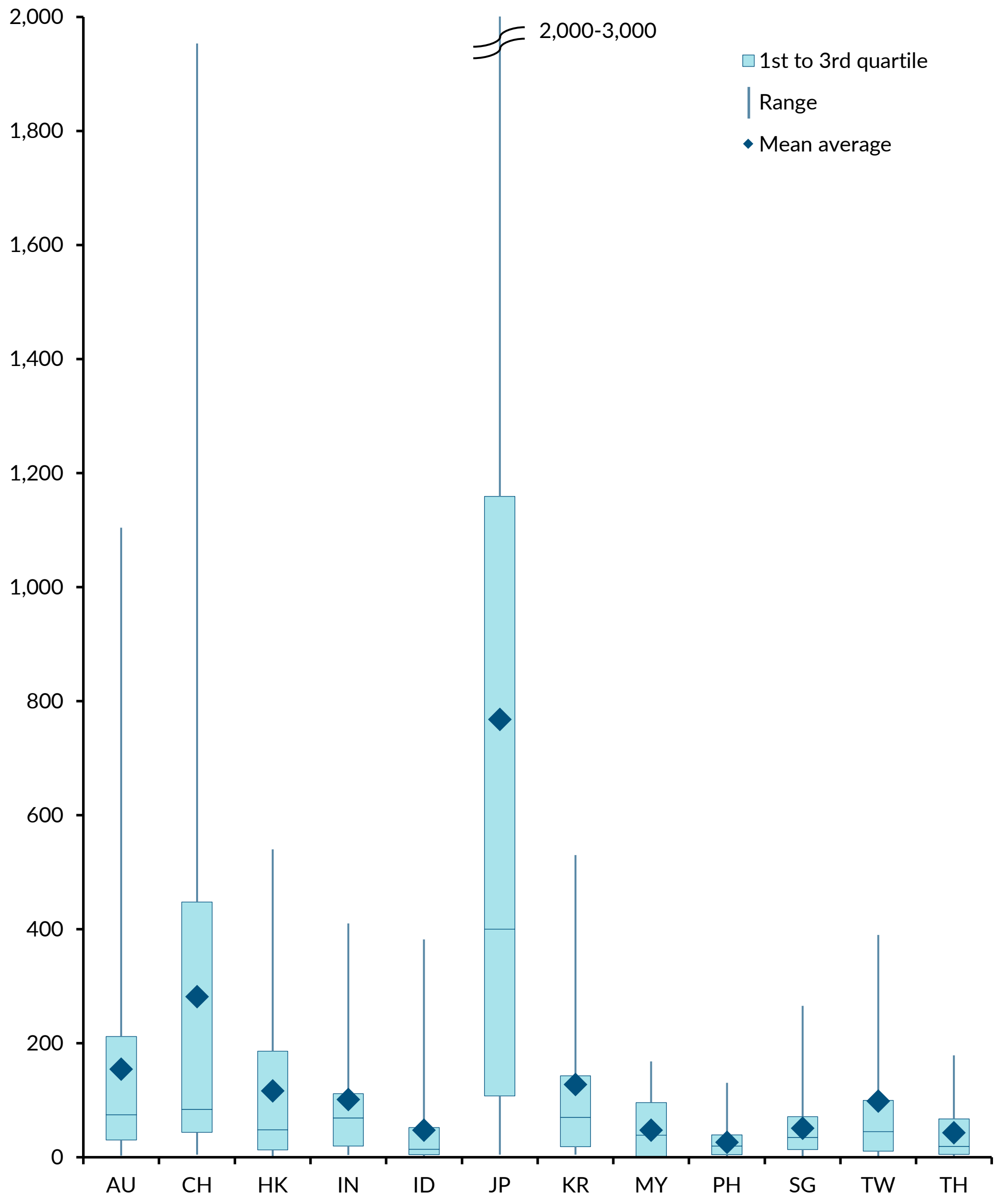
Source: ACGA

Japan is way above other markets in terms of average number of holdings

In terms of the absolute number of holdings, it is no surprise to see that Japan is the biggest market. Respondents invest in an average of 768 publicly listed companies there. China came second with 282 and Australia third with 155. For the Philippines, members invested in an average of just 27 firms. The following figure identifies holdings by range, by second and third quartile, and the mean average for each market.

Figure 17

Range and average number of publicly listed companies by market, 2020



Source: ACGA

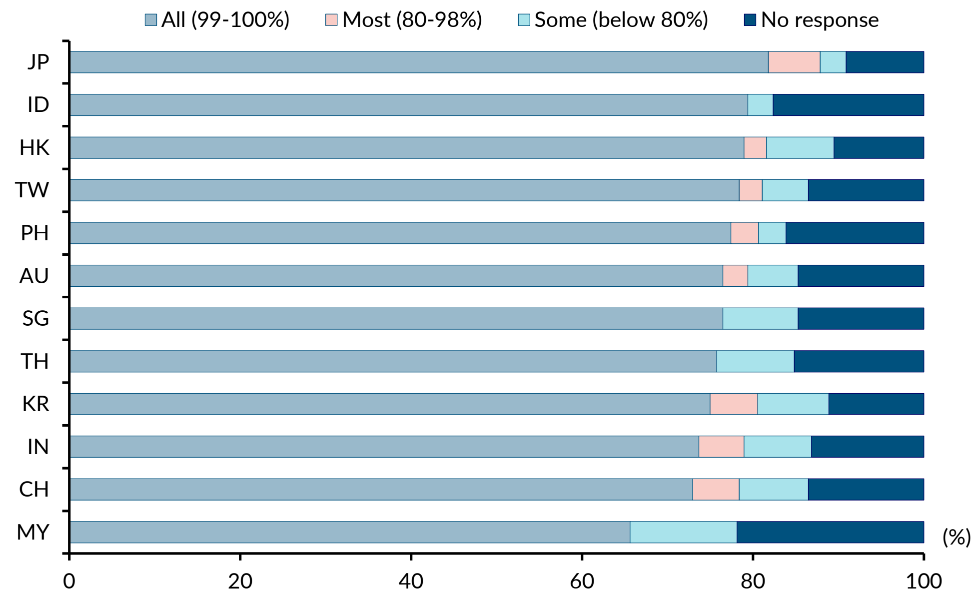
Most respondents vote in 100% of AGMs

Voting at AGMs

The figure below shows the percentage of respondents who vote at all, most, or some of their investee company AGMs, by market. Most vote nearly all their shares. Japan took the lead with 82% of respondents voting in all meetings. Hong Kong and Indonesia were joint second at 79% and Malaysia came last with 66%.

Figure 18

Percentage of respondents that vote in all, most, or some investee company AGMs, 2020



Source: ACGA

We looked at voting against in both absolute and relative terms

Voting against

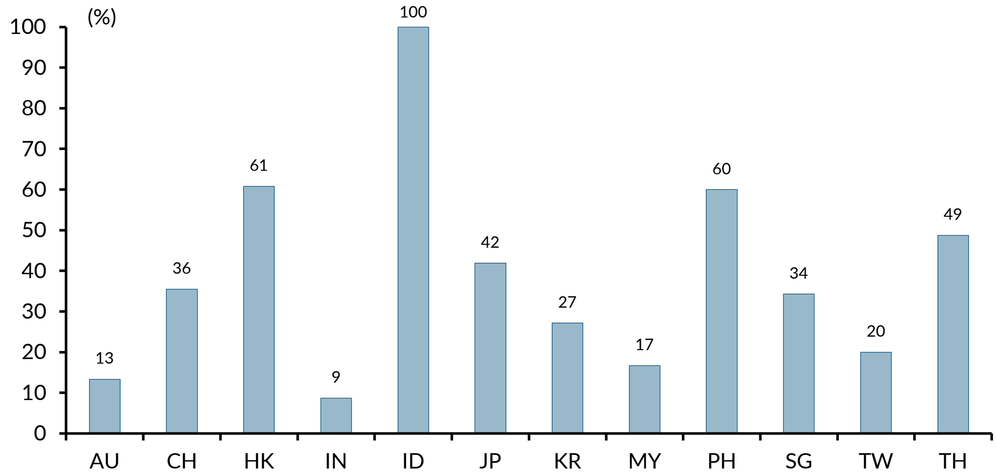
To examine the extent to which respondents are voting against management resolutions, we looked at the data from different perspectives:

1. **Absolute numbers**: We analysed the average number of AGMs per market in which respondents are voting against at least one management resolution. Not surprisingly, Japan leads the way here at 271, followed by China at 155 and Korea at 74. (See each market chapter for a deeper dive into the average figures and ranges per market.)

2. **Proportionate voting:** To get a sense of a "voting against rate", we divided the median number of AGMs with at least one against vote in 2020 by the median number of investee companies per market. Interestingly, the highest-ranking markets on this measure are Indonesia at 100% and the Philippines and Hong Kong at 60%. Then comes Thailand at 49% and Japan at 42%. The rate is only 13% in Australia and 9% in India. The high percentages for the smaller markets are clearly a product of the lower number of investee companies in those markets, with a median of 20 in the Philippines and 14 in Indonesia, as opposed to 400 in Japan, 75 in Australia and 69 in India.

Figure 19

Voting against in Asia-Pacific (% of median holdings), 2020



Source: ACGA

Voting against what?

To better understand the resolutions that the investors voted against at AGMs, the survey encouraged a free response on the various types of issues with which respondents disagreed. The following table lists the top six answers.

Investors regularly vote against board and director election at AGMs

Figure 20

Common AGM resolutions that respondents voted against, 2020

Major issues	% of poll respondents
Board/director elections (including lack of independence)	87
Remuneration	56
Share issuances (lack of strong pre-emptive rights)	33
Auditor appointment/rotation	29
Related-party transactions	16
Board diversity (including lack of plans for improvement)	16

Source: ACGA

Other resolutions drawing investor ire included:

- Poison pills
- Board spills
- Dividend payments
- Share buybacks
- Amendments to articles
- Lack of adequate disclosure in financial statements
- Reissuance of repurchased shares

In absolute terms, Japan dominates for individual engagement

Individual versus collective engagement

If individual company engagement in Asia-Pacific could be put on a set of scales, there would be no prizes for guessing which market is heaviest. Japan dominates this area, as the figure below shows, with China weighing in a distant second and Australia third.

Measuring relative engagement

To get a sense of proportionate engagement, we measured the number of individual engagements against the total number of investee firms to produce a rough average "engagement rate" of 21% across all markets. (See our market chapters for further analysis of relative engagement ratios.)

Collective engagement is mostly miniscule

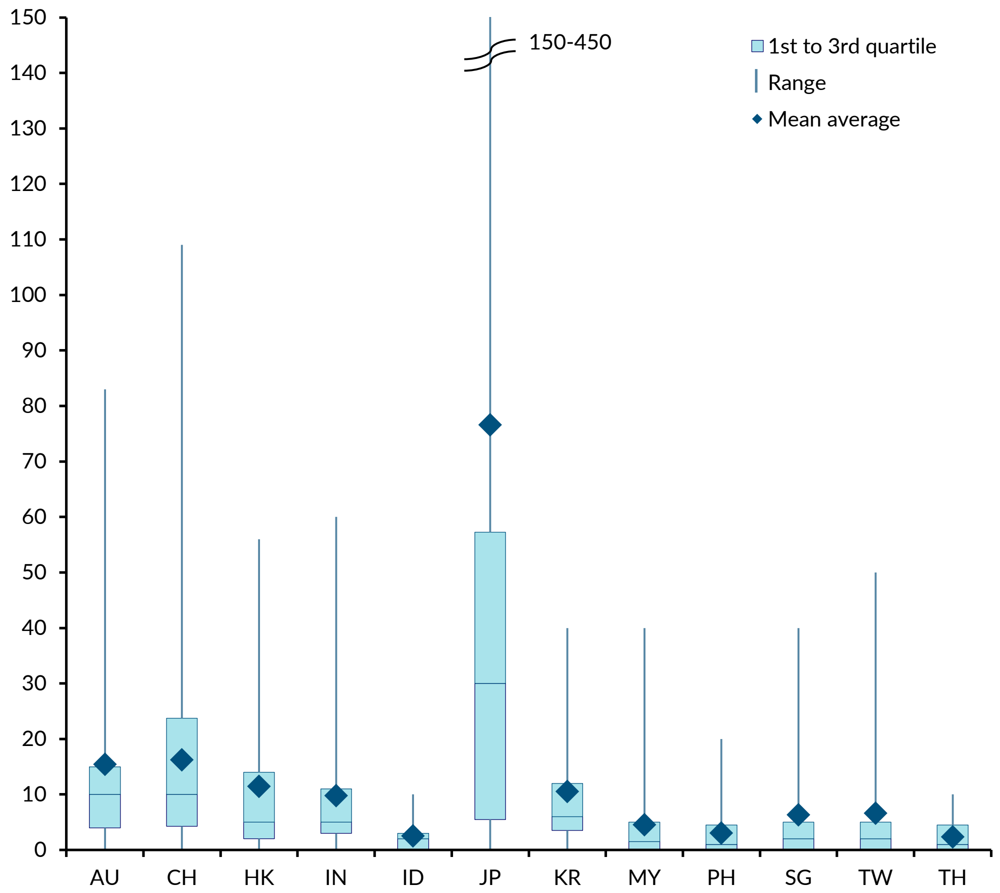
As for collective engagement, respondents engaged on average with just 3% of their investee companies across markets. While we know that the level of collective engagement in some markets such as Australia is much higher, the limited number of survey respondents did not allow us to draw firm conclusions at this stage as to a more accurate figure.

There is a need to define "engagement" more clearly

One drawback in our survey was that we did not define "engagement" clearly. Some respondents appear to consider every interaction with a company as an engagement opportunity, while others will say engagement solely refers to meetings where they provide detailed feedback to a company on governance, ESG or business matters. We plan to further refine the definition in future versions of this survey.

Figure 21

Individual company engagement (average numbers), 2019-2020



Source: ACGA

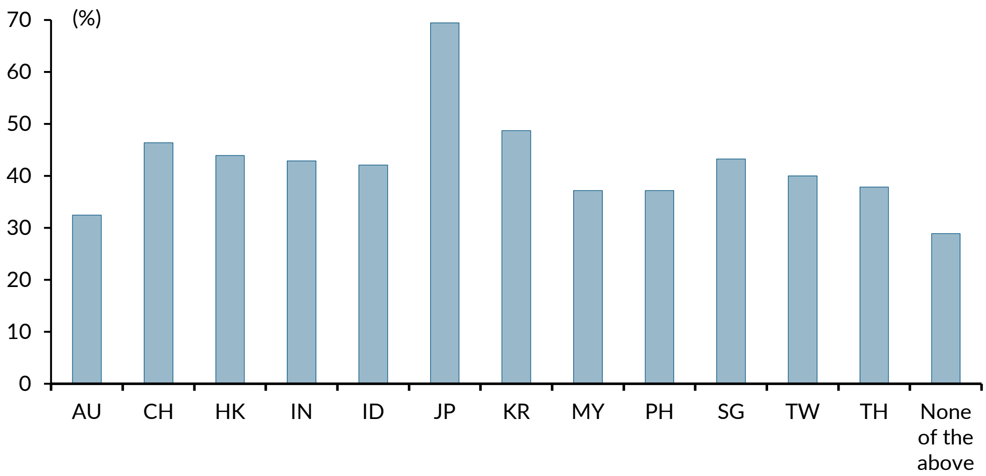
Many investors are adapting global CG/ESG policies to the region

Adapting CG/ESG policies

Another positive trend indicated by our survey results was the large number of investors who are adapting their global voting and stewardship policies to individual markets in Asia-Pacific, although the degree of adaptation varies. As highlighted in Figure 7, 69% of the respondents are adapting CG/ESG policies to suit Japanese rules and government policies, while Korea ranked second at 49% and China third at 46%. Around 29% of respondents clearly indicated that they had not localised their global proxy voting policies for Asia-Pacific.

Figure 22

Adapting global CG/ESG, voting or stewardship policies to Asia-Pacific (% of respondents), 2020



Source: ACGA

Some investors accept lower CG standards than in their home markets

When asked how they have amended their policies, some investors contrasted their 30% rule for women on boards in developed markets with much lower targets of one woman director for boards in Asia. Nevertheless, they will continue to engage with companies to improve diversity. A number of respondents said that while they may be willing to adapt their policies on such matters as board composition, they would not compromise on conflict of interest issues.

Many policy adaptations apply to all markets, some are designed for specific market conditions

Figure 23

Policy adaptations by type: Common vs unique, 2020

Common adaptations (across all markets)	Unique adaptations (in certain markets)
❑ Board independence: lowering expectations	❑ Voting against Variable Interest Entities (China, Hong Kong)
❑ Board gender diversity: lowering expectations	❑ Election of statutory auditors (Japan)
❑ Proxy recommendations to comply with local guidelines	❑ Publication of annual financial statements (Korea)
❑ General statements of adapting to the local CG Code	❑ Arbitrary increase in royalty fees to overseas parent companies (India, Indonesia)
❑ Translation into local language	❑ Discussion of compensation arrangements

Source: ACGA

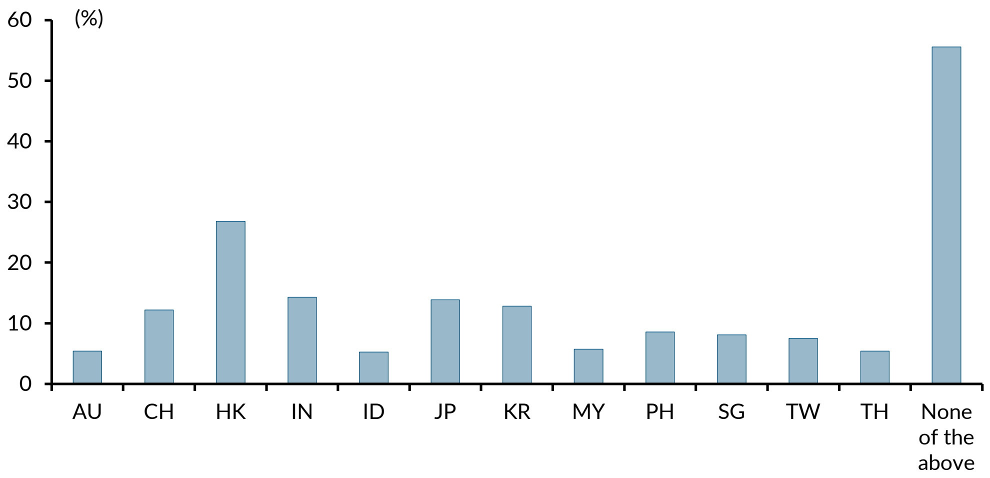
Reasons why attending AGMs in person has value

Attendance at AGMs

There is value in participating in AGMs in person in addition to individual company engagement between annual meetings. The AGM provides a unique platform for raising questions with directors, company executives and auditors, all of whom may be difficult to meet at other times of the year. Indeed, a common complaint of investors is that they find it hard to meet directors of Asian companies one-on-one. Participation in AGMs could create new opportunities for network-building and raise awareness among companies that their large shareholders are actively interested in governance issues. With their deep company knowledge and financial market expertise, institutional investors are also well-placed to raise important governance and ESG issues at shareholder meetings, which in turn would benefit retail shareholders, other stakeholders and indeed the company itself. Unfortunately, physical participation has been the exception rather than the rule over the past 10 years across the region, as the following figure shows:

Figure 24

Attending AGMs in person (% of respondents attending at least one meeting), 2011-2020



Source: ACGA

A quarter of respondents attended AGMs in at least one market in 2019; very few in 2020

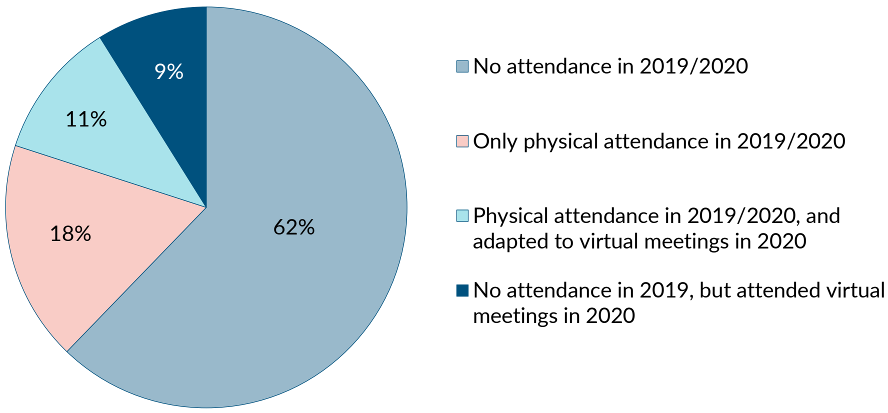
When we prompted respondents on AGM participation in 2019 and 2020, only 12 of the 45 said they had attended AGMs physically in any market in 2019. The majority of these were in Japan. Not surprisingly, due to COVID-19, only three respondents attended AGMs in person in 2020. What was something of a surprise was that 80% of respondents said they had not attended electronic AGMs in 2020 either.

Challenges in data collection, AGM timing and regulatory policy could have affected attendance results

A few factors out of the control of members may have affected these numbers. Firstly, some respondents said they simply did not have access to the attendance data internally, so it is possible that attendance may be slightly higher than the survey indicated. A second factor could be the timing of the survey. AGM attendance statistics for markets with late year-end dates such as India (31 March) and Australia (30 June) may not have been ready in time. Thirdly, fully electronic (ie, "virtual") AGMs were not an option for companies in certain markets, while most North Asian regulators did nothing to encourage even "hybrid" meetings (a blend of physical and electronic). While India and Malaysia moved to virtual meetings in 2020, not all companies were able to arrange such meetings in time. Some markets like China and Korea did not hold any virtual AGMs in 2020, while Hong Kong held just one and had a few hybrid meetings. Virtual meetings were expressly prohibited in Taiwan and Japan. While Japan promoted hybrid meetings, there were few takers.

Figure 25

AGM attendance in 2019 and 2020



Source: ACGA

Regionwide, 38% of respondents participated in AGMs in some form over 2019 and 2020

The 2019 and 2020 physical or virtual attendance was aligned with the previous 10-year datapoint, showing that 62% of respondents did not attend AGMs, whether in-person or virtual. On a positive note, 9% attended virtual AGMs with no physical attendance in 2019/2020, and another 11% of respondents adapted to virtual from physical meetings. Some respondents said they found engaging with companies outside of AGMs to be more meaningful and useful than attending shareholder meetings. Other members consider participation at AGMs has value and complements engagement outside of AGMs.

Limitations

Survey limitations and issues to improve next time

As our first attempt to gather objective data on member voting and engagement in Asia-Pacific, we recognise there were some limitations in its scope and process. Firstly, we understand that the person who responded to the survey may not have had access to all the relevant data. This could have affected results regarding AGM attendance and policy adaptations. Secondly, some of the information we sought appears to have been stored and aggregated differently by different organisations, which raises the possibility that some of the data in the survey may not be strictly comparable across respondents. Thirdly, terms such as "engagement" could have been more clearly defined, hence there may be ambiguities and inconsistencies in responses. For future iterations of this survey, ACGA looks forward to working closely with our investor members to improve the design of this survey.

Market profiles

All prices quoted herein are as at close of business 11 May 2021, unless otherwise stated

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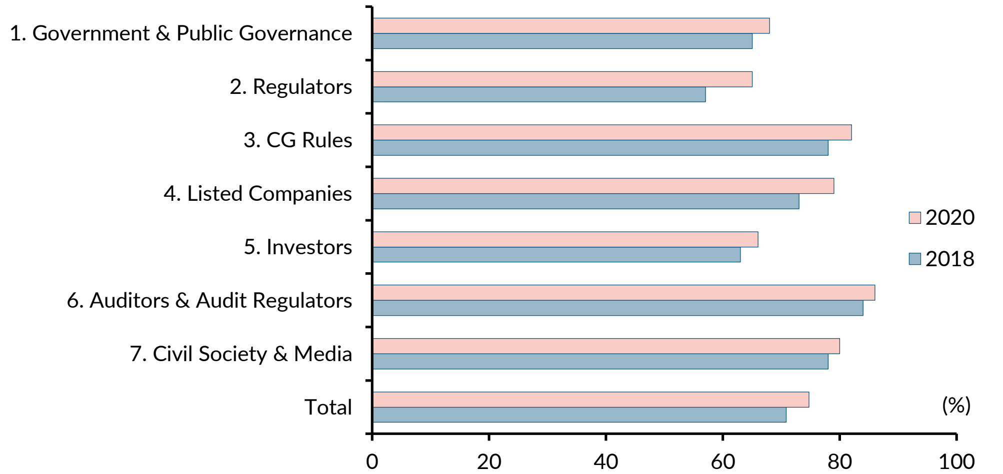
Australia – Imperfect leader

- Public governance remained the usual mix of the progressive (new whistleblowing law) and the opportunistic (government uses Covid to roll back class action rights). Australia still lacks a federal ICAC
- ASIC funding improved with new industry levy, yet assessing the sufficiency of its funding remains a challenge
- Banking Royal Commission reverberated throughout the regulatory system
- ASIC upped the ante on enforcement with a new "Why not litigate?" mantra. But data on outcomes remains somewhat slippery
- Stronger focus on ESG and sustainability reporting, including climate risk
- Investor stewardship strengthened, yet disclosure of voting records varied
- Auditor regulator toughened enforcement policy and named big accounting firms

Figure 1

Australia CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Australia once again took a commanding lead in our survey with a higher total score than in 2018 and a more than 10-percentage point lead over Hong Kong and Singapore. As in our previous report, Australia shone in CG Rules, Listed Companies, Investors, Auditors & Audit Regulators, and Civil Society & Media. It achieved a lower score in Government & Public Governance - though still did vastly better than most of the region. While its score for Regulators and Enforcement improved considerably on 2018, it is still not top of the class.

Australia takes the lead but still has blind spots

As the title to this chapter and the subsequent bullet points highlight, Australia's CG ecosystem still suffers from systemic weaknesses in public governance, especially the lack of a lead national anti-corruption agency, and bank regulatory risk management. A significant effort has gone into fixing bank governance failures over the past two years and it will be fascinating to see if these prove more effective than previous policies and guidelines. As we ponder in our Government & Public Governance section, are Australia's big banks effectively too big to govern?

There has been progress on some longstanding issues . . .

Recapping CG Watch 2018

Over the past two years, Australia has made progress on several areas highlighted in our previous CG Watch reports, notably the passage of new whistleblower legislation, a proposal for a new federal integrity commission, improved funding for the Australian Securities and Investment Commission (ASIC), stronger enforcement by ASIC, and the creation within the regulator of a national office of enforcement. Higher penalties have also been enacted for white-collar crime. Progress in some other areas has been more mixed, as the following table shows, although ACGA has revised its views on certain issues.

. . . but not others

Figure 2

Australia: Recap of 2018

	Recommendations	Outcomes
1.	Introduce a new listing rule or detailed guidance on ESG reporting	Not done. However, the revised ASX CG Principles reinforce the need for such reporting and ASIC updated its regulatory guidance to promote greater climate risk and ESG reporting
2.	Introduce a clearer rule on closed periods for director trading	Not done. However, ACGA has revised its view on the relevant listing rules, which we now believe are robust
3.	Mandate voting by poll	Not done. Yet the vast majority of larger listed companies do vote by poll at their AGMs
4.	ASIC to provide a report on audit industry capacity	Partially done. ASIC now publishes a report on audit quality indicators that covers some of this information
5.	ASX to disclose enforcement action against listed companies on an individual named basis	Not done

Source: ACGA

1. Government & public governance

Australia ranks joint 1st with a score of 68%

Although it retained the top spot, Australia's score of 68% for Government & Public Governance improved only a few percentage points compared to 2018. It now shares the lead with Taiwan, which jumped significantly in this category due to enhanced government commitment to CG and ESG. We continue to believe that Australia should be scoring much higher here (75%+) as it does in categories such as CG Rules, Listed Companies, Auditors & Audit Regulators, and Civil Society & Media.

There is still no CG roadmap

Why does Australia underperform? The reasons are little changed from our past two CG Watch surveys in 2016 and 2018. We believe the federal government lacks a clear strategy for corporate governance - indeed the Covid pandemic brought underlying tensions to the surface - and is inconsistent in its support for the policy and enforcement work of ASIC. Bank governance looks better on paper than in practice. Government efforts against corruption are not as robust as one would expect of an advanced democracy.

Two score increases out of 12 is not great

Indeed, of the 12 questions applicable to Australia in this category, the scores for only two changed since our last report. The first related to whether the funding for the securities commission is independent of government: This has improved with the advent of an industry funding model for ASIC. The second was on the powers of anti-corruption agencies, where Australia gained a point due to a change in our scoring methodology rather than substantive progress in this area. Indeed, Australia still lacks a federal Independent Commission Against Corruption (ICAC), something promised by the Morrison government in late 2018.

Governance and ethics are fundamentally solid

The bedrock of Australia's public governance system remains strong, however. Civil service ethics are high. The judiciary is clean, independent and highly skilled. The legal system allows minority shareholders a range of remedies against abusive behaviour by companies. The structure of the regulatory system governing the securities market is freer from commercial conflicts of interest than other markets in the region - though that is not a high bar to jump over.

Financial-sector governance: The big reset

A royal commission exposes bad behaviour

Following a string of financial scandals, a royal commission was formed in December 2017 to look into misconduct in the banking, insurance and superannuation sectors. Interim findings released in September 2018 were followed in February 2019 by a three-volume, 1,000-page final report listing 76 recommendations and 24 referrals for further action. The report painted a grim picture of Australia's financial services industry where naïve consumers and small businesses were walking targets for fee-obsessed bankers operating in a corporate culture ridden with conflicts of interest and lax enforcement.

Consumer horror stories steal the show . . .

A number of case studies gave tawdry examples of aggressive sales tactics, fees for no service and mis-selling which for years had been the focus of media scrutiny and public derision but not government action. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the so-called "Hayne Report", named after former judge Hon. Kenneth Madison Hayne who led the inquiry), attracted more than 10,000 consumer complaints via the Commission's web form. Thousands more phoned in or emailed. In the end, only 27 consumers of the 130 witnesses who attended seven rounds of hearings over 68 days were asked to give their personal experiences. Still, the reputations of Australia's major financial institutions took a savage beating.

. . . but there is no radical overhaul of the law

A self-serving, remuneration-driven organisational culture which lacked basic standards of governance was seen as the root cause of misconduct, while ASIC preferred mutual resolution over taking culprits to court. Boards and senior management were culpable in setting the overall tone. Yet this was not a predicament that called for a radical legislative overhaul: The law to prevent misconduct was sound, Hayne concluded, it just was not being enforced. If anything, the law needed to be simplified to eliminate myriad carve-outs and exemptions that allowed miscreants to game the system. Instead, Hayne urged a bigger picture industry reset. Among the core recommendations:

- Financial services firms should assess their culture and governance and rectify deficiencies; likewise the Australian Prudential Regulation Authority (APRA) should devise a supervisory programme to assess entities' culture and misconduct;
- APRA should improve standards on, and be able to supervise, entities' remuneration arrangements, while long-term incentive plans should also be subject to non-financial hurdles;
- Boards should challenge management and have qualitative information; staff should be encouraged to speak up; and
- Greater regulatory oversight of financial advisors; ASIC should adopt a "why not litigate" culture and move away from soft penalties.

On a more micro level were suggestions on mortgage broker reform (prospective home loan borrowers should pay broker fees rather than lenders), as well as a ban on "hawking" of products to retail clients and trailing commissions for mortgage brokers.

The government vows to act on every recommendation . . .

The report received full endorsement from the government and Treasurer Josh Frydenberg vowed to take action on all 76 recommendations. Yet two years down the line there has been some backpedalling. A January 2021 report in the *Guardian* newspaper calculated that 45 of the recommendations had yet to be implemented, 27 were already in force and four had been abandoned entirely. These include the very first recommendation on Hayne's list: That the government scrap a plan to cut responsible lending obligations from the National Consumer Credit Protection Act (NCCP). The government took out the provision in September 2020, freeing banks from the legal obligation to check whether prospective borrowers could afford to repay a loan before they were granted it. Frydenberg claimed this was being done in the name of reducing the cost and time it takes for consumers to access credit. It came into effect in March 2021.

. . . but some get the axe . . .

Meanwhile another core recommendation - that a new oversight body be set up for APRA and ASIC, independent of government - has yet to be introduced into parliament. Australia has also been slow to legislate for a compensation scheme for consumers who scammed by financial advisors who subsequently went under. On a positive note, the Australian Banking Association amended its code of practice to provide for customers with language and geographical barriers and to prevent the charging of default interest in certain circumstances. Mortgage brokers by law must also now act in the best interests of the intending borrower.

. . . while others have stalled

Of the other recommendations still in progress, some were before parliament but had been delayed by Covid (the Treasurer announced a blanket six-month deferral on the Hayne implementation roadmap in May 2020) and others were still subject to consultation. A number appear to have stalled for reasons that are not clear, such as the removal of point-of-sale exemptions (this was supposed to have been implemented by December 2020 but there has been no progress on legislation), while others, such as disclosure of lack of independence to improve quality of advice, require a government review (in this case, the review was not scheduled to happen until December 2022 at the latest).

A cost of doing business?

Australia has a long history of financial scandals

Hopes are high that the Hayne recommendations will bring about a fundamental reset in bank and financial-sector corporate governance in Australia. If history is any guide, however, expectations should probably be kept in check until the new measures have had time to mature. Australia may have had an enviable economic record over the past 20 years and a financial system noted for its relative stability, but the banking system has also produced a litany of scandals, unethical practices, and poor risk management - from the National Australia Bank's (NAB) unauthorised currency trading scandal in 2004 that led to stinging criticisms of its internal controls by the Australian Prudential Regulatory Authority (APRA) and the jailing of two traders, to the endemic mis-selling of wealth management products by financial advisors in the early 2010s, to the "fees for no service" debacle over 2016-18 (which led to the Hayne Royal Commission), and the rigging of interbank interest rates in 2018.

Rogue traders, fees for no service and dirty cash

If this were not enough, the Commonwealth Bank of Australia (CBA), the country's largest bank and one of its governance leaders, was prosecuted for systemic money laundering and paid a A$700m civil penalty in June 2018 - the largest in Australia's corporate history at the time. It did not take long for this record to be broken: In September 2020, Westpac Bank agreed to an even higher penalty of A$1.3 billion, for breaching the Anti-Money Laundering and Counter-Terrorism Financing Act. This was approved by the Federal Court the following month.

A circular game of blame

Various explanations have been put forward as to the underlying causes of these scandals. Greg Medcraft, a former ASIC chairman, blamed the culture of banks. Others have blamed weak enforcement by ASIC, which has jurisdiction over bank conduct. One could also argue that the sophisticated bank governance framework set up by APRA, which oversees the capital adequacy of financial institutions, looks good on paper but has been much less effective in practice. The underlying causes may also be due to complexity - the fact that large financial supermarkets seem engineered to produce a constant stream of unlawful and unethical practices, too many for any board to know about and oversee. Then there is the money factor - Australia has a highly profitable national banking oligopoly that has evidently bred complacency among both directors and top executives. Have regulatory fines just become a cost of doing business? CBA earned a net profit after tax of more than A$9 billion in the year when it was fined A$700m. The bank promised to become a "simpler, better bank". Time will tell.

A national integrity commission?

Nobody takes the lead on anti-graft efforts

Australia remains somewhat anomalous in the region, and indeed internationally, in having anti-corruption agencies with varying powers and responsibilities situated in each of its six states and two territories, but no lead national agency. It takes a "multi-agency" approach at the national or "Commonwealth" level, with around 10 permanent bodies and additional parliamentary committees and ad hoc royal commissions having different remits over public- or private-sector corruption. Other developed countries that address corruption through a network of agencies, such as New Zealand, Denmark and Finland, all have lead coordinating agencies.

The public wants a national corruption agency . . .

Pressure has been growing for a federal agency over the past five years. Two parliamentary select committees looked at the issue in 2016 and 2017, culminating in September 2017 with a recommendation for a broad Commonwealth integrity and corruption agency. Parliamentary debate and public opinion overwhelmingly supported a national agency and, in a show of dissent, the Australian Greens introduced the National Integrity Commission Bill 2017 in October of that year, proposing a statutory agency to police corruption among the Commonwealth departments and agencies, federal parliament, the federal police and the Australian Crime Commission. The bill made it to a second reading but was removed in June 2018.

. . . but the government proposes a softer option . . .

Another stab at a national agency was taken in November 2018 in a bill introduced by independent MP Cathy McGowan, but this lapsed the following April, and another by Greens senator Larissa Waters, the National Integrity Commission Bill 2018 (No. 2), which made it through the Senate and to a first hearing in the House by September 2019. In the meantime the government proposed, in December 2018, a watered-down alternative, a Commonwealth Integrity Commission (CIC). In part, this was a defensive tactic as the opposition Labor Party campaigned for a similar framework and looked set to win an upcoming national election in May 2019. In the end, Labor lost and it was not until November 2020 that the Morrison Liberal/National government released a draft bill. A consultation on the proposed legislation ran until March 2021.

. . . and gets panned by NGOs and academics

Critics have been blunt in their derision of the proposed CIC model. With no power to make findings of its own and limited evidence-gathering ability, it would be restricted to writing reports and referring potential breaches to prosecutors. The range of people it would apply to would be narrower than that of the state ICACs. There would be secret hearings for public officials but not police. Direct complaints about ministers, members of parliament or their staff that came from the general public would not be investigated and other public-sector complaints had to come from other departments, not individuals. Its initial funding would only be around A$30m a year.

The mooted alternative lacks teeth and credibility

A group of retired judges who formed the National Integrity Committee (NIC), have lobbied for a national agency over the past four years and dubbed the CIC "not really an anticorruption commission at all", rather "a deliberate political diversion designed to shield the public sector, and in particular politicians and their staff, from proper scrutiny and accountability". The Australian Council of Trade Unions (ACTU) noted that lawyers dubbed the CIC model a disaster and "worse than having no Commission" given its lack of teeth and powers. There remains a "compelling need" for a national agency, the NIC stressed, an independent body with broad jurisdiction replete with investigative powers, the ability to make findings of fact and hold public hearings.

An integrity impasse sets in . . .

The Morrison government has since gone slow on the initiative, citing the pandemic. Yet several high-profile NGOs such as the NIC, Transparency International (TI), the ACTU and the Centre for Public Integrity as well as academics continue to lobby for a federal ICAC. Larissa Waters is still pushing for her bill to go forward. In November 2020, TI and Griffith University released a blueprint for a national integrity system which advocated a comprehensive anti-corruption plan and a federal agency with funding of at least A$100m a year. It cited an October 2020 survey that indicated 66% of Australians believe corruption in government is a big or very big problem, up from 61% in 2018.

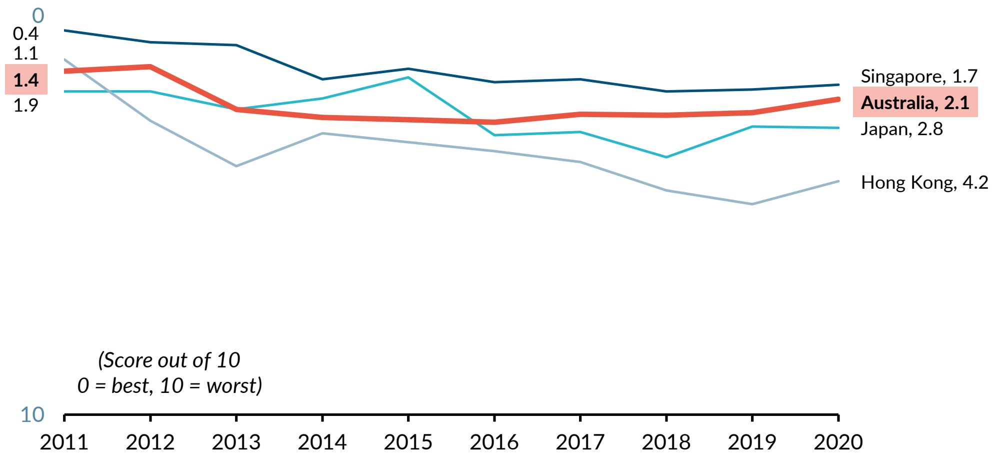
. . . as Australia slides in corruption rankings

All of this comes against the backdrop of Australia continuing to falter in global corruption indices. According to TI, Australia has declined steadily by eight points since 2012. In 2020, it ranked equal 11th with Canada, the UK and Hong Kong, scoring 77 points, well behind New Zealand (88 points) and Singapore (85 points). The country's performance in the annual survey from the Political & Economic Risk Consultancy (PERC) conveys a similar slippage, where the lower the score the cleaner the market is perceived to be, as the following figure shows. While the number for 2020 is an improvement on the previous few years, it remains below the very good scores in 2011 and 2012. To be fair to Australia, it should be pointed out that all leading markets in the PERC survey, a group that includes Singapore, Japan and Hong Kong, have slid in score as well - most noticeably Hong Kong. Relatively speaking, the Australian civil service remains one of the cleanest in the region and does not appear to suffer from endemic corruption. Elements of the private sector are a different story.

Australia's anti-graft standing has slipped

Figure 3

Slippage: How perceptions of corruption in Australia have changed, 2011-2020



Source: Political & Economic Risk Consultancy

New whistleblower haven?

Lifting the lid on bad behaviour is now easier

On 1 July 2019, new federal whistleblowing legislation took effect that consolidated piecemeal existing laws covering the private sector, provided much stronger protections for whistleblowers, and allowed whistleblowing on breaches of tax law for the first time. The law was consolidated into the Corporations Act 2001 and its provisions now cover a wider range of "eligible" whistleblowers: Current and former employees, officers, contractors, associates, trustees and other people with a sufficient connection (including spouses and relatives) to a company or organisation who may observe misconduct and be in a position to report it. In addition to companies, the law applies to banks, life insurers, superannuation entities and some non-profits. Protection is afforded to those who make reports internally or to ASIC or APRA (and in certain circumstances, journalists) and it is a criminal offence, punishable by jail of up to two years, to cause detriment to individuals who blow the whistle. This not only covers job dismissal, physical harm and harassment, but reputation damage and demotion. Breaches of confidentiality could result in a six-month jail term or fine of up to A$1m for individuals and A$10.5m for companies. Compensation is payable where loss or damage has been suffered. Companies were required to have a whistleblowing policy in place by 1 January 2020.

The new regime is yet to be tested in court

There are a number of cases before the federal courts in respect of the new law, but not yet a rigorous challenge to its parameters. In the December 2020 decision of Alexiou v Australia and New Zealand Banking Group (ANZ), a sacked ANZ trader tried to use the new law in an unfair dismissal case but the alleged conduct happened before the legislation came into effect.

Next steps

Australia needs a national graft agency

Create a national anti-corruption agency sooner rather than later and imbue it with full powers to investigate Commonwealth-level corruption in the public-sector (involving civil servants, politicians and the police) and private-sector.

Implement more Hayne recommendations

Ensure that a majority of the Hayne recommendations on financial-sector governance are implemented.

Create a national CG roadmap

A more coherent and consistent national strategy for improving corporate governance would be welcome. Current Canberra policies often seem contradictory and inconsistent.

Encourage whistleblowing

Promote greater awareness of the new whistleblowing law.

Don't let a good crisis go to waste

A dubious decision is made on disclosure rules

In May 2020, continuous disclosure requirements were watered down for six months on the highly doubtful premise that listed issuers might fall prey to "opportunistic" class-action lawsuits. It was a fortuitous turn of events for the big business groups who have persistently lobbied for this outcome over the past few years and hope the arrangement will become permanent. It did not bode well for shareholders that the initial six-month respite was extended until March 2021.

The pro-business lobby gets what it wants, and more

Australia requires listed issuers to disclose any information that a reasonable person would expect to have a material effect on the price or value of a stock. Its Corporations Act provides a civil remedy to both ASIC and private litigants for breaches. In late May 2020, the government increased the threshold and directors must now have "knowledge, recklessness and negligence" as to the materiality of information to attract civil liability. For years, business groups, the legal profession and academia have debated the virtue of a no-fault civil regime. Some wanted to follow the UK and the US (fault-based) rather than Hong Kong and Canada (no fault). By simply bulldozing the debate, Australia is now alone in requiring its securities regulator to prove fault, going well beyond the expectations of even the hardiest reformists in the pro-business camp.

The government stokes lawsuit fears

Still, these are drastic times, Treasurer Josh Frydenberg argued when he invoked a Covid emergency law to protect issuers from allegedly trigger-happy shareholders. The class actions "floodgates argument" was regularly trotted out by big business and Frydenberg during 2020 despite data showing the opposite. Monash University professor Vince Morabito, who has studied class actions for 27 years, corrected the Treasurer's claim in July 2020 that class actions had tripled in recent years: The numbers have actually been going down slightly. In the 2020 financial year there were 53 new class actions, down from 59 in 2019 and 56 in 2018. This was borne out by figures from law firm Allens Linklaters which found that not only are overall numbers falling, shareholder class actions are now outstripped by consumer and employment claims: 41% of new class action filings in 2019 were consumer-related, nearly doubling from the previous year's 23%. Employment class actions doubled from 7% to 14% of all new filings. Shareholder class actions, meanwhile, decreased from 31% to 23%. Companies are more likely to be sued by consumers and employees who band together over faulty cars and workplace harassment than poor corporate disclosure.

A battle over class actions continues to simmer

Class action fearmongerers are an innovative bunch and have pivoted in recent years: They are now pitching the debate as a David versus Goliath battle between small claimants who receive little and greedy litigation funders who take a large chunk of the winnings. At the same time, they argue, businesses are becoming risk-averse and struggle to get directors and officers (D&O) insurance. This is a familiar mantra of both the Australian Institute of Company Directors (AICD) and the Business Council of Australia (BCA), which is comprised of the chief executives of more than 130 of the country's biggest corporations.

Together with the US Chamber of Commerce, these groups were the fiercest critics of Australia's class action regime and litigation funding in response to a 2018 Australian Law Reform Commission consultation, and again in a parliamentary inquiry which in December 2020 concluded along pro-business lines: Shareholder class actions are "inefficient and contrary to the public interest", generating excessive profits for litigation funders and lawyers at the expense of companies and shareholders. Like the BCA, the parliamentary inquiry also advocated permanently retaining no-fault continuous disclosure. Unlike the BCA, AICD and the Australian Finance Industry Association, the inquiry did not go so far as to seek the removal of the right of a class action entirely for disclosure breaches, leaving only public enforcement by ASIC. Nor did it appear to be on board with the BCA's suggestion that there be limits set on damages.

ASIC pushes back, somewhat

Instead, it seems likely that any further "reform" in this area in the short term at least will continue to chip away at litigation funders. In July 2020, the government required them to be licensed with ASIC, despite the regulator questioning the policy's effectiveness and instead suggesting the industry be treated as a legal service. Indeed, ASIC has emerged as the voice of reason in the fracas, questioning the evidential basis for a review of the continuous disclosure regime back in 2018 and, in 2020, bluntly pointing out to policy-makers that disclosure was particularly important during times of market uncertainty and volatility. Disappointingly, ASIC has ultimately deferred to government on whether the relaxed disclosure rules be made permanent, but it may be taking a pragmatic stance. Several law firms have been quick to question the practical effect of the new disclosure rules: Most shareholder class actions rely on misleading or deceptive statements by issuers, rather than ones made unwittingly. Companies and directors still remain liable for these under a different section of the Corporations Act.

Victoria leads the way on contingency fees

Meanwhile, it may turn out to be a bittersweet victory but in July 2020 Victoria became the first state to allow lawyers to charge contingency fees. Whether other states will follow suit now depends on whether the Federal Court is given exclusive jurisdiction for class actions, as recommended by the parliamentary inquiry. The Federal Court does not permit contingency fee arrangements.

2. Regulators

Australia moves up to 3rd with a score of 65%

The lowest scoring category for Australia in our 2018 survey, Regulators has seen a significant eight percentage point improvement in score to 65% and its regional ranking has moved from 5th to 3rd. Although this remains the weakest part of the CG ecosystem, the gap has narrowed with other medium-scoring areas - Government & Public Governance and Investors. Unlike some other sections of our survey, the rise in score here is only marginally related to methodological changes. The reasons are more fundamental, with Australia progressing in both sub-categories of this section. However, as the absolute score indicates, it is too early to break open the bubbly.

Navigating the regulators

Australia's Treasury has oversight of market regulation at the ministerial level, sets economic and fiscal policy, and decides the federal budget. The financial markets are regulated by the so-called "twin peaks" of the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC). The former is responsible for prudential regulation of deposit-taking institutions, life and general insurance, and superannuation funds, while ASIC regulates the conduct of market participants, including companies, banks, insurers and professionals and has oversight of the Corporations Act 2001. The Australian Securities Exchange (ASX) has a frontline regulatory role over listed companies and market participants, while the Australian Competition and Consumer Commission (ACCC) deals with anti-competitive behaviour.

2.1 Funding, capacity building, regulatory reform

Australia scores equal 1st with a score of 62%

The score for this sub-category increased by eight percentage points, from a low of 54% in 2018 to 62% in 2020. More impressively, Australia's ranking jumped from a mediocre 6th to equal 1st with Hong Kong and Taiwan.

ASIC funding rethink is a boon

There were three reasons for this increase: A more robust funding model for ASIC; increased investment and effort by the peak regulator in surveillance, investigation and enforcement; and a transparent and professional system of public consultation for policy and regulatory changes. The latter question was a new addition to CG Watch in 2020 and Australia was one of only two markets in the region to score full points (5/5). The other was Hong Kong.

There are still a few gaps in tech and CG prerequisites

As in 2018, Australia scored highly in this section for the quality and usefulness of regulatory websites, but poorly on questions about whether it has developed a national electronic-voting system (ie, straight-through processing) for institutional investors - it has not - and whether there are any strong regulatory requirements for listing applicants to come to market with well-developed and mature systems of corporate governance. We also cannot find much evidence suggesting that the ASX is investing a great deal in new regulatory technology.

New ASIC funding model

The industry now funds the securities regulator

On 20 April 2016, the Australian government announced it would introduce a new user-pays industry funding model for ASIC. This was in response to a recommendation of the Financial System Inquiry (FSI) in 2014 that ASIC be funded directly by the industry, with fees and levies calculated according to the cost of regulating different sectors. It was hoped that ASIC would be less dependent on fluctuating government budgets and its spending more transparent. Another selling point was that funding by the industry would ensure ASIC's regulatory costs are footed by those creating the need for regulation, rather than taxpayers.

Who pays what? It's complex

After extensive consultation, the model adopted was based on a cost-recovery system that charged "levies" for regulatory goods and services provided to groups of individuals or organisations, and "fees" when the goods or services are provided to a specific individual or organisation. The system got going in July 2017, a sophisticated charging mechanism clearly aimed at being as fair as possible to market participants. It is also highly complicated, lacking the simple elegance of the Hong Kong model, which is based on a tiny tax on all securities transactions.

There are levies and fees

Regulated organisations are divided into six sectors and 48 sub-sectors, with 90% of industry funding based on levies: a flat levy based on the cost of regulating each individual sub-sector; and a graduated levy based on the minimum amount paid by all entities in a sub-sector with a variable component based on the actual enforcement and surveillance required. The remaining 10% of industry funding is in the form of fees-for-service, such as licensing and professional registrations, requests for changes to market operating rules and ASIC's formal compliance review of documents for corporates.

ASIC sends the market a bill

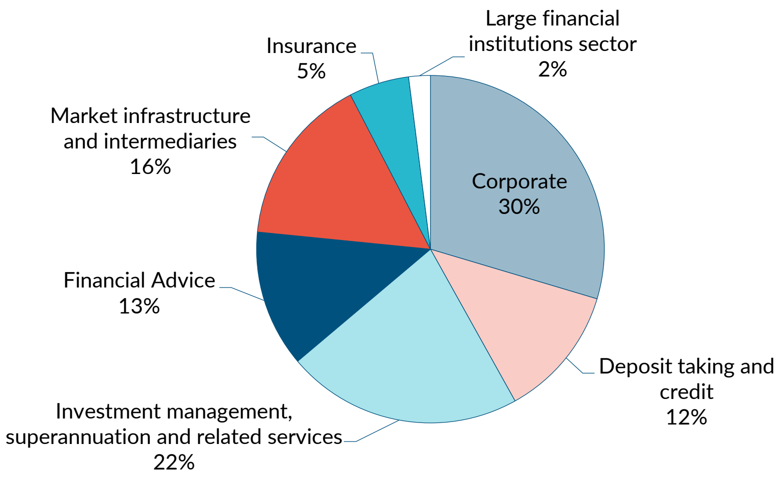
At the end of each financial year (ie, June), ASIC publishes a cost recovery implementation statement (CRIS) which sets out its forecast of regulatory costs and activities by sub-sector for the year ahead as well as details on how it allocated its costs in the previous year. These are indicative only and open for public comment. Entities submit their data on business operations via the ASIC Regulatory Portal between July and October each year. ASIC then calculates an estimate of their share of the regulatory costs by the end of the calendar year, an invoice is sent out in the following January and must be paid by March.

Looked at in sectoral terms:

Here is how much the various sectors pay

Figure 4

Regulatory costs recoverable by industry funding levies, 2019-2020



Source: ASIC Cost Recovery Implementation Statement ASIC industry funding model (2019-2020)

Funds come via the budget

It is worth highlighting that the government still pays ASIC's annual budget through an appropriation from the federal budget. The industry funding model then recovers a large portion of these costs. But not all of ASIC's costs are recovered. In 2019-20, it initially estimated that around A$324m of its "total budgeted resources" of A$430m would be recovered through levies and fees, according to a June 2020 statement.

ASIC gets more cash

ASIC's expanding budget

Funding for ASIC has increased materially post-Hayne. Some core data points:

- In 2018-19, ASIC received approximately A$374m in appropriation revenue from the government, including A$36m for the Enforcement Special Account (ESA), representing a A$26m or 8% increase compared with 2017-18. The A$26m increase in appropriation revenue relates mainly to additional funding provided to ASIC in 2018-19 for new budget measures.
- In 2019-20, ASIC received approximately A$403m in appropriation revenue from the government, including A$41m for the Enforcement Special Account (ESA), representing a A$29m or 8% increase compared with 2018-19.

The figures above are not, however, the full picture. ASIC also receives "equity injections" and a capital budget allocation. See the table below:

Here is where the money comes from

Figure 5

ASIC Annual appropriations (recoverable GST exclusive), 2019-2020

(A$, '000)	Total annual appropriation		Appropriation applied in 2020 (current and prior years)		Variance[1]	
	2019	2020	2019	2020	2019	2020
Departmental	**417,984**	**462,503**	**439,231**	**551,132**	**(21,247)**	**(88,629)**
Ordinary annual services	386,345	423,928	400,204	515,165	(13,859)	(91,237)
Capital Budget	24,345	25,149	25,958	26,569	(1,613)	(1,420)
Other services: equity injections	7,294	13,426	13,069	9,398	(5,775)	4,028
Administered	**19,683**	**10,261**	**14,905**	**5,194**	**4,778**	**5,067**
Ordinary annual services	19,683	10,261	14,905	5,194	4,778	5,067

[1] Variance in 2019 is due to accrued expenses from the prior year being drawn down in the current year from operating and equity funding, as well as unspent appropriation from departmental capital budget. Variance in 2020 is due to the payment of prior year accrued expenses in the current year and approximately A$20m of expenditure funded from the opening balance of the Enforcement Special Account. Source: ASIC Annual Report 2019-2020

Manpower is on the up

Staff numbers have been steadily rising at ASIC: Total full-time equivalents (FTE) (excluding those allocated to capital projects) have gone from 1,627 in 2015/16 to 1,940 in 2019/2020. Moreover, total staff expenses have increased significantly over the past two full financial years: From A$227m in 2018/19 to A$275m in 2019/20. One big change for ASIC's ability to recruit has been its withdrawal from the Australian Public Service on 1 July 2019. A legislative amendment in 2018 freed the regulator from an obligation to employ staff under the Public Service Act 1999, ie, the federal civil service.

A new Office of Enforcement

A centralised enforcer hits the ground running

Following the Hayne Royal Commission report and an internal review in December 2018 that drew upon outside expertise, ASIC formed a separate Office of Enforcement in July 2019. The objective was to strengthen ASIC's enforcement effectiveness by creating a single enforcement strategy, stronger governance structures for enforcement, and "collective prioritisation and accountability" for enforcement outcomes and capacity building. Clearly stung by criticism during the Royal Commission of its inadequate enforcement action against wrongdoing by banks, and its reluctance to go to court, ASIC put more emphasis on criminal and civil litigation, coining the organising principle, "Why not litigate?"

Too many enforcement chiefs in the past

Prior to these reforms, ASIC had delegated enforcement across its different functional departments and had no single head of enforcement. Instead, it had an Enforcement Committee that met fortnightly and included the commissioners and relevant senior executives. Some viewed this as unsatisfactory and expressed concerns to ACGA. As one former regulator said to ACGA in 2016, in words that were quite prescient, "ASIC is an enforcement organisation. They still do not have a national director of enforcement!"

A headless chicken approach has its limits

While dedicated enforcement divisions have long been standard practice across securities regulators globally, ASIC's former structure was based on three broad clusters: Markets; investors and financial consumers; and registry and licensing. Within these, each operation had its own enforcement unit. This had been the setup recommended by a 2008 strategic review of ASIC and put into place during 2011 and 2012. Not only did staff find the process "fairly traumatic", as staffers told a 2013 parliamentary inquiry into the performance of ASIC, but the cumbersome structure created, in the words of former ASIC enforcement lawyer Niall Coburn, "an overlay of management that is senior but not operational, and who are often not at the coalface in relation to pursuing complex investigations…".

His observation in 2013 that most senior enforcement staff had no first-hand experience of investigating or prosecuting cases would haunt the securities regulator when considering the core Royal Commission criticism of ASIC that "when deciding what to do in response to misconduct, ASIC's starting point appears to have been: How can this be resolved by agreement?" Hayne recommended the starting point should rather be whether a court should determine the consequences of a breach. The report also recommended a structural separation of enforcement staff within ASIC, that is, a return to 2008.

Simplicity is the new normal

Today, ASIC's Office of Enforcement is divided into two divisions: Financial services and markets. There is still no single head of enforcement, instead, each division is led by an executive director.

Regulatory consultations

ASIC consultations are transparent and professional

We introduced a new question in CG Watch 2020 on the transparency and professionalism of regulatory consultations. We find the system in Australia to be robust. Each year ASIC consults the market on a range of topics, publishing 15 papers in 2019-20 and 13 in 2018-19. In recent years several of these have been prompted by the findings of the Hayne Royal Commission:

- Proposed guidance on the new best interests duty for mortgage brokers provided by the National Consumer Protection Act 2009. The consultation ended in March 2020 and ASIC released a guidance note in June 2020.
- A November 2020 consultation on reference checking and information sharing as a result of the Royal Commission's indictment of "rolling bad apples" within the financial advisory sector. Comments closed at the end of January 2021.
- A March 2020 consultation on proposed legislation to set requirements for fee deductions from clients' accounts. This followed pervasive charging of fees for no service: According to ASIC, six of Australia's largest banks and financial institutions paid or offered A$607m in compensation for fees for no service as at December 2019.

Response deadlines vary

ASIC varies the timeframe for responses depending on the complexity of the issue, with periods ranging from one month to 3.5 months, and publishes submissions on its website, unless confidentiality is requested. APRA is less frequent in consulting the market but does issue a few papers each year. For example, it consulted on revisions to the capital framework and Basel III reforms (submissions closed in April 2021) and in September 2020 consulted on the treatment of loans impacted by Covid.

Regulatory reforms

Executing the Hayne wishlist

Much of ASIC's regulatory reform effort over 2019-20 was taken up responding to government legislative initiatives, such as the new whistleblowing act of July 2019, or the multiple recommendations from the Hayne Royal Commission. The pandemic then delayed the passage of many new bills by six months. While most of these reforms do not directly touch on the areas covered by this survey, aspects that are relevant include:

- **Tougher penalties for companies and the financial sector**: On 13 March 2019, the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019 came into effect. This boosts both its civil penalties (now capped at A$555m for companies) and criminal sanctions, as the following table shows:

Tougher penalties kick in

Figure 6

Giving ASIC more power

Type of offence	Previous	Current
Criminal	**Maximum prison term**	
Duties and powers of directors (to act in good faith, not act dishonestly etc)	5 years	15 years
Dishonestly failing to comply with financial and audit obligations	5 years	15 years
Intentionally or recklessly breaching officer duties in relation to registered scheme	5 years	15 years
Knowingly or recklessly providing defective disclosure documents or statements	5 years	15 years
Civil	**Maximum penalty**	
Individuals	Fines from A$6,300 - A$1.16m	The greater of A$1.11m or benefit derived/detriment avoided x 3
Companies	Fines from A$31,500 - A$2.1m	10% of annual turnover (max A$555m) OR greater of A$11.1m or benefit derived/detriment avoided x 3

Source: ASIC website, ACGA analysis

New whistleblower rules

- **Whistleblowing:** As mentioned above, Australia consolidated its whistleblowing law into the Corporations Act 2001 in July 2019 and companies were required to have a policy in place by January 2020. This must list out protections available to whistleblowers and should detail the process of disclosure, how complaints will be handled and other support available. Failure to comply could result in a A$12,600 fine. Corporations are legally obliged to protect the identity of disclosers and it is an offence to make a threat to cause detriment (such as dismissal, harassment and psychological harm) to a whistleblower.

Advice on climate disclosure

- **Updated guidance on climate disclosure:** In August 2019, ASIC revised and updated its guidance documents on prospectuses and the "operating and financial review" section of annual reports (ie, management discussion and analysis) to incorporate disclosure of climate change risks and opportunities.

Joining forces on supervision

- **New ASIC-APRA MOU:** On 29 November 2019, the two regulators published an updated memorandum of understanding (MOU). The agreement, according to ASIC, "facilitates more timely supervision, investigations and enforcement action and deeper cooperation on policy matters and internal capabilities". Cross-agency working groups will be collaborating more closely in areas such as the superannuation industry, corporate governance and culture, and supervision.

Next steps

Greater clarity is needed on ASIC funding . . .

While ASIC provides a significant amount of detail on its funding, a clearer narrative as to what the different components mean in laymen's terms would be helpful. A simple explanation of how funding has evolved over the past five years, rather than just two years, would also be welcome.

. . . and is it sufficient?

While no securities commission that we know of attempts to assess the sufficiency of their funding relative to their responsibilities, it would be interesting to see if ASIC were able to develop such an analysis.

Australia's response to Covid: Proactive

A dynamic approach to Covid

The Australian government and financial regulators were among the more active in the region in their responses to the pandemic during 2020. Initially, periodic financial reporting and AGMs were less affected than in other markets because the year-end for most companies is 30 June, annual reports are released from mid-August onwards, and AGMs are mostly held in November.

Financial reporting deadlines

Reporting practicalities come into play

The initial view of ASIC in March was that there appeared to be "no widespread indications of any significant issues for entities in meeting their full-year and half-year financial reporting obligations at 31 December 2019". The same message was delivered on 9 April for entities with 31 March 2020 year-ends. Hence, the regulator provided no significant extensions for financial report deadlines at that time, although it produced a practical FAQ on its website addressing the content of financial reporting and the range of issues that companies, directors and auditors needed to be thinking about in response to the pandemic.

An extension for some issuers

On 13 May, however, ASIC did announce an extension of reporting deadlines by one month for issuers with year-ends between 21 February and 7 July 2020 (ie, they would have four months instead of three to produce their annual reports). ASIC also indicated that it would consider longer extensions on an individual firm basis.

AGMs: Extensions and new technology

Going easy on AGM delays

On 20 March, ASIC indicated that it would take "no action" against companies with 31 December 2019 year-ends that delayed their AGMs by up to two months (ie, allowing the deadline to move from end-May to end-July). It later extended this policy to issuers with year-ends up to 7 July 2020 and said it would continue to monitor market conditions and Covid developments.

Support for virtual meetings

In its 20 March announcement, ASIC also expressed its support for virtual meetings by taking "no action" against them as long as companies used appropriate technology to allow shareholders to participate. Then on 6 May, the government announced temporary changes to the Corporations Act allowing "entirely online" meetings for the following six months, with a later extension to 21 March 2021. (See box in Listed Companies section, "Electronic AGMs: Getting non-physical", for more detail).

Reinforcing continuous disclosure

Guidance for price-sensitive information disclosure

On 31 March, ASX published practical guidance to listed companies on their continuous disclosure obligations under Covid. It reminded companies that "once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity's securities, the entity must immediately tell ASX that information." The exchange highlighted the various carve outs that issuers were entitled to under this rule (eg, information that is a trade secret) and acknowledged the challenges that companies would face complying with this rule given the uncertain impact of the pandemic. It also provided some solace to companies by stating that their disclosure obligations did "not extend to predicting the unpredictable".

Help for capital-thirsty firms

Capital raising
On 31 March 2020, ASX introduced emergency capital-raising measures to help listed entities affected by the pandemic to raise urgently needed capital. This included allowing an increase in the permissible size of private placements from 15% of issued capital to 25%; trading halts to give an issuer time to plan a capital raise; and a temporary waiver of the one-for-one cap on non-renounceable entitlement offers (a form of accelerated rights issue). Initially, the measures were in place until 31 July, but a subsequent update on 13 July extended this to 30 November 2020.

Ruffled feathers prompt tighter conditions

The policy generated heated debate and numerous complaints in the weeks after it was announced. There were complaints that institutional shareholders were being favoured at the expense of retail; that some companies were not properly disclosing their need for the capital or their utilisation of it; and that some issuers not in need of funds were opportunistically taking advantage of the rule change. In response, ASX announced a series of further conditions on 22 April, including the need to inform the exchange whether the exercise was to raise urgently needed capital to address issues arising from Covid or for some other purpose.

They were also required to provide "reasonable details" to the market on how they selected investors to participate in a placement, how they determined the allocation of shares to each, and to provide ASIC and ASX with a detailed allocation spreadsheet. On 15 September, ASX said that from 16 September 2020, "any entity wishing to rely on the Class Waivers must satisfy that the entity is raising capital predominantly for the purposes of addressing the existing or potential future financial effect on the entity resulting from the Covid health crisis, and/or its economic impact, along with satisfying the other conditions set out in the Class Waivers."

2.2 Enforcement

Australia slips to 4th with a score of 68%

The enforcement score for Australia also rose by a solid eight percentage points, from 60% in 2018 to 68%, but due to movements in other markets, its ranking actually fell slightly from equal 3rd to 4th. There remains a large amount of daylight between Australia's performance here and the leading market, Hong Kong, which scored 76%.

Credit for regulatory efforts . . .

Key reasons for Australia's improved score were: higher points for the enforcement efforts made by financial regulators, principally ASIC; evidence that enforcement strategy is evolving; and a re-rating on a question as to whether the securities commission has robust powers of surveillance, investigation, sanction, and compensation.

. . . but there is a good deal of catch-up going on

While there is evidence that Australian financial regulators have been more active in pursuing wrongdoers over the past two years, it is worth remembering that this effort is very much a response to certain systemic malpractices in the banking and financial services sectors highlighted by the Hayne Royal Commission and the political fallout from these revelations. Canberra and the nation's regulators had to be seen to act. As for ASIC, there was also a view that it had to make up for lost time and toughen its enforcement efforts.

ASIC toughens up

Why not litigate?

As we noted in CG Watch 2018, the interim report from the Royal Commission in 2018 criticised ASIC for being soft in punishing misconduct and rarely going to court. The arrow hit its mark and, with the backing of government, ASIC did something of an about-turn and crafted a tougher "high deterrence" enforcement strategy. In addition to creating the new Office of Enforcement to centralise its efforts, the strategy was underlined by a new operating principle, "Why not litigate?" (A wag might reply: "Because if you lose, the media and politicians will crucify you!") As ASIC stated in its 2019-20 annual report, its goal was as much political as regulatory: To address the "community expectation that unlawful conduct should be punished and publicly denounced through the courts".

So far, so good

The numbers tell a broadly positive story, though not quite as neatly as ASIC might like. As the table below shows, over the past two full financial years there has been a material increase in the aggregate number of criminal enforcement actions across most categories compared to the previous two-year period - litigation commenced and completed, number of people convicted, and custodial sentences. The change in the number of non-custodial sentences and fines has been more modest, while the dollar value of fines has rocketed by almost 18 times.

Numbers rising on crime and punishment

Figure 7

ASIC criminal enforcement

Enforcement – criminal	2015-16	2016-17	2017-18	2018-19	2019-20
Criminal litigation completed	7	23	16	33	35
New criminal litigation commenced	13	11	30	14	38
Number of people convicted	7	20	22	27	30
Custodial sentences (including fully suspended)	3	13	13	14	22
Non-custodial sentences/fines	4	7	13	16	8
Total dollar value of fines (A$)	$8,500	$40,500	$15,100	$266,050	$731,650

Source: ASIC annual reports, ACGA analysis

A muddled picture emerges on investigations

The picture for investigations, however, is somewhat murky. In terms of investigations commenced, the annual report for 2019-20 says there were 134 in that period compared to 126 the previous year - a modest 6% increase. Curiously, the 2018-19 report says there were 151 in that year - not 126. Hence, an 11% decrease in 2019-20 rather than a 6% increase. One hopes this is a genuine mistake. Meanwhile, ASIC's annual report for 2019-20 did not give details of the number of investigations completed, a departure from past practice. In the three prior annual reports, these were in fact on a declining trend: From 157 to 124 to 103.

ASIC apparently does not lose

Another curious aspect of the Australian system is ASIC's incredibly high success rate as a litigator - akin to what one is used to seeing in some of Asia's more autocratic political regimes. It rarely loses, despite what its media image might be. Indeed, its success rate for criminal cases hovers around 90% each year and has reached 100% on at least two occasions. On the civil front, a similar pattern emerges.

Conviction rates are high . . .

Figure 8

ASIC litigation success rate

Type (%)	2015-16	2016-17	2017-18	2018-19	2019-20
Criminal litigation completed successfully	100	91	100	89	90
Civil litigation completed successfully	94	91	99	96	97

Source: ASIC annual reports

. . . and well above the national average

By comparison, the conviction rate for criminal cases at Australia's higher courts in 2018-19 was 81% while at the lower magistrates' courts the figure was 87%, according to the Australian Bureau of Statistics. The near-perfect ASIC success rate was a topic of discussion during a 2014 parliamentary inquiry on the regulator's performance. It was noted that a high success rate may suggest "a risk averse or even timid agency, one that only takes cases it is extremely confident it will win". The statistic moreover does not give an indication of the types of cases being pursued: are they straightforward breaches or more complex matters? There is also no indication in its annual reports of the relative strength of the adversaries. Is ASIC taking on big names with deep pockets, or small fry? Some narrative as to what the numbers mean would be helpful.

Boosting supervision: Getting inside banks

Up close and personal

Following the bank governance debacle, ASIC also sought to develop new ways to understand what had gone wrong and how to improve bank culture, leadership and management of non-financial risk. It launched a "Close and Continuous Monitoring" (CCM) programme in October 2018 that initially involved enhanced supervision of the four big banks ANZ, CBA, NAB and Westpac) and one major financial services firm (AMP). This led to ASIC establishing a regular onsite presence in these organisations as well as engagement with senior executives, interviews with staff, and a review of key documents including board papers.

ASIC scrutinises the banks . . .

Between October 2018 and June 2020, ASIC staff were onsite for 222 days and met 803 banking staff at the five institutions. It completed its supervisory reviews and informed the chair and CEO of each firm about it findings, asking them to prepare an action plan in response. Key governance failings identified included: "Poor technology systems, weak processes and practices, unclear lines of accountability, and a lack of focus on the profile and influence of non-financial risk."

. . . and finds familiar problems

What is notable about these findings is that they follow a considerable period of CG reform in Australia starting in the early 2000s and a particular focus on the governance of banks and other financial firms by APRA. Some of these institutions were also among the most highly respected in Australia for good governance. If two decades cannot produce the right behavioural results in banks, one wonders what will.

Habitat studies: The Corporate Governance Taskforce

Issuers are also under the ASIC microscope

At the same time as its CCM programme, ASIC established a Corporate Governance Taskforce to "conduct a targeted and thematic review of corporate governance practices across large listed entities in Australia". It looked first at director and officer oversight of non-financial risk in seven of the country's largest financial firms and later at the governance of executive remuneration at 21 large listed entities, including the seven financial institutions. In October 2019, ASIC released its findings on the first study and concluded, in an echo of the CCM programme, that "boards were challenged by important elements of non-financial risk management" and that their "oversight was less mature than required". The end result was "some instances of systemic and significant misconduct".

Consultants are called in

As part of this initiative, ASIC hired an organisational and behavioural consultant to interview bank directors and staff, observe board and committee meetings, and undertake surveys.

A governance enigma persists

Again, it is hard to square these findings with Australia's self-perception for good corporate governance. Two conclusions seem plausible. First, that corporate disclosure has become extremely sophisticated and capable of hiding systemic weaknesses. Second, that the country's oligopolistic and highly profitable banking system has created far more complacency at the top than most suspected. If correct, this suggests that ASIC's approach of trying to reform the culture and behaviour of existing institutions may not go far enough.

Bear to the rescue?

Accountability is king

In February 2018, the government introduced a new regime designed to strengthen accountability for banks and their directors/officers in cases where laws have been broken. Called the Banking Executive Accountability Regime (Bear), it seeks to impose "explicit accountability obligations" on both banks and the individuals registered as "accountable persons". The bank is required to identify specific senior executive responsibilities and provide an "accountability map" across the institution identifying the accountable person responsible for the various activities of the business. Each accountable person has their variable remuneration deferred for a minimum of four years and risks losing a chunk of this pay if they fail to comply with any Bear obligations. APRA can disqualify accountable persons for breaches and seek a financial penalty against individuals for non-compliance.

Spot the specifics

APRA released a review of the Bear regime at three of the four major banks - ANZ, CBA and NAB - in December 2020. Westpac was not included because of an ongoing investigation into potential breaches of the Banking Act. APRA found all three to have adequate frameworks in place, although the CBA came out as the most sophisticated in its execution. The prudential regulator gave only "thematic feedback" in its review, rather woolly observations which lacked specifics. Banks for example could better monitor actions taken by accountable persons, "reflect" on whether governance arrangements show how they met their obligations, and consider how they could "more deliberately align" actions and records with expectations. All of which sounds like a lot of baloney!

FAR for the madding crowd

Following the Hayne report, the government agreed to extend the regime to all APRA-regulated entities. Under current proposals, Bear will eventually be renamed the "Financial Accountability Regime" (FAR). A consultation on FAR was however postponed until September 2020 and as yet draft legislation has not been published.

Next steps

Go beyond the numbers, ASIC

Enforcement statistics are presented by ASIC with limited accompanying narrative as to why the numbers are going up or down over time - and indeed what the numbers actually mean. More explanation would be welcome, as would five-yearly rather than two-yearly statistical tables.

Keep the data consistent

Inconsistencies in data from one annual report to the next should be corrected. If a data series is to be discontinued, some explanation should be given as to the reason.

ASIC should explain its winning streak

ASIC could better communicate the reasons for its high success rate as a litigator. Indeed, given the public perception that it is a fairly weak litigator, one wonders why ASIC does not better communicate its success.

Home comforts for white collar criminals

Intensive correction orders

White collar criminals sentenced to jail in Australia are allowed to serve half of it at home if they are given an "intensive correction order":

- In August 2019, former director and CFO of Leighton Holdings, Peter Allan Gregg, was found guilty of falsifying the company's books and sentenced to two years in prison to be served by way of an intensive correction order. This means that 12 months of the jail term could be served in home detention.
- In November 2019, a branch manager of NAB was sentenced to 12 months in prison, also to be served by way of an intensive correction order, for making false and misleading statements to the lender about 24 home loan applications.
- Others were not so lucky. Kleenmaid founder, Andrew Eric Young, was found guilty by a Queensland District Court in January 2020 of insolvent trading and defrauding Westpac of A$13m prior to the 2009 collapse of the white goods distributor. He was sentenced to nine years in jail. He would not be eligible for parole until January 2024.

Banks pay the price for shonky advice . . .

Meanwhile, the big banks and financial services firms are still paying out for the unethical practices of their financial advisory staff. Westpac was ordered to pay A$9.15m in December 2019 after one of its financial planners, Sudhir Sinha, failed to act in the best interests of the bank's clients by giving inappropriate financial advice. Sinha was banned from providing financial services for five years.

. . . and for scalping clients

AMP was ordered by a Federal Court in February 2020 to pay a A$5.175m penalty for failing to take reasonable steps to ensure its financial planners complied with the "best interests" duty under the Corporations Act. The financial planners had engaged in "rewriting conduct", where a client's existing insurance policy is cancelled and a new one taken out, which reaps higher fees for the planners than a simple transfer.

3. CG rules

Australia ranks 1st with a score of 82%

Australia's score for CG Rules improved from an already strong 78% in 2018 to 82% in 2020, helping it to retain 1st place. This was one section of our survey where the rise in scores was strongly influenced by methodological changes. It is also worth noting that the country lost points on certain questions due to tighter scoring criteria.

Only a few organic boosts

Areas where Australia scored better compared to CG Watch 2018 included: The breadth of sustainability reporting guidance; blackout periods for director trading; disclosure of related-party transactions; an up-to-date CG Code; a stewardship code that seeks investor signatories; a requirement or process whereby directors convicted of fraud are typically removed from boards; and the release of AGM materials at least 28 days before meetings. It is important to emphasise that the higher scores on these questions were due more to changes in our scoring methodology than substantive changes in the rules themselves (though some did change). We also adjusted certain scores to ensure Australia was being judged consistently against other markets. For example, we concluded that in comparison to several Asian markets - Japan, Korea, Malaysia, Taiwan and Thailand - we had judged Australia somewhat harshly in 2018 on the question of stewardship codes.

CG shortcomings are still apparent . . .

Areas where Australia lost points included: The lack of mandatory quarterly reporting for most issuers; the speed with which directors must disclose on-market share transactions (five days rather than our benchmark of three days); disclosure of share pledges by the controlling shareholder; the definition of independent director; and pre-emption rights in relation to private placements (where Australia had been scored somewhat generously in 2018). In relation to the latter issue, moreover, a loosening of capital-raising rules in response to Covid led to abuse by some companies of the additional privileges given, suggesting that the Australian system of private placements is not as robust in protecting minority shareholders as regulators like to suggest.

. . . but in other areas Australia stays the course

As for the questions in this category where the scores did not change, Australia generally performs well. In almost all of them it achieved a 4/5 or a 5/5, thus accounting for the total score of 82% in CG Rules. (For the full scores, see Appendix 2.)

Re-rating sustainability reporting rules

A clearer ESG picture emerges

Unlike many markets in Asia, there is no single guidance document on ESG or sustainability reporting from either the stock exchange or financial regulator in Australia. For this reason, we previously marked the country down. We believe a rerating is in order, however, because it does have a portfolio of rules and guidelines that listed companies are expected to follow and some of these have been enhanced over the past two years:

- The Corporations Act requires listed companies to prepare an annual directors' report that "must contain information that shareholders would reasonably require to make an informed assessment of the entity's operations, financial position and business strategies, and prospects for future financial years", according to ASIC. See s292(1) and s299A(1)(c).
- A regulatory guidance document (RG 247) prepared by ASIC called "Effective disclosure in an operating and financial review", states that it is "likely to be misleading to discuss prospects for future financial years without referring to the material business risks that could adversely affect the achievement of those prospects. This includes climate risk."
- Another regulatory guidance document (RG 228) on "Prospectuses: Effective disclosure for retail investors" said these must disclose the "risks associated with a company's business model and explicitly cite both environmental and regulatory risk as key categories of risk to be considered by persons preparing a prospectus."
- ASIC published updates to RG247 and RG228 in August 2019 to clarify how these applied to the disclosure of climate-change risks and opportunities. Additions to these principles-based guidelines included explicit references to the Task Force on Climate-related Financial Disclosures (TCFD), emphasising climate change as a systemic risk that will likely affect future financial performance and such impacts should therefore be disclosed, and providing reassurance to directors that forward-looking statements on these issues will most likely not be viewed as misleading if they are based on the "best available evidence at the time".

- The country's CG code, the "ASX Corporate Governance Principles and Recommendations", which was last updated in February 2019, includes an explicit reference to the disclosure of ESG risks. According to Principle 7.4: "A listed entity should disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks." The code also recommends using the TCFD framework for climate risk reporting.

Sustainability disclosure is improving

Listed entities are not required to publish standalone sustainability reports in Australia, but as the points above highlight, they are required to report on how they are managing material ESG risks in their operating and financial reviews and CG reports/statements. The backing of the company law gives such disclosure added weight - something lacking in most Asian jurisdictions.

Climate risk reporting: Expanding

Companies are divulging more

Historically, how proactive have Australian listed companies been about reporting on climate risk? Surveys from ASIC in 2018 and the Australian Council of Superannuation Investors (ACSI) in 2020 paint somewhat different pictures, however different sample sizes, criteria and timeframes account for much of the variation. What does seem clear is that climate risk reporting is now expanding quite rapidly, though much remains to be done.

In September 2018, ASIC published a review of climate risk disclosure by 60 listed companies in the ASX 300 - 20 issuers from each group of 100. Some key findings:

- Only 17% of sampled companies identified climate risk as a material issue in their operating and financial reviews.
- A majority of the top 100 issuers (ASX 100) in the sample had considered climate risk to some extent, but there was limited reporting outside the ASX 200.
- Much disclosure was of a general nature, rather than specific to companies.

A disparity in the quality of reporting emerges

ASIC also looked at 15,000 annual reports for all listed companies published between 2011 and 2017. It showed, somewhat counter-intuitively, that the percentage of reports containing some climate-change content actually fell from 22% to 14% over this period. Not surprisingly, there was a sharp difference between the ASX 300 (42% in 2017) and all other listed companies (10% in 2017). There was also a clear hierarchy in the volume of reporting between the ASX 100, ASX 101-200 and ASX 201-300.

There is much scope for improvement

More recently, in October 2020, ACSI published a report on climate change disclosure in the ASX 200. It said that such disclosure had significantly improved, including a more than quintupling in the number of issuers adopting TCFD - from 11 in 2017 to 60 in 2019 - and a majority (60%) now reporting the carbon footprint of their operations (Scope 1 & 2). Yet there remains much room for improvement. Among many other factors: TCFD disclosure is not integrated into financial statements; only a third of companies have set CO_2 emission reduction targets; and only seven companies have set science-based targets aligned to the Paris Agreement.

ASX is upping the CG ante

The new CG code

In February 2019, the ASX Corporate Governance Council released the fourth edition of its corporate governance code, first published in 2003, called the "ASX Corporate Governance Principles and Recommendations". The new Principles took effect from January 2020.

The new code aims to refine the board . . .

The new code modernises the third edition (2014) in certain important ways. It more clearly delineates the board's role in defining the entity's purpose, values and culture. It says that listed entities should confirm they have conducted "appropriate checks" of a new director's background and give reasons why it supports the election or re-election of a director. Issuers should set gender diversity targets not only for the board, but for senior management and the workforce generally. If a firm is in the ASX 300, the gender diversity target should not be less than 30% for each gender. The new code updates the commentary around how to get the most out of a board "skills matrix". And, among many other things, it refines the definition of independent director.

. . . but evades a social licence

One term it dropped after the consultation process was the concept of "social licence to operate". The Council's rationale was that while there was "considerable support from many stakeholders" for its inclusion, there was opposition from others. It therefore replaced the phrase with "references to 'reputation' and 'standing in the community' ". The Council said it believed the concepts were synonymous, a point of view that many governance advocates might find unconvincing. As the Australian Council of Superannuation Investors (ACSI) notes, "social licence to operate" implies engaging actively with all key stakeholders and understanding their concerns. In our view, "reputation" is a more neutral term and does not carry the same action-oriented focus.

Losing points

Where points were lost

Australia lost points on certain questions for the following reasons:

Quarterly reporting is still limited

- **Quarterly reporting:** Australia has had a limited version of quarterly reporting for some time. Issuers in the mining and oil/gas production industries must produce quarterly *activity* reports, while those in mining and oil/gas exploration must produce both quarterly activity and quarterly *cashflow* reports. Certain new issuers who apply to list under the "assets test", such as smaller firms investing in new technology, must also produce quarterly cashflow reports. In December 2019 the rules were tightened to require the latter to publish quarterly activity reports as well. While this approach enhances transparency among certain categories of risky issuers, we deducted a point because such reporting is not mandatory for all companies and to align with our scoring with other markets.

Five days to report director trades

- **Director trading:** Issuers in Australia must disclose changes in the "notifiable interests" (eg, shareholdings) of a director within five business days. Our question follows regional best practice and sets three working days.

Cooling-off periods for INEDs are short

- **Definition of independent director:** While the revised ASX CG Principles improves on the definition of independent director, we deducted a further point for the short three-year cooling-off periods applied to former executives and people who have had a material business relationship with a company. Three years is a relatively brief timeframe even in a dispersed ownership market such as Australia.

Capital-raising rules ricochet

- **Pre-emption rights:** The ASX may set stricter standards on private placements (15% of issued capital each year) than either Hong Kong or Singapore (20%), but it still falls below Malaysia (10%). Of more concern was the fact that during 2020 the rule was temporarily relaxed to allow issuers to raise a further 10% if they needed additional capital in light of the pandemic - not in itself a bad thing, except that several issuers who evidently did not need the cash then abused the rule. ASX had to put out a revised rule (see box above, "Australia's response to Covid: Proactive").

Next steps

Streamline ESG guidance

While Australia's portfolio of rules and guidance on ESG reporting appears to be having positive outcomes, it may be beneficial for ASIC or ASX to collate these in a single guidance document with examples of what meaningful disclosure looks like. This could help to encourage deeper reporting among listed companies beyond the ASX 200.

Climate clarity, please

We would encourage ASIC to run its climate reporting survey again and to promote such reporting among a wider range of issuers.

INEDS need to chill more

The relatively short cooling-off periods in the ASX CG Principles' definition of "independent director" seem expedient rather than evidence-based. It may be time for a new approach.

Prize open placements

Retail shareholders should be allowed easier access to private-placement fund raisings.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

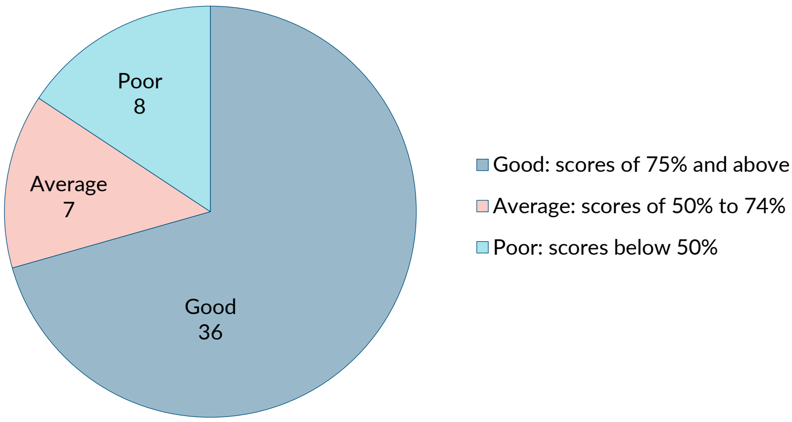
Australia ranks 1st with a score of 79%

As expected, Australia tops the charts here once again with a score of 79% and well above the rest of the region. Its score improved six percentage points on 2018, with lower scores in four of the 20 market-level questions and a higher score in five, although this was largely due to changes in the content of our underlying survey, evaluation process, and scoring methodology (which included negative scores for some questions). Our aggregate results showed that large caps performed well in 36 of 51 questions, averagely in seven and poorly in eight (see figure below).

The large caps stack up

Figure 9

Australia: Large-cap aggregate results on CG performance (51 questions), 2020



Source: ACGA, ARE

Where Australia does well

Disclosure is fast and inclusive

According to our analysis, companies in Australia provide investors with comprehensive and quick access to information. Issuers make timely announcements on corporate actions either on company websites or ASX, including AGM agendas and circulars prior to meetings and voting results shortly afterwards. Most companies also share investor Q&A as part of their AGM videos.

Boardroom skills are set out

With a more demanding and modern CG Code compared to the rest of the region, Australia earned the highest score for the quality of discussion on board composition. Its CG Code recommends issuers to have a board "skills matrix" and most companies surveyed illustrated the broad range of skills that each director brings to the board, with a link to their business and future challenges. Board diversity is also covered in some detail in the Code, requiring issuers to disclose a diversity policy, set measurable objectives and share their progress in each reporting period. All 15 large caps disclosed a plan for board diversity, 14 of which provided targets of varying levels of clarity and one gave no targets.

Executive autonomy is high

Australia also scored the highest across the region regarding the independence of both board and audit committee (AC) chairmen. Of the 15 large caps, all but one had chairmen whom we would consider independent (ie, no relationship to the company, an affiliate company, or the largest shareholder). Crown Resorts was the only issuer that received a lower score on this question, with a chairman that acts as the CEO, and no lead independent director to compensate for the lack of independence. As for AC chairmen, none of the 15 were related to their auditors (eg, were former partners of the auditing firm) or their company.

Board mechanics are set out

In terms of board governance, disclosure on overall board activities and remuneration committee reports were extensive. The remuneration not only of each director but each senior executive was reported by name and broken down into major components. We also found that most independent directors are not paid with stock options, with the exception of Crown Resorts.

Where Australia performs averagely

Codes of conduct disappoint

Although Australia was the top scorer in the region on policies for mitigating corruption, especially on the quality of whistleblowing policies, we noted room for improvement on the quality of codes of conduct. Issuers should have public codes of conduct that extend to suppliers. As the CG Code only advises issuers to have a code of conduct for their directors, senior executives and employees, the majority of the 15 issuers have not extended their codes to suppliers.

Beneficial owners are hidden

As in most markets, Australian issuers provide a list of their top 10 to 20 shareholders, but only one of the 15 large caps disclosed beneficial owner names in place of the usual list of custodian bank nominees.

There is a mixed bag on expenses

Most of the issuers reviewed - 10 out of 15 - scored well on a question as to whether they provided a detailed breakdown of operating expenses, by function and nature, or conversely have a substantial amount of unexplained “other expenses”. However, a handful of companies dragged down Australia’s score. Two of 15 provided a limited discussion as to why they had a substantial amount in “other expenses”, while the other three provided no discussion in their footnotes. This was one question where we introduced negative scoring.

Disclosure of board activities can be patchy

On disclosure of board activities, Australian large caps are generally good at disclosing the work of their remuneration committees, but less so for audit and nomination, with mostly boilerplate and formulaic committee reports. All 15 large caps disclosed activities within the year for their remuneration committees, but only three reported on the same level for their nomination and audit committees, while the others mostly shared only their terms of reference and member lists. This was an issue we raised back in 2018 and the quality challenges are unchanged.

Some ESG reports are vague

Lastly, while issuers in Australia address the issue of materiality in ESG or sustainability reports, we noted areas for improvement, including the discussion of the materiality process as well as disclosing metrics and targets for material issues. A majority of the 15 large caps provided a summary of material issues in the form of a matrix, table or list; however, there was limited discussion as to how materiality was determined and relevant to the business. As for management of the issues, companies for the most part discussed material issues in detail. We also looked at whether issuers identified issues aligned with the Sustainability Accounting Standards Board (SASB). While some issuers did well on sub-questions relating to metrics and targets, others could improve on the disclosure of specific performance metrics and meaningful targets to track the management of material issues.

Where Australia does poorly

Issuers tend to scrimp on shareholder engagement

Surprisingly, we also found that issuers provided inadequate levels of information on outreach to shareholders and stakeholders. Most issuers - 11 out of 15 - either reported only on the types of such activities or disclosed no information; a minority disclosed more information, including the nature of discussions or the number of engagements. As for communication with stakeholders, only two of 15 discussed activities specific to the year, four discussed generic activities, while the other nine either had limited or no discussion on stakeholder engagement in their annual or sustainability reports.

Boardroom report cards: Could do better

We also found areas of weakness in board evaluations. The CG Code recommendation on board evaluations only requires disclosure of whether a board performance evaluation has been undertaken and the discussion on the process, with no specific advice on the sharing of results. Although most companies said they undertook board assessments and six disclosed they had appointed third-party consultants to assist, none gave any narrative on results or next steps. While we recognise that disclosure of board evaluation outcomes is still a controversial topic, we would note that some companies around the world are starting to loosen up and share at least high-level conclusions from the exercise.

Board training lacks detail

Lastly, the CG Code recommends issuers to have a training programme for directors. While the companies surveyed provided good disclosure on whether they offered induction and ongoing professional development to executive and non-executive directors, most gave only brief statistics on training topics, with four of the 15 providing no details on training content at all.

Where Australian companies could improve

Figure 10

Helicopter view: Rating Australia's CG disclosure and governance, 2020

Good	Average	Poor
❑ Detailed AGM circulars, voting results and Q&A discussion during meeting ❑ Board skills matrix and targets for improving board diversity ❑ Independence of board chairmen and audit committee chairmen ❑ Detailed director attendance statistics ❑ Remuneration reports ❑ Board directors and senior managers remuneration ❑ ESG reporting on materiality lists/priorities	❑ Less than half of public codes of conduct extend to suppliers ❑ Disclosure of largest shareholders but not beneficial owner names ❑ Breakdown of operating costs, explanation of "other expenses" is done badly by a third of companies surveyed ❑ Boilerplate reports for audit and nomination committees ❑ ESG reports often lack discussion of materiality processes, performance metrics and targets for material issues	❑ Lack of details on shareholder and stakeholder engagement ❑ Companies undertake board evaluations, but little description of assessment outcomes ❑ Companies provide training to executive and non-executive directors, including induction and ongoing professional development, but with limited details of these activities per director

Source: ACGA

Australia could up its game

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Establish and disclose targets for board diversity
- ❑ Extend public codes of conduct beyond members of the company, to suppliers
- ❑ Disclosure of beneficial owners in top 10 to 20 shareholder lists
- ❑ Better disclosure on operating costs, with minimal aggregation of "other expenses". If the latter are aggregated, they should be explained
- ❑ High-level details on board evaluation outcomes
- ❑ Detailed disclosure of director training
- ❑ Improve audit and nomination committee reports with narrative on specific activities during the year

Medium to long-term challenges

- ❑ Proactive shareholder and stakeholder engagement
- ❑ ESG/sustainability reports to include substantive discussion of the materiality process, and setting meaningful quantifiable metrics and targets

The Crown affair

No dice at Barangaroo

An inquiry into whether ASX-listed Crown Resorts was fit to run a harbour front casino in Sydney's Barangaroo area concluded in February 2021 with a resounding no dice. After 18 months of evidence and testimony, former judge Patricia Bergin released a two-volume takedown on the gaming firm, released under parliamentary privilege, replete with censures for money laundering, dealings with groups linked to organised crime and a failure to prevent staff from being jailed in China. The picture that emerged was of a board ill-appraised, woefully conflicted, and ultimately obedient to on-off director and controlling shareholder James Packer.

The Packer protocol emerges

Packer's private investment company, Consolidated Press Holdings (CPH), holds about 36% of Crown. In what Bergin dubbed "remote manoeuvring", Packer continued to exercise power even after he had stepped down from the board in December 2015, through a mix of his personality and the "somewhat supine attitude adopted by Crown's operatives". Packer received information on the company on a near daily basis, initially informally, then from July 2016 in the form of a Services Agreement between Crown and CPH until he rejoined the board in August 2017. When he stepped down from the board again in March 2018, a "Controlling Shareholder Protocol" was put in place where Packer continued to be appraised through daily financial reports and details of board meetings.

A board behaving badly

Indeed, our evaluation of Crown as part of our listed company survey noted it made no disclosure of its shareholder engagement activities. Likewise, it gave no meaningful disclosure on the activities of its nominating committee beyond a formulaic list of members, their independence status, and a terms of reference. As emerged from the inquiry, the merit of board appointees was at times dubious: Andrew Demetriou, former CEO of the Australian Football League (AFL) and a friend of Packer's, had been a non-executive director at Crown since January 2015. He had no formal training in casino regulation, did not know much about junkets, was unaware that Crown had staff in China, and when asked at the inquiry what he understood the role of an independent director to be, read from a pre-prepared note. Another non-executive director, Benjamin Brazil, also knew Packer as a friend and volunteered to sit on the board. Throughout his eight-year tenure, he worked full-time at Macquarie Bank.

Dirty cash but no anti-money laundering nous

Among the executives past and present taken to task by the inquiry, few appeared to have an appreciation of the risks involved in running a casino business, in particular triad links to the VIP junket market and a low appetite in China for touting. Money laundering through two Crown subsidiaries appeared crude enough that a number of banks had been flagging concerns for years. Yet the first anti-money laundering training given to directors - much to Bergin's palpable irritation - was a one-hour online course toward the end of the public inquiry!

While back at the board . . .

During the time in question, Crown's chairman and CEO were the same. Only in late 2019 did it split the role. Board evaluation was done merely by a questionnaire sent to each director. The section on risk management in its annual report identified only generic industry-wide pitfalls such as legal and regulatory changes.

. . . women fare better than men

Interestingly, of all the directors and former directors in the spotlight, the ones who have emerged with their reputations most intact have tended to be female. Helen Coonan, who took over as chair in January 2020, received credit for accepting the "serious corporate failures" of Crown. Likewise Jane Halton, non-executive director, was dubbed a "truthful witness" and left with her integrity intact. Crown still has a chance to put the odds back in its favour: Bergin proposed the gaming giant draft a remedial action plan, so the Barangaroo licence may yet still be in play.

All things bright and virtual

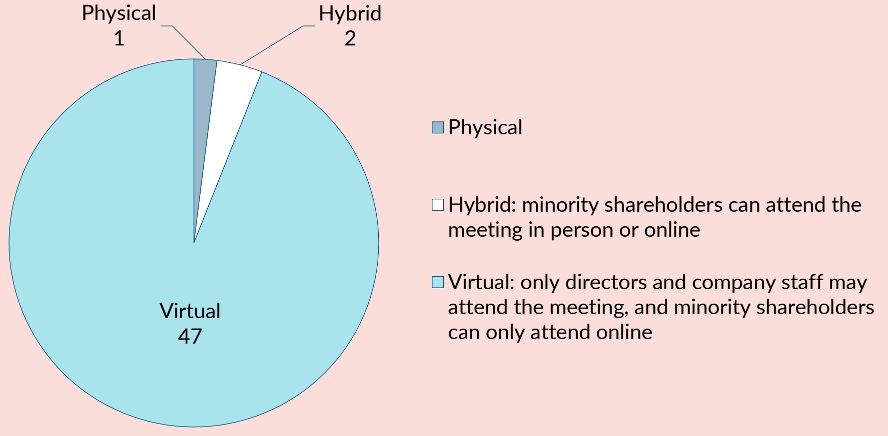
Electronic AGMs: Getting non-physical

Unlike AGMs in much of the region in 2020, the timing of most annual meetings in Australia was only mildly affected by the pandemic. This is because most issuers in Australia have year-ends in June, with AGMs normally held towards the end of the year, in November, rather than in the first half as they are in Asia. The big change in Australia in 2020 was the use of information technology and the rise of virtual meetings. A review of the top 50 listed companies by market value showed that most, 47 of the 50, heeded the government's call to hold entirely virtual meetings. Two held hybrid meetings and only one organised a fully physical AGM.

Here is the AGM playbook

Figure 11

AGM modes in Australia: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

Physical meetings are novel

The one physical meeting, Aristocrat Leisure, was held in February 2020 before Covid affected Australia. With the pandemic reasonably under control in Western Australia towards the end of the year, Fortescue Metals Group (FMG) held a hybrid meeting in Perth on 11 November 2020 and offered shareholders a physical location as well as an online option. Interestingly, although shareholders could virtually vote and ask questions live, FMG specified that only shareholders who showed up in person would be considered in attendance. The other issuer to hold a hybrid meeting, James Hardie Industries on 5 November 2020, held the physical portion in its place of incorporation, which is now Dublin, at 9pm GMT at night. This was timed to allow shareholders in Australia to join at 8am Sydney time the following day.

5. Investors

Australia ranks 1st with a score of 66%

Australia's score here improved by three percentage points to 66% and it ranked 1st once again, with Japan a reasonably close 2nd at 60% and other markets well back. The next highest scoring markets were India and Korea at 44% each. Hong Kong and Singapore were even further behind at 34% and 39%, respectively.

The domestic dimension

Institutional investors have established CG/ESG policies

As in other markets, we analysed five of the largest domestic asset owners for the existence of a CG/ESG policy and 10 of the biggest asset managers. We found that four asset owners disclosed their own policies - the Future Fund, Australian Super, First State Super (now called Aware Super), and Unisuper - and all of the asset managers. It was pleasing to see that most of these policies give importance to environmental and social issues as well as governance factors. Some also discuss the issue of modern slavery/forced labour in company operations and supply chains, particularly for companies with significant offshoring, in their ESG charters. This has become a hot topic in Australia.

Domestic firms vote and most report on voting at the company level

Almost all of the asset owners and managers publish a voting policy and all vote their shares. Most of the asset owners (four out of five) and six out of 10 asset managers provided disaggregated voting records down to the company level. While none of the investors we surveyed provided reasons for voting against management resolutions, there is a healthy level of such voting on issues like: Remuneration reports; climate change transition; expenditure reports on pollution controls; business alignment with the Paris Agreement; election of new directors; shareholder proposals regarding linking executive pay to sustainability and diversity; and shareholder proposals on reporting measures to prevent sexual harassment. These examples show the active use of voting to drive a CG or ESG agenda. We did not however find much evidence of domestic institutional investors attending AGMs.

There is stewardship zeal

While large investors may not attend many AGMs in person, there is a high level of support for the broader concept of stewardship among both asset owners and managers in Australia. Most of the former are signatories to the Australian Asset Owner Stewardship Code, developed by the Australian Council of Superannuation Investors (ACSI), while managers are expected to follow the "Principles of Internal Governance and Asset Stewardship" from the Financial Services Council (FSC), an industry body. The trustees of industry funds registered with the Australian Institute of Superannuation Trustees (AIST) are meanwhile expected to follow the AIST Governance Code Guidance, which focusses largely on the internal governance of funds.

Most institutions have internal CG/ESG teams and publish detailed responsible investment reports that highlight the extent of voting and engagement during the year. There is a high level of individual engagement with companies, while collective engagement of regulators and companies is largely facilitated by industry bodies such as ACSI and the Responsible Investment Association Australasia (RIAA).

ACGA surveyed its members in Q3 2020 on voting and engagement in Asia-Pacific

The foreign dimension

As part of our research for CG Watch 2020, ACGA also conducted a survey of our global investor members to understand their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time of the survey, this group managed in aggregate more than US$26 trillion globally. As the responses showed, Australia is an important investment destination:

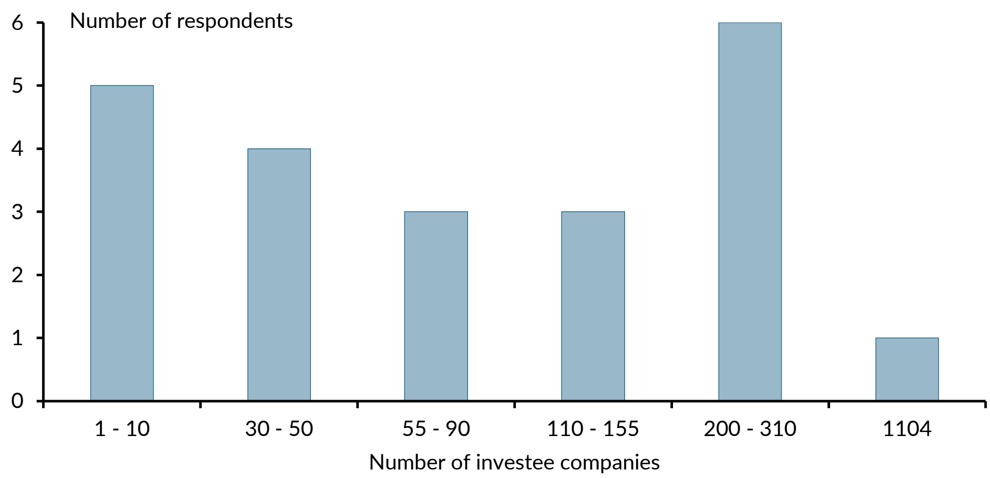
- 37, or 84% of foreign-investor respondents indicated that they invest in Australia - a result in line with Thailand, slightly below Indonesia and Japan at 86%, and slightly higher than Singapore at 82%.
- Only 22 respondents answered the question on the exact size of portfolios in Australia. They invest in an average of 155 companies each, with a range from three to 1,104. The average figure places Australia at third, well below Japan and China, and just above Korea, Japan and India in the 100 to 130 range.

Another way to show the extent of investment in Australia is to group portfolios by size. As the following figure shows, portfolio sizes are scattered across the spectrum, with the majority of respondents owning fewer than 100 investee companies, while the largest portfolio has 1,104 stocks.

Big and small portfolios Down Under

Figure 12

Foreign investors in Australia: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Foreign investors are active voters

Respondents take voting in Australia seriously, although they vote against in fewer meetings compared to other major markets:

- The vast majority of respondents vote in 100% of AGMs each year, but a few vote in only 10% to 30% of meetings.
- On average, they voted against at least one management resolution in 25 meetings in 2020. The median figure was 10 meetings, with a range from zero to 186. The average figure places Australia at seventh in the region, just below Taiwan and India, and far below Japan, China and Korea. This is perhaps not surprising, given the generally higher standards of corporate governance in Australia, a longer tradition of investor stewardship, and a more responsive corporate sector.

- As a proportion of their holdings, respondents voted against at least one management resolution in less than 25% of meetings. This was the lowest figure among the 12 markets we cover.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Company engagement

Foreigners are engaging

Many of our foreign investor members do engage individually in Australia. On average, respondents engaged in total with 15 companies individually over 2019 and 2020.

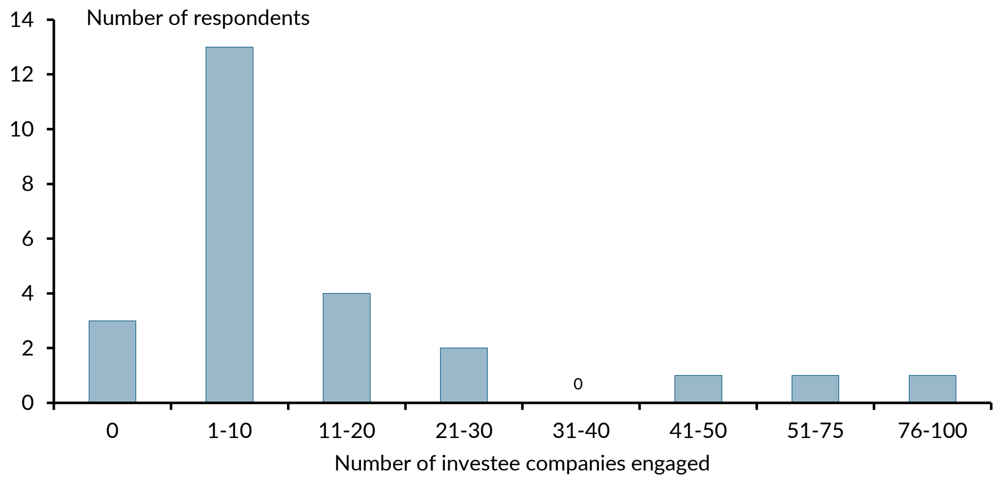
The majority keep it niche

Again, a more representative way of illustrating this is to show it as a distribution. Of the 37 respondents who indicated that they invest in Australia, 25 answered our question on company engagement. Of these, only three said they undertook no engagement at all over 2019 and 2020. As the following figure shows, most of the respondents engaged individually with 10 or fewer firms over the two years, while a few engaged with more than 40.

Company engagement by the numbers

Figure 13

Foreign investor engagement prevalence in Australia, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

In relative terms, most respondents engaged with 10% or less of their portfolios

In terms of the relative level of engagement in Australia (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 10% or less but rises to 20% to 30% for three institutions and 45% to 50% for two (both of which is within the 30-50 band in portfolio size).

The retail dimension

Retail shareholders are quite active . . .

Participation by retail shareholders at AGMs is healthy in Australia. The Australian Shareholders Association (ASA) offers a proxy voting service for retail shareholders, has volunteers that track individual companies, writes company analysis and attends AGMs. Its contribution helps ensure retail shareholders get a voice in meetings through the substantive questions ASA puts forth. For example, in the Mirvac 2020

AGM, five live online questions were asked and all came from ASA's representative, Sonja Davie. They touched on issues concerning operating profits, remuneration, the ceiling with regards to securities held by directors, the human resources committee, and the display of existing proxy results before voting.

. . . and vocal

ASA also makes regular submissions on policy issues to advocate equitable treatment of shareholders. Some recent submissions covered issues such as reforms of virtual meetings and electronic documents execution, a submission to the Financial System Reform Taskforce on Financial Accountability Regime, and a response to the Australian Law Reform Commission discussion paper on Corporate Criminal Responsibility. ASA is also the founding member of the Alliance for a Fairer Retirement System that advocates on behalf of senior Australians, shareholders and self-funded retirees.

Next steps

Voting disclosure should be across the board

We recommend that all institutional investors in Australia, both asset owners and managers, disclose voting down to the company and resolution level. Reasons for voting against resolutions would be helpful too.

Attending AGMs has value

While most investor engagement with companies is done outside of shareholder meetings, there is a value in institutions attending and posing questions to directors and senior management in public. The AGM is also a unique opportunity to ask the external auditor how, or even if, they are assessing emerging issues such as the financial impacts of climate change risk (physical or transition).

A united front might help

There is scope for domestic and foreign investors to explore opportunities for collective engagement.

Climate activism heats up

A low carbon crusade by two high-profile NGOs

One of the more significant developments in the shareholder activist space over the past two years has been the involvement of NGOs such as Market Forces (MF), an affiliate of WWF, and the Australasian Centre for Corporate Responsibility (ACCR). MF runs climate activism campaigns through its website and publishes research reports and posts blogs to raise awareness of how, in its view, Australia's big banks are undermining the Paris Agreement, some insurance companies support fossil fuels, and how certain superfunds and non-financial companies continue to undermine climate action. ACCR runs a climate programme that aims to accelerate Australia's transition to a low carbon economy. It engages with ASX-listed companies on their climate risk disclosure and pushes them to set emission targets in line with the Paris Agreement.

Spurring mainstream investors into action, but . . .

Both organisations make active use of shareholder proposals to encourage investors to vote on climate-related issues at company meetings. At ANZ Bank's most recent AGM on 16 December 2020, for example, MF coordinated a shareholder resolution to ask the bank to align its policies with Paris Agreement goals - a respectable 28.9% of shares were voted in favour. Earlier in the year, at the Santos AGM on 3 April 2020, shareholders voted in unprecedented numbers for two shareholder resolutions filed by ACCR: 43.39% of votes supported a resolution on "Paris Goals & Targets", while 46.35% of votes got behind a resolution on "Climate-Related Lobbying". ACCR filed identical resolutions at Woodside's 2020 AGM later the same month and it saw votes in favour of 50.16% on the first and 42.66% on the second.

. . . resolutions not formally put to AGMs if article-amendment votes fail

It is important to stress that the votes above all represented proxies cast before the meeting. Due to a quirk of Australian company law, none of the resolutions were formally put to the meeting on the day and voted on. This is because they were all conditional on a previous special resolution being passed on amending the articles to allow shareholders to pass advisory votes on specific topics of material relevance to a company. These resolutions usually fail spectacularly - garnering no more than around 6% to 8% of votes in favour. Yet it appears that boards are increasingly paying attention to the resolutions not passed.

6. Auditors & audit regulators

Australia ranks equal 1st with a score of 86%

Already the highest scoring segment of our survey, Australia nevertheless added a further two percentage points here to reach 86% and retain equal 1st with Malaysia. Developments in this part of the ecosystem have clearly felt reverberations from the impact of the Hayne Royal Commission into banking and financial services, bringing pressure for tougher supervisory action across the board.

Status quo with a few significant tweaks

While the overall score in this category was little changed, the components of the score did change. Scores on three questions went up, including: Rules to strengthen the independence of auditors (due to the arrival of a new whistleblowing law), disclosure of enforcement activity by the audit regulator, and the quality of the audit regulator's annual report. While scores on two questions went down: Whether the audit regulator exercises effective disciplinary control over the accounting profession, and how well the regulator is promoting capacity, quality and governance improvements within audit firms.

A tougher enforcement stance

Australia among the first to create an independent audit regulator in Asia-Pacific

Among its many hats, ASIC is responsible for the "surveillance, investigation and enforcement of the financial reporting and auditing requirements of the Corporations Act". It became the country's independent audit regulator in July 2004 when it launched an audit inspection programme following the passing of the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004. This made Australia one of the first jurisdictions in the region to create such a body - the other two being Japan and Singapore. ASIC's powers were enhanced following the issuing of legally enforceable auditing standards in July 2006 and then deeper cooperation with international audit regulators in July 2007.

Honing in on audit quality

As with other aspects of securities enforcement in Australia, the narrative around audit regulation has taken on a more purposive character over the past two years. In July 2018, a Parliamentary Joint Committee on Corporations and Financial Services called for a review of ASIC's audit regulatory powers. This was followed by a report on Auditor Disciplinary Processes from the Financial Reporting Council (FRC) in April 2019 that recommended a number of improvements in the way ASIC and other disciplinary entities, including industry bodies, operated. Regarding ASIC, the FRC said the regulator should:

1. Better integrate its systems to track enforcement matters across teams and produce a more structured approach to auditor surveillance.
2. Evaluate its criteria for audit enforcement actions and explain how the "why not litigate?" approach would apply to auditor misconduct.

3. Consider the division of resources between audit inspection and financial reporting surveillance to ensure good audit quality.
4. Publish the results of audit inspections in greater detail, including naming firms.

ASIC wants to compel remediation of audits

ASIC welcomed the FRC report and supported its recommendations that it be given the "power to compel remediation of defective audits, alongside the power to publish notices when this occurs". ASIC said that such a power should "facilitate more effective and timely outcomes to improve audit quality, and should include remediation measures needed across a firm."

A blunter inspection report

A few hard truths

One tangible change came relatively quickly in ASIC's audit inspection report. Produced every 18 months between 2011 to 2018, the report moved to a 12-month cycle for the July 2018 to June 2019 period. With a degree of impatience, the 2018-19 report said: "Although our reviews are risk based and the number of key audit areas and files reviewed is limited, it is clear that the level of findings remains too high." As a result ASIC would "adopt a more intensive supervisory and regulatory approach", including new initiatives such as: a more robust approach to enforcement; more transparency regarding adverse findings in audits undertaken by the Big Four audit firms; a review of conflicts of interest, culture, talent, governance and accountability for audit quality at the largest six audit firms; consulting on whether to report findings to audit committees and directors; and an additional report on audit quality measures and indicators.

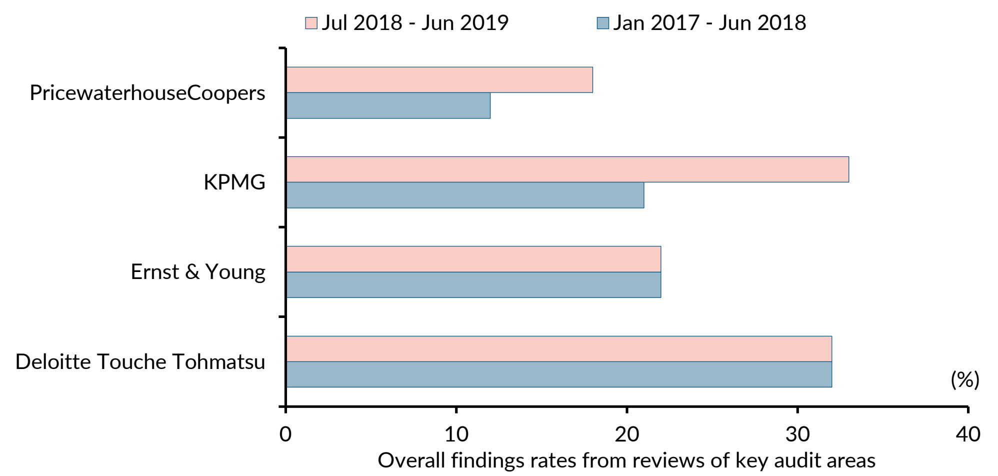
Naming and shaming

As the FRC recommended, ASIC did move to naming the big firms in the report, as the following figure shows:

Finding fault at the Big Four . . .

Figure 14

Adverse findings in Big Four audit files, January 2017-June 2019



Source: ASIC, Audit Inspection report for 2018-19 (Report 648)

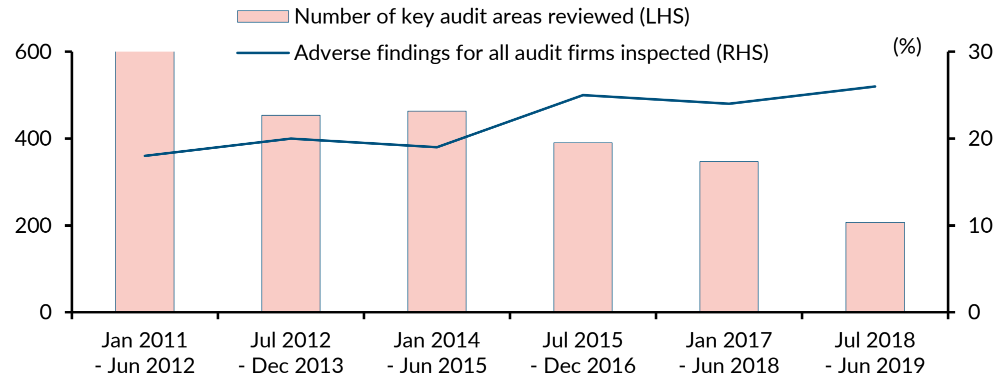
. . . relatively speaking

It should be noted that the percentage figures above relate to a relatively small number of audit files: From six for Deloitte to 10 each for KPMG and PwC and 12 for EY. Moreover, the number of "key audit areas" examined varied too: From 19 for Deloitte to 34 to 36 for PwC and KPMG, and 45 for EY. While the small and varied numbers may distort the percentage figures, it is interesting to note the comparable figures for all audit firms inspected over the same period:

The bigger picture

Figure 15

Adverse findings in all audit files reviewed, January 2011-June 2019



Source: ASIC, Audit Inspection report for 2018-19 (Report 648)

Adverse is the new normal

According to the most recent inspection report for July 2019 to June 2020, the situation did not significantly change for the largest audit firms (this time measuring the big six, including BDO and Grant Thornton). It appeared to get noticeably worse for the other audit firms inspected, as the table below shows, but ASIC noted that it inspected different firms and numbers of files in each period hence the figures are not directly comparable. Once again, ASIC said that audit firms "need to work on improving audit quality and significantly reducing the number of instances where auditors do not obtain reasonable assurance".

Here are the latest figures

Figure 16

Adverse findings by size of audit firms inspected

Type of audit firm (%)	Jan 2017 - Jun 2018	Jul 2018 - Jun 2019	Jul 2019 - Jun 2020
Largest six audit firms	20	26	24
Other audit firms that audit more than one listed entities	29	34	48
All audit firms	**24**	**26**	**27**

Source: ASIC, Audit Inspection report for 2019-20 (Report 677)

Inspection reportage

The latest inspection report also produces adverse finding figures for each of the big six firms by name and complementing it are, for the first time, a set of individual inspection reports on each of the firms. The reports give examples of audit review findings that highlight a risk of material misstatement in accounts and summarise ASIC's review of a firm's management of conflicts of interest, its internal governance, and accountability for audit quality.

Adverse, not misstated?

Measuring systemic audit quality

Since its "adverse findings" figures often seem extremely high - especially when blasted out through the media - ASIC is at pains to point out that the findings "do not necessarily mean that the financial reports audited were materially misstated". The point is rather that, in its view, the "auditor did not have a sufficient basis to support their opinion on the financial report". In substantive terms, the largest number of adverse findings in its 2018-19 and 2019-20 reviews related to the audit of asset values, in particular the impairment of non-financial assets, and of revenue.

Politicians need answers

Nevertheless, the Parliamentary Joint Committee on Corporations and Financial Services (PJC) issued a report on 13 February 2019 recommending that ASIC should "conduct, alongside or within its current Audit Inspection Program, a study which will generate results which are comparable over time to reflect changes in audit quality." As ASIC itself admits, caution is needed in extrapolating its inspection results to the entire market.

Seeking indicators of good auditing and good behaviour

Audit quality measures and indicators
As part of its quest to raise auditing standards, ASIC published a new report in December 2019 intended to provoke discussion on the "measures and indicators that might be used by auditors and audit committees in monitoring initiatives to improve audit quality" and the "good behaviours" that support audit quality. The report covered the 1 April 2018 to 31 March 2019 period and, most interestingly, provided a range of statistics on "input indicators" for audit quality. These included staff mix (ie, hours spent by partners, managers and staff on audits), training, audit fees in both relative terms (eg, average fees to net profit after tax for ASX 300 issuers) and absolute terms (eg, total audit and non-audit fees in dollar terms for the ASX 300). For this group of large issuers, audit and audit-related fees far outweigh the non-audit fees paid to their auditors - indicating they are conscious of the need for auditor independence. Taken as a whole, however, the total revenue earned by the big six audit firms for "other services" dwarfs what they earn from audit: A$6.25 billion compared to A$1.38 billion for the year to either 31 May 2019 or 30 June 2019.

Data has its limits

In its commentary on each set of figures, ASIC explained their potential relevance to audit quality and some limitations that needed to be taken into account. For example, on staff mix it noted that the figures may indicate whether audit firms are applying sufficient experience and expertise to audits. However, the appropriate mix of staff and the hours required will vary depending on the complexity of the audit and the company being audited.

ASIC finally goes metric?

This report, which was updated for the 2019-20 financial year, marks a departure from ASIC's previous views on audit quality indicators. When ACGA first posed this question in 2016, the regulator expressed scepticism that aggregate figures on audit-firm inputs, HR resources and fees would say much about audit quality. This was supported by an auditor who said audit committees were not interested in such market level data, but cared very much about the skill and experience of their company's audit firm. It would seem that, at the regulatory level at least, the view is becoming more nuanced.

Does the market agree?

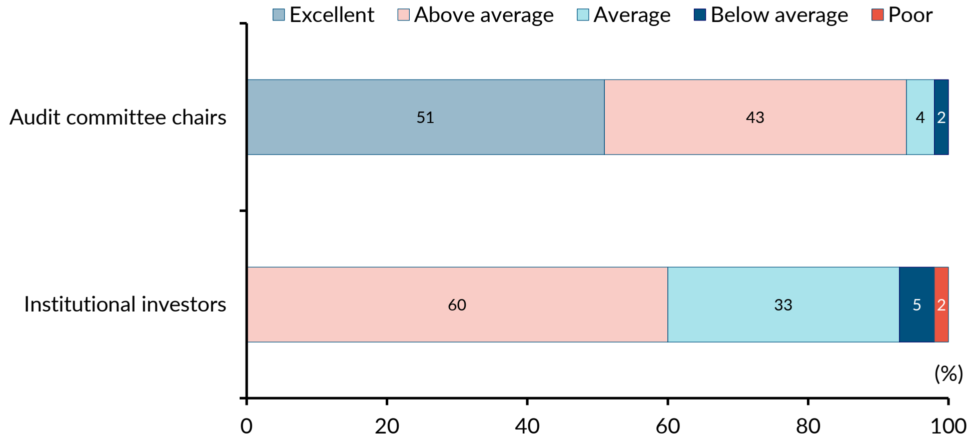
The market is more positive on audit quality than ASIC

While ASIC accepts that its audit inspection process is limited and is not intended to be a description of audit quality per se across the whole market, it does stand by its findings and is clearly concerned about the professional judgment and skill of many auditors. Do market participants agree? It would appear many do not, if the findings of annual surveys undertaken by the Financial Reporting Council (FRC) and the Auditing and Assurance Standards Board (AuASB) are to be believed. The two bodies undertook perception surveys of audit committee (AC) chairs in 2020 and institutional investors in 2019. As the following figure shows, 51% of AC chairs thought audit quality to be "excellent" and another 43% "above average". Hence, 94% above average! The numbers for institutional investors were more balanced: 60% considered it to be "above average" vs 33% for "average". (Note: "Audit quality" was not defined for the surveys, hence the results are highly subjective.)

AC chairmen are more positive than institutional investors

Figure 17

Perceptions of audit quality in Australia



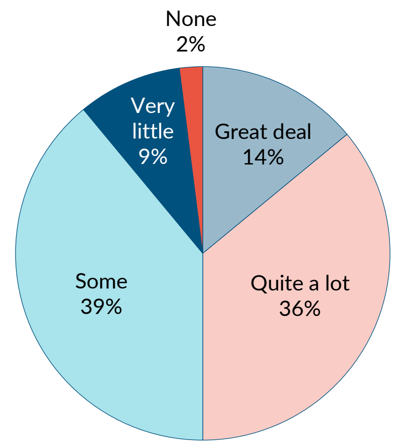
Source: ASIC, Audit Quality Measures, Indicators and Other Information 2019-2020 (Report 678)

And retail shareholders are more sceptical than institutions

Meanwhile, Chartered Accountants Australia and New Zealand (CA ANZ) asked retail investors in 2020 how much confidence they had in audited financial reports. As the figure below shows, half have a "great deal" or "quite a lot" of confidence, while the rest have only "some confidence" (39%), "very little confidence" (9%) or "no confidence" (2%).

Figure 18

Confidence in audit: Survey of retail investors, 2020



Source: ASIC, Audit Quality Measures, Indicators and Other Information 2019-2020 (Report 678)

Auditor scrutiny for all

Next steps

The increased transparency in ASIC's audit inspection report provides investors with valuable insights into areas for improvement in audits undertaken by the big six firms. It would be interesting, and fair, to extend this to other auditors of listed companies - especially those with the highest ratios of adverse findings.

Have data, dig deeper

ASIC's new report on audit quality measures and indicators is a welcome addition to its research on the current state of the audit industry in Australia. It would be helpful if the regulator could, as it gathers more data, delve more deeply into the relevance of these "input indicators" to audit quality and provide more commentary around limitations.

The big picture is needed

The Parliamentary Joint Committee's recommendation that ASIC conduct a more comprehensive survey of listed-company audit quality in Australia - essentially an output assessment - is a challenging one. Nevertheless, given the differing perceptions of audit quality among audit committee chairmen, institutional investors, retail investors, and the regulator itself, it would help to have a survey that provided a rigorous assessment of the state of play. To put it more bluntly, what is going right in audit in Australia?

In reverse?

Controversial accounting spooks the market

Construction giant CIMIC Group is one of several big names to attract criticism for its fondness of "reverse factoring", a controversial accounting technique with the potential to mask huge debts. Its share price took a monster hit in May 2019 when Hong Kong-based GMT Research claimed factoring was at play as it queried up to A$1 billion in profits. When CIMIC eventually disclosed factoring of close to A$2 billion in July 2019 along with lower-than-expected half-year results, it further spooked the market. For the best part of 2020 CIMIC's decision to stick with the finance arrangement was the source of media and political ire as it forced long payment terms on pandemic-weary suppliers.

A free pass to bury debts

With reverse factoring, also known as supply-chain finance, suppliers can sell receivables to a third party if they want to get paid earlier. Companies such as CIMIC can then book the amounts owed to the intermediary as payables instead of debt. It is a handy off-balance sheet financing tool if you want to create an illusion of cashflow and reduce the appearance of debt. There is no accounting rule stipulating that the figure be disclosed in financial reports: Indeed, ratings agency Fitch describes it as a "debt loophole". It played a key role in the January 2018 collapse of UK construction giant Carillion.

Suppliers and shareholders are not impressed

CIMIC did not immediately come clean on the extent of its reverse factoring, instead asserting that its accounts were technically compliant and accurate. This failed to hit the mark with a group of investors who filed a class-action lawsuit in August 2020 on the basis that CIMIC, among other things, breached continuous disclosure rules by failing to promptly divulge the impact of factoring on its earnings. The construction firm also attracted criticism for "supply chain bullying" where it extended payment terms to 65 days from the usual 30, pushing suppliers toward third party finance to get paid earlier, but less. This did not sit well with Australia's small business ombudsman and in November 2020, CIMIC announced plans to return to 30-day payments.

A reluctant retreat?

Other big names with a penchant for supply chain finance such as Rio Tinto and Telstra have taken criticism on the chin and promised to ditch the arrangements altogether. CIMIC has been less emphatic but appears to be moving away from the practice: In its 2020 annual results, the company reduced its factoring balance from A$1.96 billion in 2020 to A$976m for the 2020 financial year.

7. Civil society & media

Australia ranks 1st again with a score of 80%

Australia's score improved incrementally in this category as well, rising two percentage points to 80% and retaining 1st place. There was little change in the overall ratings from 2018, with the exception that the score for one question rose by two points (on the involvement of business and industry associations in CG and ESG) and another fell by one point (participation in regulatory consultations). Australia continues to have a vibrant and diverse civil society ecosystem for corporate governance. It would be nice if the print media exhibited a similar level of diversity.

Going back to school

A training legend

Australia continues to gain full marks in our survey for director and company secretarial training (Q7.1 and Q7.2). The Australian Institute of Company Directors (AICD) is the lead director training body in Australia and holds regular courses around the country and throughout the year that can stretch from a day to multiple days. It offers beginner and advanced courses on topics such as cybersecurity, diversity, ethics, health and community, big data, corporate governance and sustainability. Directors can earn "director professional development" units, which help companies track the performance of their directors and ensure they are equipped to perform at a high-level.

Company secretaries are well-briefed on CG

As for company secretary training, the Governance Institute of Australia (GIA) holds regular courses throughout the year that can range from a few hours to 20+ hours. It also runs short events/webinars and courses that touch on a wide range of governance, ESG, legal, financial and risk management issues. Similar to AICD, GIA's members can earn continuing professional development hours to ensure the members are equipped with the most up-to-date knowledge and skills.

Professional, business and investor associations

Professionals raise the bar . . .

A number of professional bodies such as Chartered Accountants Australia New Zealand (CA ANZ), CPA Australia, and the Institute of Internal Auditors (IIA), contribute towards raising standards through original research, seminars and events, and regular dialogue with regulators, standard setters and others. We see their efforts as largely positive and continue to rate their efforts as 4/5 (Q7.3).

. . . but business associations are often conflicted

Business associations, in contrast, have tended to score poorly in our survey (Q7.4) as to whether they are working with their members to improve corporate governance and ESG. This is either because the good work they do is undermined by efforts against CG reform or because many business chambers do not focus a great deal on governance. Most controversially, some leading groups - including AICD and the Business Council of Australia - threw a wet blanket over the ecosystem by successfully lobbying for a moratorium on class-action lawsuits linked to continuous disclosure breaches during the pandemic in 2020 (see box "Don't let a good crisis go to waste" in Government & Public Governance section for more). This exaggerated the alleged problem and did nothing for Australia's reputation. Meanwhile, the score increased on this question because we broadened its scope to include investment trade associations (previously grouped with other investor NGOs). As mentioned in the Investors section, the Financial Services Council (FSC) is the industry body for asset managers and author of their stewardship code.

Some leading lights champion the cause

Among "other non-profits" working directly in the CG and ESG space, the Australian Council of Superannuation Investors (ACSI) and the Responsible Investment Association of Australasia (RIAA) stand out for their commitment to the cause and helped to ensure Australia maintained full marks on this question (Q7.5). ACSI has produced a series of research reports over the years on a range of topics, most recently company governance culture (a collaboration with AICD), financial materiality and ESG, and climate change disclosure in the ASX 200. It has a full-time staff and is financially self-sufficient. RIAA has been running a successful operation for 20 years and also has a full-time staff and is financially self-sufficient. Its main areas of focus at present include the Australian Sustainable Finance Initiative, improving the quality of ESG research, human rights (including the issue of modern slavery), and an Impact Investment Forum now in its fourth year.

Participation in regulatory consultations good, but no longer a perfect score

We did, however, take a point off the score for a question (Q7.6) on the extent to which all the groups above participate in public policy discussions and regulatory consultations on CG and ESG issues. While most of them do and some are members of the ASX CG Council, we raised the bar here in our scoring methodology and concluded that 4/5 was a fairer representation of reality.

Academia

CG is firmly on the curriculum

There is a strong culture of academic research on corporate governance in Australia and all major universities have law schools or business schools that cover CG. See the table below for some recent academic publications concerning the Australian market.

A sample of recent CG research

Figure 19

A selection of recent academic research on CG in Australia

Paper	Author/s	SSRN post date
Stewardship and Collective Action: The Australian Experience	Tim Bowley and Jennifer G. Hill, Monash University	3 Feb 2020
The Third Wave of Shareholder Influence and the Emergence of Informational Activism in Australia	Michael Jefferies, PwC Australia	6 Jan 2020
Is There A Governance Deficit In The Largest Australian Banks?	Patrick J. McConnell, Macquarie University	11 Dec 2019
The Australian Paradox: Conservative Corporate Law in a Progressive Culture	Victoria S. Baumfield, Bond University	8 May 2019
The Wider Implications of the Hayne Report for Corporate Australia	Andrew Lumsden, Corrs Chambers Westgarth	19 Mar 2019
Corporate Social Responsibility, Board Structure, and Gender Diversity: Evidence from Australia	Zhongtian Li, Suichen Xu, Ellie Chapple, Queensland University, and Jing Jia, University of Tasmania	22 Jan 2019

Source: Social Science Research Network

Media

The Murdoch factor

Media reports actively, but not always impartially, on CG issues. A key challenge is the dominance of the Murdoch stable of papers, led by *The Australian*. Its business pages tend to be more balanced than its political coverage, which is known for being biased. The main Fairfax papers, which include the *Sydney Morning Herald* and the *Australian Financial Review* (AFR), are reasonably balanced in their coverage. The AFR reports in some detail on ASIC, APRA and ASX.

The facts get in the way of a good story

There are experienced reporters in all the major outlets and the quality print media remains an important source of information on financial, regulatory and corporate developments. One criticism is that reporting on regulatory issues can often descend into the "he said, she said" mode: Focussing on the politics of the case, not the substance. Indeed, stories often leave out critical facts that would help to make sense of an issue, especially those relating to legal developments. An example was some slightly confusing coverage of the class-action moratorium introduced in May 2020. Finally, the media can sometimes be quite uncritical of federal government criticism of regulators.

Next steps

Tone down the rhetoric

A less ideological and emotional discussion on the pros and cons of class actions and how they are affecting the securities market, as opposed to other areas of commerce, would be welcome.

Bridge the culture divide

We note that AICD recently published a report with ACSI on Governing Company Culture in December 2020. The report is described as "a first-of-its-kind collaboration between investors and directors to understand how culture is overseen, assessed and influenced in ASX listed companies, and understand what information is currently available to investors." Such collaborative efforts appear to be an excellent way to broaden understanding of governance from different perspectives.

Stop scratching the surface

Deeper investigative media reporting on governance issues and regulatory actions would contribute significantly to the public's understanding of listed companies and the financial markets.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- Slow or no implementation of the remaining recommendations from the Hayne Royal Commission
- No progress on the establishment of a national anti-corruption agency - or the creation of an agency with weak powers
- Continued failure of bank compliance with anti-money laundering rules
- Any fundamental weakening of the class action system
- Any erosion of funding for ASIC

What to fix

Quick fix list

Issues to address as soon as possible:

- Move ahead with the creation of a federal anti-corruption agency
- Promote greater awareness of new whistleblowing law
- ASIC to publish more narrative around its enforcement statistics
- ASIC or ASX to consider whether a single ESG reporting guide would be useful
- ASX disclosure of its enforcement actions against listed companies still opaque. This could be easily fixed on its website
- Institutional investors to disclose voting down to the company level

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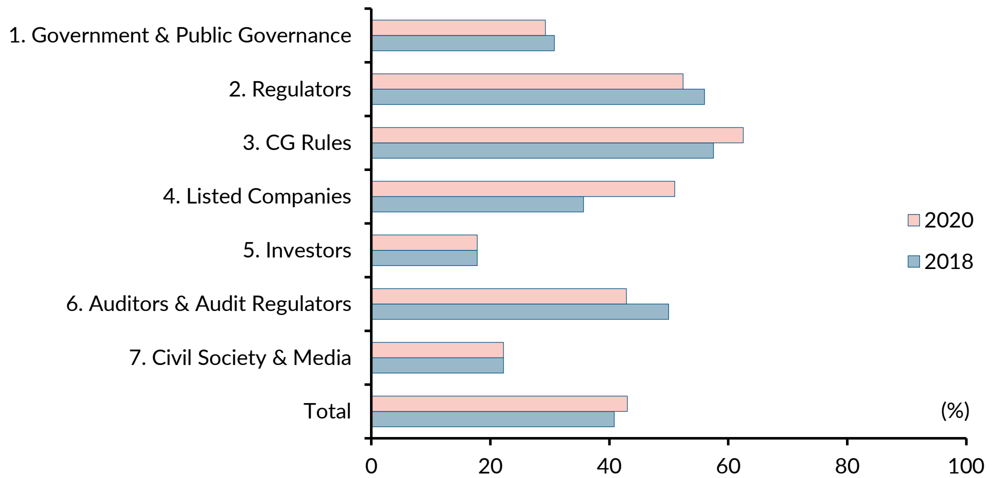
China – Dual-track strategy

- New tech board and registration-based IPO system a political success, but has it come at the cost of investor protection and good corporate governance?
- Financial regulators made strides in improving enforcement efficiency, but CG rule changes have limited impact
- A new Securities Law took effect; ESG information guidance still pending
- SOE reforms saw some progress, but not yet reflected in enterprise performance
- A new Investor Services Center facilitates class-action suits and has won financial remedies for retail shareholders
- As the voice of government, the media has a strong influence on market behaviour

Scores rise in two categories, are stable in two, and fall in three

Figure 1
China CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Dual-track strategy brings tougher enforcement, but easier listings with potentially lower CG standards

Over the past two years China has pursued a dual-track strategy on corporate governance and capital market reform. It has made some solid progress on the policy front, such as improving the delisting mechanism, enhancing enforcement and encouraging class-action lawsuits. At the same time, it has created a more permissive registration-based IPO system to allow faster and easier listings on its new Science and Technology Innovation Board, nicknamed the Star Market, which could create novel CG risks for investors. One new risk is dual-class shares, which are intended to lure back the country's tech giants listed in the US. With capital market changes moving ahead faster than fundamental CG improvements, investor concerns about systemic risks are likely to grow. One policy that could help to rebalance the governance equation, an ESG reporting framework for listed companies, has been delayed due to pushback by listed companies.

The US-China trade war was a catalyst for tech firm secondary listings

At the macro level, the US-China trade war and other geopolitical tensions have not only affected foreign companies trading, investing or operating in China, but also overseas-listed Chinese companies. Some of the larger ones, principally tech firms like Alibaba, JD.com and NetEase, have been hedging their bets by undertaking secondary listings, mostly in Hong Kong. Why Hong Kong? One theory is that although they operate in China, they prefer the more predictable regulatory regime in Hong Kong, the city's open capital account, and its stronger base of global institutional investors.

Enforcement remains a strong part of the CG ecosystem

As in our previous surveys, China's regulatory enforcement has proved to be one of the strongest aspects of its CG ecosystem. An amended securities law aims to trigger a deterrent effect by significantly increasing fines for wrongdoing, while coordination among regulators seems to be improving under the leadership of the newly established Financial Stability and Development Committee (FSDC).

Grey areas in investor voting

Progress is proving more difficult in other areas. The government for example has tried to encourage domestic shareholders to vote more at AGMs. In 2019 it abolished a special rule that required overseas-listed companies to issue AGM notices 45 days in advance of meetings, whereas domestic investors only received the notices 28 days before. According to a local business chamber, this gave foreign investors an advantage and demoralised domestic ones. Evidence to date suggests the rule change has had little effect. Meanwhile, foreign investors have grievances too: Some have had votes rejected by board secretaries of listed companies with no explanation provided.

The Luckin accounting fraud shook the market

In auditing, the regulatory environment was quiet until the Luckin Coffee fraud case shook the market in May 2020. The independence of auditors is questionable without clearer disclosure of the fees that firms receive for non-audit services such as consulting and advisory.

No change in China's ranking, but a slight increase in score

Overall, China's total score has risen two percentage points and its ranking remains 10^{th}. Scores have fallen in three categories (Government & Public Governance; Regulators; Auditors & Audit Regulators). The first two reflect a lack of focus on some aspects of CG development and regulatory opacity. Scores fell in the third area due to changes in methodology that put more weight on the independence of the audit regulator. Conversely, changes in methodology led to rising scores for CG Rules and Listed Companies. Consistent scores in Investors and Civil Society & Media reflect areas of progress being offset by regress.

Recapping CG Watch 2018

China has made progress on some recommendations from CG Watch 2018

Of the seven key recommendations we made in CG Watch 2018, China has made progress on two. The potential for improvement is appearing in other areas, as the table below shows:

Areas of progress: English-language regulatory websites, new Securities Law

Figure 2

China: Recap of 2018

	Recommendations	Outcomes
1.	A clear signal from the government to focus on corporate governance development	Some progress
2.	Encourage companies to make more disclosure around Party Committees	No change
3.	More English disclosure on regulatory websites	Big improvements
4.	Speed up the revision of the Securities Law and promulgation of the Foreign Investment Law	Both laws passed, but content was not all that we expected
5.	A defined stewardship code and/or a state asset owner taking the lead on engagement	No, but there are signs that investor stewardship is on the regulatory radar
6.	More meaningful disclosure on Key Audit Matters in the long-form audit report	No change
7.	Do not introduce dual-class shares (DCS)!	DCS was introduced shortly after our 2018 report was published

Source: ACGA

China scores 29% and ranks 11th

1. Government & public governance

China scored 29% in this category, a two-percentage point fall from our last survey, and fell one place to 11th. Areas of improvement included better coordination among regulators and more access to courts for minority shareholders seeking to settle disputes. Conversely, the worsening economy as a result of the pandemic led the government to postpone some progressive ESG policies, including one requiring all listed companies to make mandatory environmental disclosures by the end of 2020. Overall, a range of contradictions in CG and ESG policy and practice mean that China's score has remained low in this category. While such contradictions are not surprising in a capital market as complex and rapidly changing as China's, they do have a tangible impact on corporate governance outcomes.

A clearer articulation on what "corporate governance" means in China would be welcome

One challenging issue is the tendency of government entities to give out mixed signals on corporate governance. Many high-ranking officials have made public speeches on the importance of corporate governance to the long-term development of the capital market, yet this is not always followed up with concrete policy changes or greater investment in regulatory agencies. As we highlight in the next section on Regulators, the budget for the China Securities Regulatory Commission (CSRC) does not appear to have changed significantly in recent years. Nor is there a clear articulation of what corporate governance means in China. As is now well known to most foreign investors, "corporate governance with Chinese characteristics" contains some unique features, not least the leading role given to committees of the Communist Party of China (CPC). How this works with other elements of the system that draw upon European company law and global CG standards, such as independent directors and board committees, are questions of more than academic interest to foreign investors.

Policy contradiction is apparent in many aspects of CG in China

An example of conflicted policy is the push to build a bigger capital market by opening new boards and allowing faster new listings. Yet the government remains fearful of market volatility and, following lessons learned from the stock crisis of June 2015, seeks to find ways to stabilise the market. This intensifies the conflict of interest between the market-promotion and supervisory roles of financial regulators. Exhibit A is the push for the registration-based IPO regime, which we discuss further below.

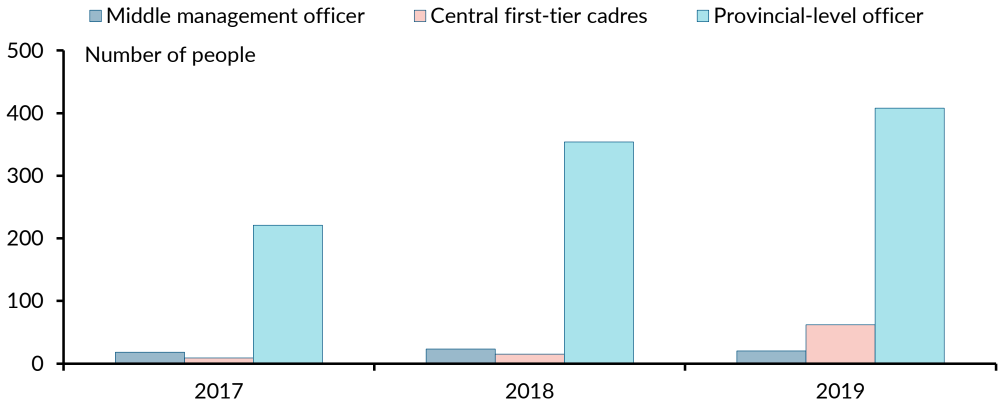
The anti-corruption drive snared many high-level officials in 2017-19

On the issue of corruption, China laid the groundwork in March 2018 for a new national agency, the National Supervision Commission, which was given broad powers to detain individuals who commit bribery or corruption. During 2017-2019, the number of senior public officials punished for corruption increased, most notably among central first-tier cadres and provincial officials.

Punishments are on the rise

Figure 3

Number of high-level public officials punished for corruption is on the rise, 2017-2019



Source: Xinhua News Agency

China's anti-corruption work is limited in focus

Despite these efforts, China's score here dipped for the following reasons: Unlike most other markets in the region, it does not have an independent anti-corruption agency; its corruption work focusses mostly on the public sector, whereas the most effective agencies in other parts of Asia have powers to pursue both public and private sector corruption; and information on individual corruption cases is often limited. It is important to stress that we are assessing China here against regional standards and best practices, not some notional international standard.

The tech board experiment

China experiments with a new tech board and registration-based IPO system

On 23 January 2019, Xi Jinping approved a plan to establish a new Science and Technology Innovation Board run by the Shanghai Stock Exchange (SSE). It utilises a US-style registration-based IPO system that relies more on disclosure of information by listing applicants and replaces the slower approval system run by the CSRC for the mainboard. Ironically, many of the rules underlying the new tech board were not particularly innovative, since China closely copied them from Hong Kong, which itself took inspiration from the US and allowed the listing of companies with dual-class shares and pre-profit biotech companies in April 2018. The good news for domestic investors is that they can now share in the growth of a wider range of China's private sector firms.

VIE entities allowed to list on the new tech board

Companies with variable-interest entity (VIE) structures can list on the new board upon the issuance of Chinese depositary receipts (CDRs) - thus covering most of the big Chinese tech firms listed in the US or Hong Kong. *(For an explanation of the inherent policy contradictions underlying VIEs, see ACGA's China CG Report 2018 on our website.)* The SSE widened the limits on daily share price movements to 20% versus 10% for the mainboard. No share-price movement restrictions will be imposed on stocks for their first five trading days.

CSRC issues new rules on share pledges

On 1 March 2019, the CSRC issued rules governing the new board that mainly focussed on enhancing disclosure of share pledges made by major shareholders and related-party transactions. The rules made it clear that the information provided by pre-profit companies would be subject to more scrutiny to protect investors' interests.

CSRC promises to respond to IPOs within five trading days

On 23 August 2019, the CSRC issued special rules for the asset restructuring of companies listed on the new board. The rules stated that the CSRC would reply to an IPO application within five trading days of receiving the submission materials from the SSE. The special rules also stated that new economy companies listed on the board could issue new shares, at a discount of up to 20% to the market price, for asset acquisitions. In this context, companies would be able to choose a market price that was their average trading price over the previous 20, 60 or 120 trading days.

Dual-class shares arrive in China

DCS listings allowed but no special safeguards for investors

Dual-class shares (DCS) was the other big change brought by the new tech board. Disappointingly, the CSRC did not specify any safeguards for these companies. It only required IPO sponsors and lawyers to give a professional opinion regarding legal and regulatory compliance.

Mainland investors get access to Hong Kong-listed DCS firms

On 2 August 2019, the Stock Exchange of Hong Kong, Shanghai Exchange and the Shenzhen Stock Exchange (SZSE) issued a joint consultation on allowing mainland investors to access DCS issuers listed in Hong Kong through the Stock Connect scheme. On 28 October, Meituan and Xiaomi were officially included in the scheme and remained the only two companies with a DCS structure in Stock Connect as of the end of 2020.

UCloud becomes the first DCS IPO in China in January 2020

On 20 January 2020, nine months after the new tech board was launched, China welcomed its first DCS listing, UCloud, a BVI-incorporated company. The three founders hold A-class shares that carry five times the voting rights of ordinary B-class shares and, upon listing, controlled 19.4% of the equity and 54.6% of the voting rights. It is understood that four other companies applied for DCS listings during 2020, with all in different stages of review by the end of the year.

Re-reinforcing Party Committees

The leading role of the Party Committee in SOEs has been reaffirmed

On 5 January 2020, the CPC reaffirmed the critical role of Party Committees in state-owned enterprises (SOEs). This issue had gone quiet following a wave of article amendments by SOEs in 2017 and 2018 to emphasise the role of Party Committees in decision-making. In this relatively unheralded document, reported by Xinhua News Agency, the fourth section reiterated that Party Committees were superior to the board of directors and that, ideally, the board chairman should also be the Party secretary, while the vice chairman or a key executive director should act as the deputy.

Party Committee rules apply to all SOEs and even many private firms

Even before the Party Committee was included in the amended Corporate Governance Code issued in September 2018, investors have sought more transparency on the scope and practical impact of Party leadership in listed companies. Article 39 of the new regulation further broadens the Party Committee's reach by making it clear that these rules apply to all SOEs, including those where the state has a controlling stake of less than 100%. The rules say that even companies only partially owned by the state should comply with the regulations where possible. This essentially broadens the scope of Party leadership to many private sector firms as well where the state has limited ownership. Meanwhile, a number of foreign firms have also been under pressure to set up Party Committees.

Green finance on pause?

China made a landmark statement on carbon neutrality by 2060 . . .

In late August 2020, China made a landmark commitment to achieve carbon neutrality by 2060. While impressive, many observers are concerned that the country's efforts to promote green finance have been stagnating. At the same time, the Mandate 2020 campaign, which had been designed to require all listed-companies to make mandatory environmental disclosures by the end of 2020 and was strongly pushed in 2018 and 2019, appeared to slip down the policy agenda due to the worsening economy after Covid.

. . . but there has been reduced spending on the environment

This reduced focus on environmental issues is evident in government budgets and reporting. According to experts, the 2020 budgets for air and water pollution management were slightly reduced and remained stable for soil pollution. While this may seem reasonable during a pandemic year, the figures were in sharp contrast to the previous year's expenditure: In 2019 budgets for the three areas increased 25%, 45.3% and 42.9% YoY, respectively. Furthermore, Premier Li Keqiang's Public Work Report in 2020 only mentioned the environment a few times, whereas in 2019 his speech devoted a long section to it. It is to be hoped these changes are only temporary.

Next steps

More investor safeguards are needed for DCS firms

We suggest the government reviews investor protection mechanisms on the new tech board as they relate to dual-class shares.

Aligning CG and ESG is critical

A clear statement from government on the importance of corporate governance to China's capital market development and to the evolving area of green finance and environmental risk management/sustainability would be welcome. It is critical to ensure that the country's corporate governance framework is aligned with ESG and sustainability.

Class actions have been rare in China . . .

The rising tide of class actions

Although class-action lawsuits are allowed under Chinese law, they have been rare in practice. Two major issues stopped investors from using this legal weapon to protect themselves. Firstly, given the size and complexity of China's capital market, it was difficult to find other investors who had suffered the same losses to co-organise a campaign. Secondly, even if organising a campaign was possible, it was costly to find lawyers to take on such cases.

. . . but in March 2020 the process was simplified

On 24 March 2020, the Shanghai Financial Court issued guidance to simplify the litigation procedure and cost of class-action lawsuits. The guidance stipulated that investors who suffered losses would be part of a class action against the wrongdoer by default unless they chose to opt out. The court also proposed establishing a digital platform to smooth implementation. This would enable investors nationwide to register for class actions and coordinate more easily. It would be linked to the exchange clearinghouses for automatic checks on the authenticity and accuracy of investor records.

Cases can only go forward once the authorities have established wrongdoing

Because class-action lawsuits can only proceed in China when wrongdoing has been established, investors only need to provide their personal information, the company or individual they wish to sue and the remedy sought. All the details of the case will be supplied by the authorities, significantly lowering the litigation cost for both investors and the court.

Class actions are on the rise

As the table below shows, the new rules seem to be having an effect: The number of cases initiated in 2020 is significantly higher than in the previous two years, as is the number of companies being sued and the amount of compensation sought.

Figure 4

Class actions on the rise in China, 2018-2020

Year	Total cases outstanding	New cases initiated	Number of companies sued	Compensation (Rmb m)
2018	245	19	27	1,487
2019	217	16	34	3,112
2020	209	33	52	3,807

Source: ValueOnline, ACGA analysis

Remedies sought have risen almost 33% since 2018

According to ValueOnline, a Shenzhen-based compliance software developer, the average remedy claimed in class-action suits has risen by almost 33% from around Rmb55m per company in 2018, the year when cases started taking off, to Rmb73m in 2020. The biggest claim has been against Shanghai DZH, which attracted 166 cases amounting to Rmb1,145m.

The Investor Services Center, created by the CSRC, plays a unique role in the system

There remain a number of procedural and substantive issues to be resolved in the country's class action system. One is the role of the Investor Services Center (ISC), a non-profit established under the CSRC and intended to represent investors in most lawsuits. One of the ISC's jobs is to appoint a public-interest attorney for each case, but it is not clear who they are and how are they selected. More fundamentally, the purpose of having a class-action mechanism is to serve as a further deterrent effect against management wrongdoing. Yet if companies are already punished by regulators, what extra impact will a class-action lawsuit have? Still, such suits serve a useful purpose in allowing minority shareholders to defend their rights as shareholders and seek at least some compensation for malfeasance.

2. Regulators

China scores 52% and ranks 9th

China scored 52% in this category, a four percentage-point fall from our last survey, and its ranking has dropped from equal 6th with Korea to 9th. On the positive side, English disclosure on regulatory websites has improved and the momentum on enforcement has been maintained. The CSRC has also started using social media to disclose its enforcement decisions and now publishes half-yearly enforcement data on its website. Points were deducted, however, for three main reasons: Limited information available on regulatory funding compared to other markets in the region; a mismatch between the reforms that the two stock exchanges have been required to undertake and the resources they were allocated; and a conflict of interest between the political and supervisory roles of the regulator, most apparent in the way in which the new tech board in Shanghai was set up and dual-class shares introduced.

2.1 Funding, capacity building, regulatory reform

China scores 42% in this sub-category

China's score for this sub-category fell from 48% in 2018 to 42% in 2020. With the arrival of the new tech board and the adoption of the registration-based IPO regime, we expected that the CSRC and stock exchanges would have been given bigger budgets: Less regulatory vetting prior to IPO should mean a stronger surveillance and investigation function post-IPO. However, the annual budget planning reports issued by the CSRC suggest that it spent less of its total budget on enforcement and investigation in 2020 than in the previous two years, as the following table shows:

Figure 5

CSRC spending less of its total budget on enforcement and investigation, 2018-2020

(Rmb million)	2018	2019	2020
A. Enforcement	285	368	263
B. Investigation	68	84	65
Other	948	895	1,075
Total expenditure	**1,301**	**1,347**	**1,403**
A+B as % of total expenditure	*27*	*34*	*23*

Source: CSRC, ACGA analysis

CSRC spending on HR dropped almost 7% in 2019

Surprisingly, the CSRC budget showed a 6.8% decrease in human resource expenditure from Rmb603m in 2018 to Rmb564m in 2019. Budgets of the two exchanges are not publicly available, but we understand that neither conducted major new recruitment exercises since our last report in 2018 (although there was some internal transfer of staff to create new departments). Beyond the figures above, little data is available on regulatory funding in China. No figures are given for staffing levels, skills or expertise.

English websites of regulators are getting better

Despite these budgetary constraints, regulators deserve credit for upgrading their English websites. The CSRC and SSE have both updated their English websites to April 2020, with the SZSE to August 2019. This is a big improvement on 2018, when the CSRC and SSE English websites were only up-to-date as of 2012 and the SZSE to 2016.

Registration-based IPOs trial on ChiNext

China is extending its experiment in registration-based IPOs

On 27 April 2020, China began trialling a registration-based IPO system on the ChiNext board in Shenzhen. ChiNext was established under the SZSE in 2009 as a stepping stone to the mainboard. Due to low liquidity and high volatility, however, the board proved unreliable. With the new tech board in Shanghai developing in an orderly way, and given the government's desire to roll out registration-based IPOs to all boards in China, the ChiNext board was chosen as the next place to trial the system.

The CSRC will no longer approve IPO applications for ChiNext

Under the new system, the CSRC will no longer approve IPO applications for ChiNext and will rely instead on the SZSE. The CSRC also removed the 23x price earnings limit for IPOs on this board, doubled the restrictions regarding price-volatility limits (from 10% to 20% in either direction), and simplified the delisting procedure. As with the new tech board, no share-price movement restrictions will be imposed on stocks for their first five trading days. On 24 August 2020, the first batch of 18 companies listed under the new regime started trading on ChiNext. Their average price movements for the first five trading days were frothy, to say the least:

The first batch of IPOs under the new system began trading in August 2020 and the average share price shot up

Figure 6

A volatile market: first five-day trading of companies listed on ChiNext under new regime, August 2020

Date	Average stock price performance (%)
August 24	212.37
August 25	22.72
August 26	(7.75)
August 27	(13.00)
August 28	(11.54)

Source: Shenzhen Stock Exchange, ACGA analysis

SOE reform: Policy vs practice

SASAC wants to enhance the autonomy of central SOEs

On 3 June 2019, the State-owned Assets Supervision and Administration Commission (SASAC), an entity under the State Council that owns, supervises and seeks to enhance the management of 96 major SOEs (excluding financial enterprises) under the control of the central government, issued a new list of authorised powers to central SOEs and regional SASACs. The aim was to give them more autonomy in making their own business decisions and allow their operations to become more market-oriented. Some significant powers that will be delegated to central SOEs include the ability to:

- Approve mixed-ownership plans (although companies in key sectors related to national security and economic performance will be excluded);
- Approve asset restructuring plans for state-owned parent companies and non-state-controlled listed subsidiaries;
- Approve state ownership management/transfer plans of non-listed companies owned by central SOEs (excluding the same key sectors as under the first item above);
- Approve the issuance of corporate bonds per quotas approved by SASAC; and
- Recruit and manage professional managers from among the public, to gradually increase the percentage of employees recruited via this channel.

But practice and theory don't always align

As ever with policies that purport to delegate more decision-making powers to SOEs in China, however, the reality is likely to be far more complicated than theory suggests. The delegation of powers is not a new concept and usually comes up against hard barriers to change, not least the propensity of the government to interfere in the running of SOEs.

Challenges with new share incentive schemes

On 9 November 2019, for example, SASAC issued revised guidance to encourage SOEs to apply share incentive schemes to better align company performance with management remuneration. For SOEs applying the incentive scheme for the first time, SASAC raised the ratio of shares from 1% to 3%. For those already in the scheme, the 1% ratio of shares still applied. The income cap for recipients under such a scheme was also removed. However, the take-up was less than expected.

It appears that the schemes only apply to people hired from the market

Observing that the previous guidance did not have its expected effect, on 31 May 2020 the State Council issued further guidance for setting up share incentive schemes in central SOEs. However, a close reading of the guidance showed that Article 16 said only those managers recruited from the market (not appointed by the state or SASAC) could participate in the scheme. This ruled out almost all senior managers of such enterprises. Another issue is that share incentive schemes, widely adopted by tech companies around the world, rely on the share price of these high-growth companies rising steadily over time. However, the poor share price performance of most central SOEs will make such schemes less attractive for their employees.

Regulatory coordination improving

FSDC has played a coordinating role since November 2017

A modernising feature of China's regulatory system in recent years has been greater coordination among key regulators. The State Council got the ball rolling in November 2017 when it set up the Financial Stability and Development Committee (FSDC), which brought together the heads of the CSRC, China Banking and Insurance Regulatory Commission (CBIRC) and the People's Bank of China (PBOC), and is chaired by Vice Premier Liu He. The FSDC holds regular meetings to discuss ad hoc issues to stabilise the market and ensure sustainable financial development. On 15 April 2020, it held a meeting to calm the Chinese capital market's response to Covid.

Seven authorities issued a joint statement on supervision of the new tech board

The next development came on 9 July 2019 when seven authorities (the CSRC, CBIRC, National Development and Reform Commission, PBOC, SASAC, State Administration for Market Regulation, Civil Aviation Administration of China, and the China State Railway Group) issued a statement announcing their coordinated enforcement against wrongdoers on the new tech board. This was the first time that multiple authorities had jointly issued a document that detailed the consequences for individuals who indulged in capital market misconduct. According to the document, issuers and/or individuals who have been the subject of an investigation and penalised will:

- Be banned from obtaining further funds from banks;
- Be banned from accepting roles as company legal representatives, directors or supervisors;
- Have their licence to participate in stock, fund or options markets revoked; and
- Be banned from travelling on a plane or high-speed train in China.

One-way connection

London-Shanghai Stock Connect off to a slow start

On 17 June 2019, the long-awaited London-Shanghai Stock Connect scheme was officially launched. First proposed by President Xi during his trip to the UK in October 2015, the intended December 2018 launch was initially delayed by the trade war between the US and China. Under the scheme, London-listed firms would be able to issue Chinese depositary receipts (CDRs) in Shanghai, while China-listed firms would be permitted to list global depositary receipts (GDRs) in London.

Two China GDRs have listed in London, but no UK CDRs yet

Despite four years of preparation, it appeared the scheme was suspended for a few months in the first half of 2020 when the UK-China relationship soured following the Hong Kong protests in 2019. Then in June 2020, the CSRC approved a GDR issuance by China Pacific Insurance Group, which subsequently became the second company to do so (after Huatai Securities). So far no UK-listed company has sought to issue CDRs.

Next steps

More transparency on regulatory funding welcome

More transparency around regulatory spending and funding would be welcome, including from the two stock exchanges, and would help to underline how China intends to build internal capacity to carry out new regulatory reforms and supervise the new tech board.

An annual update on SOE reform would be helpful

Given the multi-faceted and multi-level nature of SOE reform, it would be helpful if SASAC were to produce an annual report for public consumption on progress made at the central, provincial and local levels. Media reporting on SOE reform is fragmented.

Longer and more open consultation periods would be beneficial

A longer and more open market consultation process, with all documents in English, would help to build foreign investor support for and understanding of regulatory reforms. Regulators usually allow only a two- to four-week consultation period and all documents are issued only in Chinese. The final rules are typically no different from the drafts issued. As capital markets develop, public consultation processes often become more formal and established.

China's response to Covid: Light touch

No major changes to rules on reporting or AGMs despite Covid

As China was the first country to experience Covid and one of the first to see its initial wave of cases decline, financial authorities there did not see the need to make dramatic changes to financial reporting or AGM rules. They allowed a brief one-month extension for audited annual accounts, but made no changes to AGM rules. This was in part due to an already generous six-month window in which to hold meetings.

Financial reporting extensions

Most A-shares able to meet new deadline for audit filings

The due date for 2019 audited annual accounts was 31 March 2020 for companies listed in China and Hong Kong, and 30 April for those listed in the US. Since most Chinese companies only reopened in early March, however, it was difficult for them to meet these deadlines. The Shanghai and Shenzhen Stock Exchanges therefore extended the due date for filings by one month to 30 April. While most A-share companies were able to meet this deadline, 108 did not and announced they would publish by the end of May or June.

Periodic reporting vs continuous disclosure

Instead of timely announcements, firms used Q1 reports to address Covid

Financial regulators in China did not issue any formal guidance on the obligations of listed companies to promptly inform the market of price-sensitive events resulting from the pandemic. Not surprisingly, few companies produced such announcements, preferring instead to address the impact of Covid in their first quarter reports due at the end of April 2020. According to Wind, an information provider, 1,752 issuers produced their Q1 2020 quarterly reports on time. Of those, 1,351 (80%) mentioned Covid and 1,068 (60%) reported that Covid had had a negative impact on their performance over January to March 2020.

Shanghai study analyses post-pandemic announcements

In a separate study released on 1 March, the Shanghai National Accounting Institute categorised post-pandemic announcements into three groups:

1. **General notices (following board meetings):** These mainly related to corporate donations and the production of personal protective equipment (PPE) for sale (ie, a change or addition to the business line).
2. **AGM/EGM-related:** Notices regarding the cancelling or delay of meetings, or changing from physical to hybrid. For example, of 433 announcements, 53 related to cancellation and 109 to the delay of meetings.
3. **Financial reporting:** Companies that informed the market that their audited accounts would not be ready by the usual deadline. For example, of 91 companies that had indicated they would publish their reports early by the end of February, only 37 (41%) actually did so.

No formal guidance from regulators on disclosure

While formal guidance on disclosure has not been forthcoming from regulators, some informal statements have been released. For example, in mid-May the Jiangsu Bureau of the CSRC urged companies to communicate more with shareholders and make greater use of electronic channels to produce "rational expectations".

China again scores 64%, but falls to 6th place

2.2 Enforcement

China scored 64% in this sub-category, once again making it the country's highest scoring area in our survey. It continues to make progress on enforcement, with big increases in administrative penalties and enforcement activities in 2018 and maintenance of this effort in 2019 and 2020. Local regulators are using social media to improve the transparency of enforcement decisions, although the depth of information provided is much more limited than Hong Kong, for example. Stock exchanges have also imposed tougher delisting rules and started using settlement as an enforcement tool. Nevertheless, China's ranking fell from 2nd to 6th on a regional basis because other markets are moving ahead faster.

Enforcement decisions and fines increased 40% in 2018

Some key facts on China's securities enforcement efforts in 2018:

- The CSRC imposed 310 enforcement decisions and total fines of Rmb10.6 billion (US$1.6 billion), representing a 40% increase in both number and value from the year before. It also banned 50 individuals from entering the market.
- Of the types of misconduct, 87 cases were related to insider trading, while 56 were for false disclosure.
- On 22 February 2019, the CSRC announced it had completed special on-site inspections of 264 corporate bond issuers for the 2018 financial year. This was seen as a reaction to several cases of corporate default.

Enforcement outcomes continued strongly in 2019 . . .

Key facts for 2019:

- The CSRC issued 296 enforcement decisions and total fines of Rmb4.18 billion, representing a stable number of decisions though a large drop in fines. It also banned 66 individuals from entering the market - a material increase on 2018.
- Of the types of misconduct, 55 cases were related to insider trading, 29 to false disclosure and 14 to market manipulation. A total of 10 institutions were fined, including securities firms and accounting firms.

. . . and for the year of 2020

Key facts for 2020:

- For 2020, the CSRC had issued 339 enforcement decisions. A total fine of Rmb5.3 billion was issued and the commission banned 57 individuals during the year—a faster pace than in 2018 (50) but slower than in 2019 (66).
- Of the types of misconduct, 111 cases were related to false disclosure, 118 to insider trading and 13 to market manipulation.
- The CSRC also conducted 255 enforcement actions against securities firms and their associated individuals, an increase of 59.4% from the previous year.

CSRC maintains a steady stream of enforcement actions

Figure 7

Key CSRC enforcement facts, 2018-2020

Year	Number of enforcement decisions	Total fines (Rmb bn)	Number of individuals banned from market
2018	310	10.6	50
2019	296	4.18	66
2020	339	5.3	57

Source: CSRC

The SZSE appears to be doing more enforcement than the SSE

For 2020, the SSE publicly criticised 113 companies and issued condemnations, a more severe form of punishment, against 43 others. The respective figures for the previous year were 103 and 39. In comparison, the SZSE appeared to be doing more: It publicly criticised 191 companies and issued condemnations against 62 others in 2020. The respective figures for the previous year were 162 and 68.

BrightGene muddies market with "massive" claim

False testimony
One of the more interesting enforcement cases of 2020 involved a company called BrightGene, a pharmaceutical company listed on the new tech board. On 11 March 2020, the CSRC Jiangsu Bureau issued a warning letter against the firm after it announced that it had successfully developed a medicine similar to Gilead's Remdesivir, believed to be a treatment for Covid, and that it could put the new medicine into "massive production". In its letter, the Bureau stated that although the company did disclose the possible risks with the new drug, its use of the phrase "massive production" could mislead investors into thinking the drug was further advanced in development than it really was. In fact, at the time it was still in the clinical trial stage.

Since the quality of disclosure is crucial for the registration-based IPO system to work, and since the system is still in an early stage of development, regulators clearly wanted to take no chances.

CSRC takes aim at banks and brokers for shoddy due diligence

Pressure on intermediaries
The CSRC has also been taking aim at intermediaries, principally investment banks and brokers, for shoddy due diligence:

- On 21 May 2019, the CSRC announced an enforcement action against two sponsor representatives from China International Capital Corporation, the largest local investment bank in China, for falsifying the prospectus and other documents of an applicant to the new tech board.

Financial advisor misleads investors

- On 5 July 2019, the CSRC censured and fined New Times Securities a total of around Rmb45m (US$6m), including confiscated revenue of Rmb20m and a total fine of nearly Rmb25m, for failing to perform due diligence properly. New Times acted as the independent financial advisor and major underwriter for the 100% acquisition of Jiangsu Bada Garden by Shenzhen Ecobeauty. It made misleading statements in its report as the independent financial advisor regarding the progress of the acquiree's underlying business, as well as estimated revenues for 2015.

Easier listings on the tech board = easier delistings

New listing regime: Easy in, easy out
The new registration-based IPO system is also having an impact on delisting rules. On 16 November 2018, the two exchanges issued consultation conclusions on the mandatory delisting of issuers found to have committed serious misdemeanours. This followed earlier guidance from the CSRC asking the bourses to strengthen their frontline regulatory role in preparation for reforms to the IPO system.

Mandatory delisting now applies to four kinds of illegal activity

Regulators have been trying to standardise and clarify the delisting rules since 2016, when the first issuer was struck off for illegal behaviour-a company called Zhuhai Boyuan Investment. The new rule specifies four kinds of significant illegal activity that would trigger a mandatory delisting: IPO fraud, restructuring fraud, fraudulent information in annual reports to avoid delisting, and other scenarios that the exchanges deem relevant. The rule also cuts the suspension period before final delisting from one year to six months, while extending the reapplication period from one year to five years. Companies delisted for IPO fraud, however, will no longer be allowed to re-list.

Four companies delisted on a single day in May 2019

On 17 May 2019, the two exchanges delisted two companies each. Three of the four were delisted for making three consecutive years of losses (one company applied to leave voluntarily). The fourth was removed because its auditor failed to provide an unmodified opinion for two years in a row.

Delisting rules tweaked further in December 2020

On 14 December 2020, the exchanges issued a public consultation on new delisting rules. Under the proposals, companies would only be forced to delist if they had made a loss and their total revenues were less than Rmb100m. In cases of financial fraud, delisting would only be imposed if a company had inflated profits by more than 100% or net assets by more than 50% over three consecutive years and the sum in both cases equalled Rmb1 billion or more. It appears that some respondents felt these proposed thresholds were too high. According to an FAQ published by the Shanghai Exchange on 31 December, it will now require delisting if a company has inflated profits or net assets by more than 50% and the sum involved is Rmb500m or more in two consecutive years.

A total of 28 companies delisted in 2019 and 2020

In 2019 and 2020, a total of 12 and 16 companies were delisted, respectively, surpassing the sum of the previous three years. About half of these companies were delisted for breaching listing rules or laws; the other half due to poor price performance. Meanwhile, the two exchanges have been under pressure to permit more IPOs as part of the new registration system. Expect more delistings in the years to come.

A new tool: Regulatory settlement

First administrative settlement in April 2019

On 23 April 2019, the CSRC announced that it had settled a case with Goldman Sachs (Asia) and Gao Hua Securities for a fine of Rmb150m (US$22m). The case was triggered by internal control failures related to suspected insider trading over the trading of stock futures during October 2013 and July 2015. This was the first administrative settlement China has seen since the CSRC issued its “Implementation Measures for the Pilot Program of Administrative Reconciliation” in February 2015.

Second case in January 2020

The second case came on 20 January 2020 when the CSRC announced a settlement with Shanghai Sidu Trading, a subsidiary of the hedge fund Citadel Group, and four associated companies in a case of suspected market manipulation dating back to 2015. The companies agreed to fines ranging from Rmb1m to Rmb670m (US$140,000 to US$96m) and promised to enhance their internal control practices.

Settlement fines go into an investor protection fund

The measures are aimed at making regulatory enforcement in the Chinese capital markets more effective, especially in cases where regulators find it difficult to collect adequate evidence to prosecute. Fines collected in such cases are managed by the China Securities Investor Protection Fund, a wholly state-owned company formed under the CSRC. Investors who have suffered losses due to related misconduct should be able to apply for a remedy from the fund through the courts. However, in some cases, investors might struggle to establish the link between their loss and the misconduct.

Two high-profile company chairs blurt out material information before releasing formal announcements

"Spoiling" the market

In 2019 the chairs of two leading companies in China put out information spoilers in advance of formal public announcements. The first to do so was Dong Mingzhu, chair of Gree, a leading electronic appliances retailer, who disclosed the profit of the company at its annual meeting in mid-January before the company publicly announced its financial performance that night (oddly, the company was not due to announce its results at its own AGM!). The following day, the Shenzhen Exchange sent a regulatory letter to Dong reminding her to comply with rules on not disclosing price-sensitive information before a company has made a public announcement.

One month later, on 18 February, the Shenzhen Exchange issued a similar regulatory letter to Fang Hongbo, chair of Midea, a rival of Gree, for making a statement about the company's profit performance at a public forum two days prior to the company making its public announcement.

Dong and Fang also received warning letters from the Guangdong Bureau of the CSRC. Interestingly, after Dong was reprimanded, Liu Shuwei, an independent director of Vanke and a good friend of Dong's, issued a public letter questioning the behaviour of Fang. This letter was widely believed to have been behind Fang's reprimand.

More information on enforcement decisions would be welcome

Next steps

It is encouraging to see that the CSRC and two stock exchanges have been able to maintain their momentum on enforcement over 2019 and 2020, and the additional information provided on their enforcement actions is welcome. However, what is still lacking in China are regulatory announcements on individual cases that outline which specific laws and regulations have been broken and how the regulators came to their decision on specific sanctions. Going forward, we would welcome such detailed announcements.

Stock exchanges could play a greater frontline role

The CSRC is a powerful regulator. Under the new IPO regime, however, we hope the two exchanges can play a bigger role in punishing wrongdoers and rejecting unsuitable IPO candidates.

3. CG rules

China's score rises five points to 63% but it stays in eighth place

China's score in this category rose five percentage points from our last survey to 63% and its ranking remained at 8th. The higher scores here were mostly a result of changes in the criteria for questions on related-party transaction disclosure, the prohibition of insider trading, independent director disclosure, and establishing nomination committees. Points were deducted due to the brevity of AGM minutes, which normally do not include Q&A with shareholders, and the absence of a stewardship code in China.

There remains a wide gap in China between rules and practice

It is important to note that this category assesses rules on paper, not in practice, and there is often a wide gap between the two in China. For example, it scored 2/5 for the ability of minority investors to nominate independent directors - something that is permitted under the Company Law - but such cases are rare. Another example is the formal protection of minority shareholders during takeovers, voluntary delistings and other major transactions where conflicts of interest may be involved: China scored 3/5 for this question because some robust rules are in place, but in practice there is still huge room for improvement.

CAPCO issues new guidance for independent directors

The past two years have brought some positive changes in CG rules: The Securities Law was revised in response to the new IPO regime and the China Association for Public Companies (CAPCO), a quasi-regulatory entity set up under the CSRC, issued new guidance for independent directors following the 2001 guidance issued by the CSRC. The Foreign Investment Law was amended, although it did not address key issues such as VIEs that had been in the first draft published by the Ministry of Commerce in 2015.

Plans for ESG reporting guidance put on hold

Meanwhile, the CSRC put on hold plans for ESG disclosure guidance for listed companies due to the worsening economic conditions during the pandemic. The Company Law and the Anti-Monopoly Law have been going through another round of review and are expected to be revised shortly, while regulators are still hesitating to issue a stewardship code for domestic institutional investors in China.

Two revised laws

An amended Securities Law took effect in March 2020

On 28 December 2019, the Standing Committee of the National People's Congress (NPC), China's parliament, passed the revised Securities Law, effective from 1 March 2020. The amendment process began in April 2015, shortly before China's stock markets crashed, leading to a delay in its arrival.

The law ushered in the new IPO registration system . . .

The revision comprised three significant changes. The fundamental goal of the law is to confirm the adoption of the registration-based IPO system for all boards under the two exchanges. However, considering the impact this reform would likely have on market regulation, the NPC authorised the State Council to phase in the implementation across boards and sectors.

. . . increased the cost of misconduct significantly . . .

The revised law increased the cost of misconduct significantly. During the stock market crisis, market participants were shocked by how low the penalties were for breaking the rules: Amounts were capped at Rmb600,000 (US$87,500). Since then the CSRC has gradually increased the penalties for market misconduct, with the scope further enhanced by the new law. For fraud, the highest penalty has increased from 5% of a perpetrator's ill-gotten gains to double the amount of gains. For false information disclosure, the maximum penalty has increased from Rmb600,000 to Rmb10m.

. . . and strengthened disclosure of substantial shareholdings

The law also strengthened the requirement for disclosure of substantial shareholdings. Article 63 states that shareholders with more than 5% of a company's equity must announce each 1% increment and cease acquiring shares for three days upon reaching each 5% threshold. Breaching this rule will result in a 36-month disenfranchisement for the shareholder. This rule suggests a continued aversion to hostile takeovers in China and may hamper the development of shareholder activism.

A new Criminal Law took effect in March 2021 and raised penalties

Then on 26 December 2020, the NPC passed a revised Criminal Law, effective from 1 March 2021. The focus of this amendment is on increasing the cost of rule breaches to ensure effective implementation of market regulation. Some major changes include:

- For IPO fraud, the maximum sentence has increased from five to 15 years and the highest penalty has increased from 5% of the illegal gains to double the amount of gains (these penalties are aligned with the revised Securities Law).
- For fraudulent information disclosure, the maximum sentence has risen from three to 10 years and the per-case penalty cap of Rmb200,000 has been removed.
- Controlling shareholders and actual owners of the company who are directly or indirectly involved in IPO frauds or fraudulent information disclosures will be subjected to the same penalties as above. Intermediaries that are involved in such cases will be subject to a maximum sentence of 10 years.

CAPCO revises its 2001 guidelines on independent director duties

New guidance for independent directors

On 12 August 2020, CAPCO issued the second version of its guidance for independent directors. Some major changes:

- The requirement for independent directors to work on-site in companies for at least 10 business days each year has been deleted. The new guidance instead requires them to contribute the equivalent of at least 15 business days of their time each year to a company.
- Independent directors are entitled to consult law firms to seek advice on board resolutions, with the costs borne by the company.
- Messages in emails, SMS texts and WeChat are now part of the work record of directors and should be kept for at least five years.
- Independent directors should express their opinions on company voluntary delistings to better protect the interests of minority shareholders.

CAPCO wants independent directors to report more to regulators

The new guidance also encourages independent directors to investigate, inquire and report to the CSRC or stock exchanges when there are unresolved disagreements with the listed company. According to the Shenzhen Exchange, more independent directors have in recent years been taking an interest in ownership battles or reporting rule breaches so as to lower or waive their liabilities when things go wrong. However, it should be emphasised that such cases are rare and most independent directors still choose to resign when disputes arise.

The guidance only applies to CAPCO members, not all listed companies

It is also noteworthy that the new CAPCO guidance is only applicable to its members, which comprised 2,228 listed companies as of September 2020 or about 55% of all listed companies in China (a proportion that is steadily shrinking given the rapid increase in IPOs on the new tech board). Hence, the guidance issued by the CSRC in 2001 remains the only one applicable to all listed companies.

A new Foreign Investment Law took effect in early 2020

Foreign investment law lite

On 15 March 2019, the NPC issued the long-awaited Foreign Investment Law (FIL), which took effect from the beginning of 2020. The final version showed significant divergence from the first draft released by Ministry of Commerce (MOFCOM) in January 2015 that tried to resolve key questions, such as how to deal with the VIE structure used by many overseas-listed Chinese companies and improve the protection of minority interests. Later, on 31 December 2019, Premier Li Keqiang promulgated the implementing rules for the law. Amid the trade war negotiations and to mitigate tension with the US, the focus of the new law is on fair treatment of foreign investors and companies, as well as intellectual property protection.

It promises to protect the IP of foreign enterprises . . .

Although the new law promises to protect the intellectual property of foreign-invested enterprises, the Chinese government has repeatedly denied that any transfer of intellectual property by foreign enterprises in China has been done "against the company's own will". Instead, such transfers have been a "voluntary sacrifice to enter the grand Chinese market". It is difficult to imagine how Beijing will be able to enforce a law which addresses a problem that, in its view, has never existed.

. . . and to treat them fairly

Even more problematic is the goal to treat all foreign-invested enterprises and foreign investors fairly. On top of government subsidies, the Anti-Monopoly Law exemptions and other generous benefits granted to central state-owned enterprises (whether or not they achieve discernible performance improvements), the National Reform and Development Commission and MOFCOM issued an updated "negative list" with 33 items on 23 June 2020 for foreign investors in China. Although this is a shorter list than the previous version, it is fair to say that foreign investors are far from being "fairly treated" in China.

Amending the Company Law to permit dual-class shares would be regrettable

Next steps

There has been some discussion as to whether the Company Law should be amended to allow for dual-class shares. We would consider this to be an extremely negative development for corporate governance in China and could entrench a governance discount if such capital structures became common. We sincerely hope the law will not move in this direction.

Policymakers should move forward with ESG reporting guidance for companies

Pressure is building for some form of ESG disclosure guidance for listed companies. Since most markets in Asia and around the world now require companies to make ESG disclosure on a "comply or explain" basis, China needs to move faster to develop a roadmap for its listed companies. Foreign investors would greatly welcome such a development.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

China's most improved category: Score rises to 51% and ranking to 9th

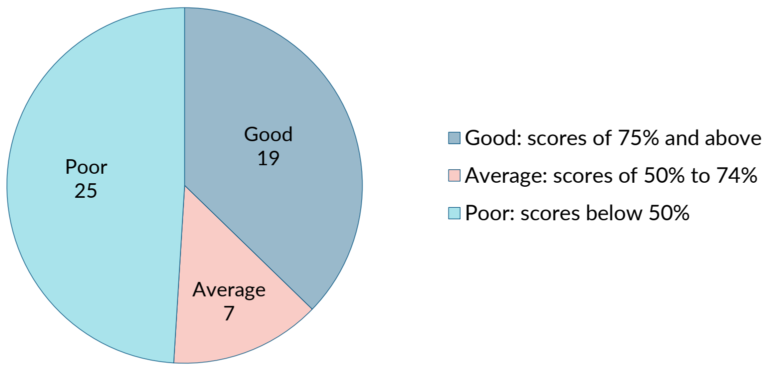
This was China's most-improved category in our survey. Its score increased from 36% to 51% over the two years and its ranking rose from last to 9th. While we found some genuine improvements in company disclosure, the main reason for the big change in score was methodological: We reduced the number of questions overall and rerated the way we scored others, with a greater emphasis on disclosure (*see the Markets Overview chapter for more details*). Since corporate disclosure in China is very much driven by regulators, and since the latter provide quite comprehensive templates for companies to follow, issuers in China sometimes score better on certain questions than their counterparts in other parts of the region. Chinese companies scored poorly, however, on ESG materiality and reporting -which is not surprising since China does not yet have standardised ESG disclosure guidance. A further reason for China's higher score was the inclusion of mid-cap firms as well as large caps: China's mid caps tend to score better than those in markets such as Indonesia, Korea and the Philippines, perhaps because they are larger and better resourced.

Aggregate results for the 51 questions in our large-cap survey were as follows:

Almost half of China's scores were rated as "poor"

Figure 8

China: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where China does well

Operating expenses are usually well-reported

As the figure above shows, Chinese companies scored well on 19 out of 51 questions. They did best on certain aspects of financial disclosure, including a question about operating expenses. This gauged the extent to which companies disclose "other expenses" in their accounts and, if they do, is there sufficient explanation of such expenses. We are looking for all expenses to be itemised in an "expenses by nature" table in the notes to the accounts, with minimal or no aggregation of other expenses. Numerous companies in other markets take liberties in this area, often leaving large unexplained "other expenses" lines in their accounts - sometimes running to hundreds of millions or billions of US dollars. This is a concern, especially in markets where corruption is rampant.

Good disclosure on director remuneration

Companies made clear disclosure on director remuneration, including independent director pay, and have remuneration policies in place. Again, this was due mainly to mandatory regulation.

Corporation action announcements are timely

China also did well on providing basic investor relations (IR) information: IR contacts are provided for all companies we surveyed and they tend to make timely announcements for corporate actions, including mergers, acquisitions and divestments, and give a rationale for each transaction. Some narrative disclosure is also good: the MD&A in annual reports normally provides an overview of business segments, strategy and operating results to help stakeholders better understand the company and the external environment it faces.

Audit committee disclosure is better than other board committee reporting

As for the quality of board committee reporting, Chinese companies are best at explaining what their audit committees do, followed by remuneration committees. Audit committees have been mandatory under the listing rules in China since April 2018 - although they were common before then for larger issuers and SOEs. Some state companies have been required to disclose a separate audit committee report that includes specific critical points of discussion or actions taken during the year.

Where China does averagely

Most CG reports are compliance-driven

Chinese companies scored moderately well on a further seven of 51 questions. An example is disclosure on how they have implemented the CG Code in their daily operations and management. The CG Code is not based on "comply or explain", hence most companies have statements about how they have complied with each principle in their CG reports. A few companies still provide only a simple statement in the form "we comply with the CG Code", with little further narrative discussion.

Supplementary narrative on financial reports is limited

Although issuers do well relatively in terms of financial disclosure in their annual reports, not much information is available beyond what regulators require. For example, the IR sections of websites contain only limited supplementary presentations on annual financials. AGM materials are often lacking too: Some circulars do not contain enough detail for investors to make voting decisions and none of the companies we reviewed included a description of shareholder Q&A in their AGM reports.

Top 10 shareholder lists are full of nominee names

Another weakness is disclosure of the largest shareholders. It is not difficult to find the list of top 10 shareholders, but it mostly shows nominee holdings with limited or no description of beneficial owners beyond the controlling shareholder. One struggles to learn the full ownership structure of most companies. We understand that this is an issue the exchanges have been watching closely since 2016 and hope it can be addressed soon.

Disclosure of shareholder and stakeholder engagement leaves much to be desired

Companies also performed unevenly on disclosure related to shareholder engagement (above average) and stakeholder communications (below average). About half of the companies in our survey (mostly large caps) disclosed the number, types and nature of discussions they had with different stakeholders, while other companies still disclosed only a list of stakeholders with no further information. To be fair, we have seen an improvement here compared to our last survey in 2018 despite the fact that China still lacks an investor stewardship code that could catalyse greater engagement between companies and shareholders. Yet there is still a long way to go, with many foreign investors finding it tough to engage in meaningful dialogue with issuers in China.

Where China does poorly

Disclosure on loans is limited

Chinese companies scored poorly on almost half of the 51 questions. We see four areas where Chinese companies badly need to improve. The first is disclosure around loan issuance, with many companies not providing a detailed outline of loans taken up. Some did not disclose any information, which created a mismatch with their balance sheets.

Few companies disclose a whistleblowing policy with communication channels

It was alarming to find that only two of the 15 large caps we reviewed had a whistleblowing policy with reporting channels, confidential contact details, and assurances that anonymity would be protected. And only three had a code of conduct that applied to all members of the company, including directors, executives and employees, and suppliers.

Board diversity and independent leadership is lacking

The third problem area relates to board composition and independence. Not surprisingly, none of the 15 large caps designated their chairman as independent, nor were there any lead independent directors (something that is not required in China). On board diversity, none of the companies mentioned at least four types of diversity, such as gender, age, length of service, nationality, experience and skills, nor a plan to improve it. Most see it just as an issue of gender. None disclosed a board skills matrix or attempted to outline how their boards comprised an appropriate mix of skills relevant to the company's business.

ESG disclosure at a nascent stage

Lastly, Chinese companies did poorly on disclosing ESG materiality issues. Only four of the 15 large caps and one of the 10 mid caps had developed a "materiality matrix", something that is increasingly becoming the norm around the region. Of these five companies, less than half published comprehensive ESG metrics and none disclosed targets for improvement. And only four large caps and one mid cap disclosed concrete steps to address climate risk in their public reports.

Where Chinese companies can improve

Figure 9

Helicopter view: Rating China's CG disclosure and governance, 2020

Good	Average	Poor
❑ "Other expenses" broken down in detail ❑ Corporate actions promptly disclosed ❑ MD&As provide good overview of company strategy and operations ❑ Director compensation disclosure quite detailed ❑ Audit committee reports quite useful	❑ CG Code application not well described ❑ Limited supplementary explanation of annual financials on website ❑ AGM circulars often need more information to allow investors to vote in an informed way ❑ Top 10 shareholder lists full of nominee names ❑ Stakeholder engagement disclosure limited	❑ Disclosure of loan issuance very limited ❑ Few whistleblowing policies in place ❑ Few codes of conduct apply to outsiders as well as employees ❑ Board independence and diversity not evolving ❑ Use of board skill matrices non-existent ❑ Weak disclosure of ESG materiality, metrics and targets

Source: ACGA

Key ACGA advocacy suggestions for listed companies in China

Next steps

Key advocacy points flowing from the above include:

Quick wins

- ❑ More information on loans utilised
- ❑ More detailed explanation about CG Code implementation
- ❑ Better disclosure of shareholder engagement
- ❑ Shareholder Q&A should be disclosed in AGM reports
- ❑ Whistleblowing policy and code of conduct should be easily available

Medium to long-term challenges

- ❑ Beneficial ownership should be disclosed in top 10 shareholder lists
- ❑ More disclosure on communication with stakeholders as part of the ESG reporting process
- ❑ Consider appointment of lead independent directors
- ❑ Board diversity disclosure and planning could be improved with a mandatory requirement for a skills matrix
- ❑ More disclosure around ESG materiality with a mandatory materiality matrix

The Ant in the room

Jack Ma gets himself into hot water and Ant IPO is pulled at the last moment

As 2020 came to a close, Alibaba found itself attracting attention of the wrong sort. Following comments critical of the central government by founder Jack Ma at a Shanghai conference in October 2020, Ant Group, a major Alibaba affiliate, was forced to pull the plug on a massive IPO the night before its debut. Alibaba also came under investigation from the State Administration for Market Regulation, which cited monopoly concerns.

Some see the crackdown on tech as inevitable

Although most commentators interpreted the sudden tightening of scrutiny of Alibaba to be a result of Ma's "bold" speech at the Bund Summit, another perspective is that such a move was almost inevitable. According to this view, Ma's speech created the perfect excuse for regulators to take overdue action on the grounds of anti-competitive behaviour by the country's tech giants, an issue widely discussed in the national media.

Tech-firm data could have national security implications

Two other issues seem relevant. First, the large volume of data held by these tech companies could become a national security issue if it was leaked or hacked. While the government has no issue asking these companies to share their data, questions about ownership of the data remain and there seem to be delays in the sharing of it.

Online financial firms distorting the value of bank account information

Beyond personal information and transaction records, the government is keen to have timely financial information on each citizen to help it make economic decisions. In the past, people had accounts in bank branches closest to them and the government would use this data to evaluate the economic performance of different areas of the country and allocate resources accordingly. Today, online financial platforms led by Ant either re-lend the money they collect or make other investments. They put it in banks with which they have the closest relationships, sometimes in different cities, thus distorting the usefulness of the data banks hold.

Government worries about the lower savings rate among young people

These developments coincide with, and helped to catalyse, another trend: A lower national savings rate, especially among the younger generation. Although the savings rate has stayed above 40% over the past decade - almost double the global average - recent data shows that people born after 1980 are saving much less than their parents did at the same age. The ease of making purchases online thanks to the development of ecommerce is a key driver for this change. Some personal loan products such as Hua Bei (just spend) and Jie Bei (just lend) developed by Ant and another "buy now, pay later" service, Jingdong Baitiao, developed by JD.com, have greatly contributed to the savings decline. Until recently, any college student with no income could easily borrow up to Rmb30,000 by just tapping a few icons on their mobile. This limit has since been cut to Rmb3,000.

Lower saving adds to concern about ageing population

Since a high savings rate has underpinned the economic transformation of China, it is not hard to see why the combination of lower saving and an ageing population has spurred the government to take action against the large tech firms - not to mention the financial business they are taking away from the state-owned banking system.

Ant restructured as a bank, while Alibaba cops US$2.8 billion fine

On 12 April 2021, the PBOC announced that Ant Group would be restructured as a financial holding company, subjecting it to greater regulatory scrutiny and control. The company, which once labelled itself a "technology company that happens to be in the finance industry", would effectively be regulated as a bank. As part of the overhaul, Ant Group was forced to cut its "improper" linkage between Alipay and its credit card and consumer loan business. Ant Group announced that it would set up a personal credit reporting company and apply for a licence to "strengthen the protection of personal information, and effectively prevent the abuse of data". The restructuring plan came just two days after Chinese officials imposed a record US$2.8 billion fine on Alibaba Group for antitrust violations.

Hangzhou government sends officials into private firms

Hubei and Wenzhou have done this before

The line between SOEs and POEs is less clear than many think

Most AGMs in China in 2020 were physical meetings

Hybrid but not fully virtual AGMs allowed in China

Only one top 50 firm held a hybrid meeting

100 officials to 100 POEs

On 20 September 2019, the Hangzhou municipal government announced its plan to send 100 government representatives to 100 first-tier privately owned enterprises (POEs). As the capital of Zhejiang Province, Hangzhou is one of the richest cities in the country and 99% of its firms are privately owned. The first batch of companies includes famous names such as Alibaba, Ant Financial, Geely, Hikvision and Wahaha.

This was not the first time that a Chinese regional government had sent officials into POEs in its jurisdiction. In October 2015, the Hubei Provincial Government announced a plan to send 10,000 cadres to companies. Three years later, in November 2018, the municipal government of Wenzhou, another rich city in Zhejiang Province, announced a similar plan.

Some view this kind of plan as more a local initiative than one ordered by Beijing. In this scenario, officials were assigned to "enhance the communication between these POEs and the local government". Maybe that is the reason why we have not seen similar interventions expanding rapidly across the country. Others believe Beijing is keen to see the country's new economy companies put in their rightful place. Whichever theory is true, this move supported one observation from ACGA's 2018 China CG Report: That the line between SOEs and POEs is not as distinct as many would assume (*see Chapter 3.5: "SOEs vs POEs: Similarities and differences"*).

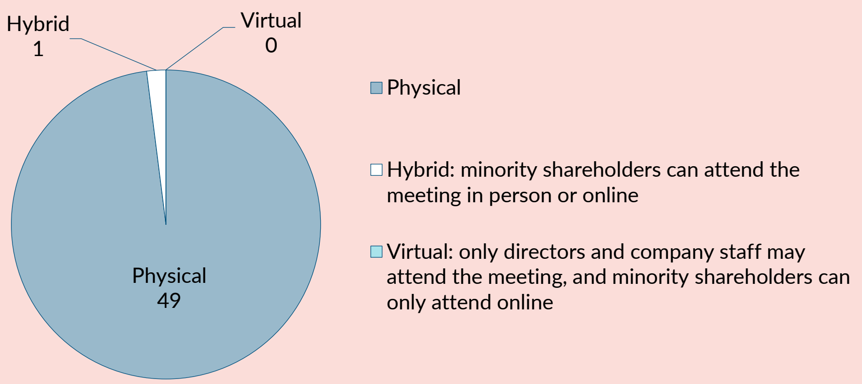
Electronic AGMs: Virtually absent

With the Covid epidemic appearing to be largely under control in China by mid-March 2020, and issuers having until the end of June to hold their annual meetings, China's regulators did not see the need to grant any extension for AGMs. They did however encourage shareholders to vote online in advance of meetings rather than attend in person. Rules allow online voting from no earlier than 3pm on the day before the AGM to no later than 3pm on the day of the meeting. Most companies opened their platforms just 30 minutes before the start of their AGMs.

Company law in China allows hybrid AGMs, but not fully virtual ones. And mainland companies do not need to amend their articles to hold a valid hybrid meeting. As it turned out, few companies held even hybrid meetings. As an ACGA survey of the top 50 listed companies (by market cap) showed, the only issuer to hold a hybrid meeting was Wuliangye, a producer of alcoholic drinks. Its meeting was held on 29 May 2020, with a 100-person limit at the physical location. The other 49 companies all held physical meetings, as the following figure shows. What this meant in practice is that companies made no effort to broadcast their meetings to minority shareholders.

Figure 10

AGM modes in China: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

China's score and ranking stayed the same, but underlying elements changed

While China's score and ranking for Investors remains the same as in our last survey - 18% and 12th - this outcome hides some underlying changes. Following the mid-2018 inclusion of A-shares in the MSCI emerging markets index, we have observed more foreign institutional investor voting and company engagement as capital has poured in. We are also seeing the emergence of a nascent local proxy voting advisory industry and, with changes to class-action laws, a more active domestic retail shareholder base.

Sadly no change to role of domestic investors

What has not changed a great deal, unfortunately, and accounts for much of the low score, is the role of domestic institutional investors. While institutional funds are gaining traction in China as the government promotes professional fund management over retail investment, many of them lack clear policies on CG and ESG, including voting policies, and do not disclose their performance on voting or engagement. It is still early days for investor stewardship in China.

A lack of public policies

Few domestic investors publish CG/ESG policies

Analysis undertaken by ACGA of the top five asset owners in China and the top 10 asset managers found that only two owners (Ping An Insurance and CIC) and one manager (China Southern) had explicit CG or ESG policies that were also publicly available. None disclose their voting records or state whether they engage with issuers. Harvest Fund Management deserves a mention for creating an in-house framework for scoring the ESG performance of more than 3,700 A-share companies.

Still reluctant to vote

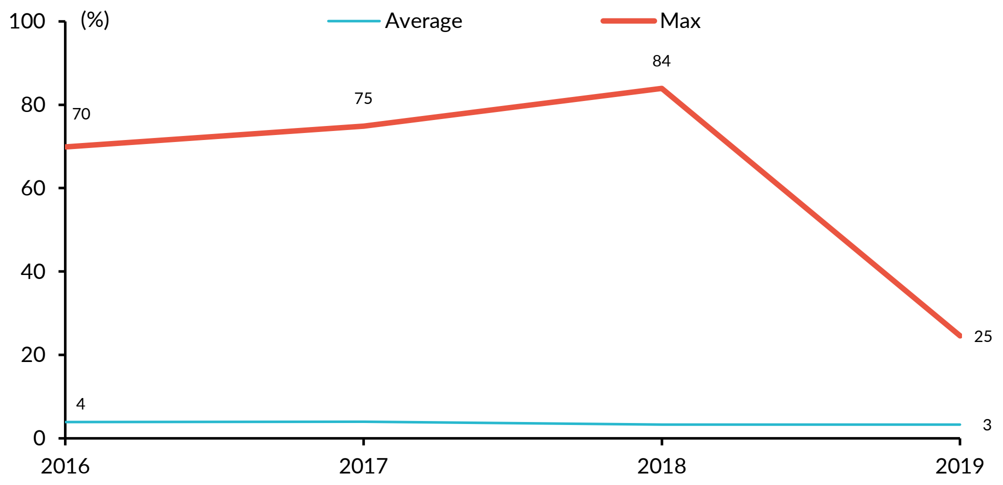
Average voting levels are low

Voting with one's feet is still the most common exit for unhappy investors in China. According to ValueOnline, a Shenzhen-based compliance software developer, only around 3% of minority investors voted at AGMs of A-share companies between 2016 and 2019 on average (see figure below). This is not surprising for retail investors, who could be forgiven for having limited knowledge of governance issues and would only vote in exceptional circumstances. But it is disappointing that institutional shareholders do not vote in larger numbers.

For the market as a whole, votes from minority investors make up less than 4% of the total vote

Figure 11

Percentage of votes from minority shareholders at AGMs of A-share companies, 2016-2019



Source: ValueOnline, ACGA analysis

The Investor Services Center could catalyse more retail participation in governance

An entity that may help to change the dynamic is the China Securities Investor Services Center (ISC), a non-profit established by the CSRC in 2014 that is taking the lead on shareholder activism through facilitating class-action lawsuits in the Chinese context. According to Huang Yong, vice general manager of ISC, it had settled 8,047 cases with total compensation to investors of Rmb2.65 billion by September 2020. On average, about 90% of investors who participated in class actions through the Center would get some remedy.

The National Social Security Fund is starting to talk about responsible investment

Another agency that could have a positive impact is the National Social Security Fund (NSSF), which in August 2020 announced it was hiring asset managers to undertake responsible investment globally. This is one of the few times we have seen the NSSF mention “responsible investment” in a public document.

The foreign dimension

ACGA surveyed its investor members in September 2020

As part of our research for CG Watch 2020, ACGA also conducted a survey of our global investor members in Q3 2020 to understand their level of voting and engagement in the 12 Asia-Pacific markets we cover. More than half of ACGA’s investor members - 45 out of 92 - responded. At the time of the survey this group managed in aggregate more than US$26 trillion globally. As the responses showed, China is not surprisingly an important investment destination:

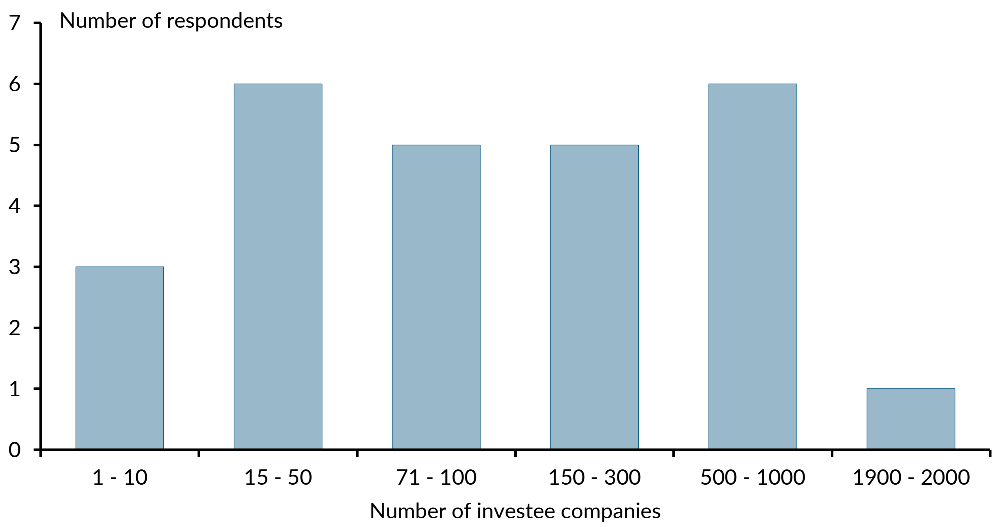
- ❑ 91% or 41 respondents indicated that they invest in China - placing China at equal 2nd in the region with Hong Kong, slightly below India (93%).
- ❑ Only 26 respondents answered the question on the exact size of portfolios. They invest in an average of 282 companies each, with a median of 85 and a range from five to 1,953. This places China 2nd in the region, behind Japan with an average of 768, a median of 400, and a range from five to 3,000.

Another way to show the extent of investment in China is to group portfolios by size. As the following figure shows, portfolio sizes are scattered across the spectrum, with around half of respondents owning fewer than 100 investee companies, while the remaining range between 150 and 2,000.

The number of investee companies per member ranges from less than 10 to almost 2,000

Figure 12

Foreign investors in China: By size of portfolios, 2020



Note 1: Not all respondents answered this question; 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points. Source: ACGA Member Survey, September 2020

Respondents take voting seriously in China and voted against a reasonable number of management resolutions in 2020:

- Most respondents with holdings in China vote in 100% of their investee-company AGMs each year. One votes in 92%, one in 70%, one in 50% and one in 30%.
- On average, they voted against at least one management resolution at 155 meetings in 2020. The median figure was 30 meetings, and the range was one to 1,386. Again, this places China second in the region. The comparable figures for Japan, the biggest market, were 271 (average), 168 (median) and zero to 971 (range).
- As a proportion of their holdings, respondents voted against at least one management resolution in 36% of meetings in 2020. This ratio is comparable to Japan (42%).

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Company engagement

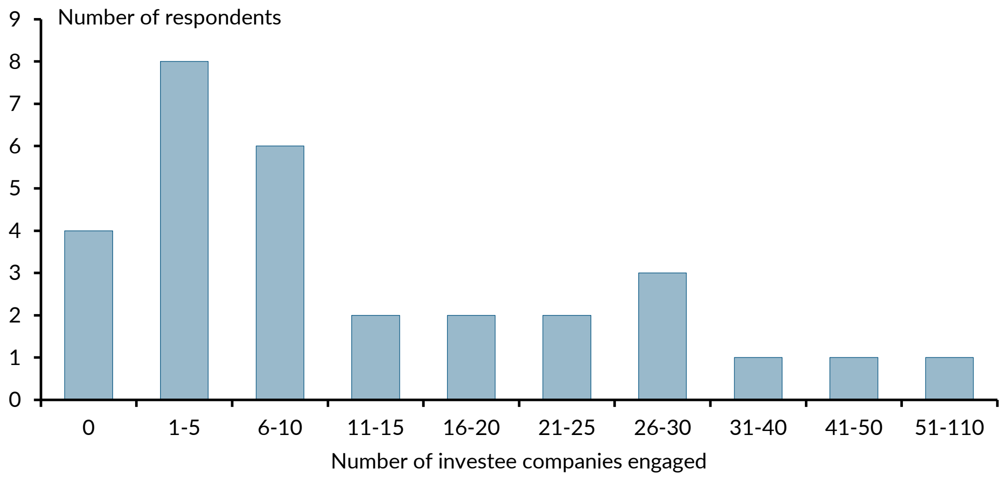
Members engage on average with 16 companies each . . .

In terms of dialogue with issuers, China accounts for the second-largest slice of the foreign-investor engagement budget in the region, with the first being Japan by some margin. The total for China was 487 companies and respondents engaged on average with 16 companies over 2019 and 2020. In contrast, the total number of companies engaged in Japan over the same period was 1,991 with an average of 77 per respondent. Again, a more representative way of illustrating individual engagement is to show the distribution. As the following figure shows, the biggest group of respondents engaged with one to five companies, followed by six to 10. A smaller group engage with more than 30 companies each year.

. . . with a range from less than five to more than 30

Figure 13

Foreign investor engagement prevalence in China, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Average result is lower than most markets

In terms of the relative level of engagement in China (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 20% or less but rises to 25% to 35% for three institutions, 50% for one (a respondent within the 71-100 band in portfolio size) and 83% for another.

46% of respondents adapted their voting and stewardship policies for China

While almost all respondents stated that they applied global voting and stewardship policies to their work in Asia, an impressive 46% said they had adapted their policies for China - one of the highest proportions in the region after Japan (69%) and Korea (49%). (By "adapt" we mean such things as translating or amending your policies to take account of local rules or governance practices.)

ESG engagement rising

Foreign investors have been engaging more on ESG over the past three years

Despite or perhaps because of the considerable effort that foreign investors are making on governance issues in China, they are finding the going tough. During 2020 we also canvassed the views of ACGA investor members in our China Working Group on voting and engagement challenges. All confirmed that they vote all their shares in A-share companies, while around half said they had been engaging more with Chinese companies over the past three years, especially on ESG issues. The other half said they would approach companies when necessary. Several members noted that they were increasingly trying to apply the same standards and policies on voting and engagement in China as they do in developed markets.

Challenges to effective engagement are numerous

Not surprisingly, most members experienced difficulties when trying to engage in China. Quite a few said it was difficult to get corporate access. Letters often went unanswered because companies did not have professional investor relations teams, including some large caps. And in general Chinese companies were not as open to dialogue as their counterparts in other Asian markets, in particular Japan and Korea.

Engaging on board composition is hard

When companies in China do initiate pre-AGM meetings with investors, they typically come with a specific agenda: To secure voting support for certain resolutions. As one member commented, "We don't try and engage much over typical AGM issues such as board composition because it is so hard. We have to save our energy for other engagement efforts."

Next steps

Domestic investors could develop deeper CG and ESG policies and practices

With the Chinese capital market in transition to becoming more institutional, now is a good time for domestic institutions to develop deeper policies and internal capacity to vote their shares and engage with companies on governance and ESG issues. This is not just a compliance exercise, but a long-term process of managing investment risk and searching for new investment opportunities.

Individual investors may one day be able to initiate their own law suits

While the ISC's efforts to drive momentum on class actions in China is positive, the Center faces restrictions as a government-supported self-regulator. It is unable to act in cases involving SOEs or where regulators have not begun formal enforcement proceedings against wrongdoers. With the Shanghai Financial Court simplifying litigation procedures and the revised Securities Law emphasising investor protection, the time may soon come when individual investors are also able to initiate suits against wrongdoers.

Some issuers arbitrarily reject the against votes of foreign investors

Vote rejections

A thorny problem in China has been the issue of vote rejections at AGMs. In recent years, some ACGA members have seen votes arbitrarily rejected by Chinese companies without explanation. Such rejections have become apparent through notifications from proxy service providers, by double checking voting results from AGM announcements, or through follow-up meetings with issuers. Are vote rejections lawful? We think not. But some members have been informed by Broadridge, the global vote tabulator, that issuers in China had the right to ask their shareholders to explain votes against a management resolution and then to determine whether or not to accept the votes.

CSRC agrees that vote rejections are not lawful

In 2019, ACGA raised this issue with the CSRC and found that the regulator agreed with our position. Voting rights are a basic right for anyone who invests in Chinese-listed companies, an official told us, no matter who you are or how you have made the investment. Local lawyers also agreed that there are no legal grounds in China for companies or board secretaries to reject votes. Nor are shareholders under any obligation to give reasons why they may wish to vote against.

Shareholders can check if their votes have been counted

Ensuring vote confirmations are sent by issuers to sub-custodians and/or investors would appear the best way to eliminate future vote rejections. Article 37 of the Rules Governing Annual General Meetings of Listed Companies (2016), issued by the CSRC, entitles shareholders or their agents to check if votes submitted online or via other channels have been received by companies. However, this is not so helpful for foreign institutional investors since they find it hard to register for the national online voting platforms provided by the Shanghai and Shenzhen stock exchanges. (Registration requires proof of identity, an ability to read Chinese, voting records and other logistics.) A better solution would be for the stock exchanges to create a new e-voting channel to ease the way for foreign investors to vote in China.

6. Auditors & audit regulators

China scores 43% and ranks 12th

China's score dropped seven percentage points to 43% from our last survey in 2018 and its ranking fell one place to 12th. Despite the significant drop, this lower score does not reflect a decline in auditing standards or regulation. Rather, it is mostly due to stricter criteria in our scoring methodology on such things as the adoption of international accounting and auditing standards, the independence of auditors, and disclosure by the domestic audit regulator on its inspection, investigation and disciplinary work. While China has an independent audit regulator for listed company audits, the work is split between two main government agencies, and much less information is available on their work than in the other markets we cover in this survey.

Incomplete standards convergence

China's accounting standards are not fully converged with IFRS

Our questions on the adoption of accounting and auditing standards have been tightened from whether local standards are broadly in line with international standards to whether they are fully converged. Given that China has developed equivalents to most but not all International Financial Reporting Standards (IFRS) and there is usually a time lag in the adoption of new International Standards of Auditing (ISA), points were deducted on both questions in our survey (Q6.1 and Q6.2). China still achieved 4/5 for accounting standards, however, with the main gaps being in the areas of related-party transactions, investments in associates and joint ventures, and financial instruments. As for auditing standards, the score here dropped a point to 3/5 because of delays in introducing new standards and a lack of clarity around the standard-setting process employed by the China Institute of Certified Public Accountants (CICPA).

China's auditing standards are not fully converged with ISAs

It is worth noting that in 2018 the International Federation of Accountants (IFAC) stated that China had only "partially adopted" ISAs. Moreover, some key information on the adoption of new standards is not accessible in English. For example:

1. To what extent has CICPA issued and translated ISAs?
2. To what extent has CICPA published proposed ISA standards or revisions for consultation in China?
3. Did CICPA respond to all new ISAs proposed by the International Auditing and Assurance Standards Board (IAASB), particularly the major projects?

More information in English on standard setting would be welcome

As China's capital market becomes ever more closely linked to international markets and investors, a more transparent standard-setting process would help to strengthen its auditing industry and raise investor confidence. While standards are still in the process of convergence, CICPA could provide clarity by making its plans for full convergence more public, including a statement on its website or on the cover of its standards as to whether each standard is fully converged.

Lagging on auditor independence and voice

China has similar rotation rules as in other markets

The independence of external auditors is influenced by a number of factors. One key element is the length of time that auditors have worked for a listed company, with consensus that long-term relationships can compromise independence. In this area, China's rules are in line with international standards and auditors are generally rotated every five to eight years.

Disclosure on non-audit services is limited

One area where China is weak, however, is the lack of disclosure by most listed companies on the non-audit work, such as consulting and tax, that they engage auditors to undertake. As the economy has grown, such non-audit services have become increasingly lucrative and could impair the independence of auditors-as well as the perception of their independence.

Auditors are not encouraged to blow the whistle

China is also weak in the protection it accords to auditors who blow the whistle. In our listed-company survey we found that no company offered a satisfactory whistleblowing policy for its auditors or other suppliers. We also note that it is not uncommon for auditors in China to encounter difficulties when they try to access key documents. Indeed, the weak position of external auditors in China may in part derive from the weak position of independent directors who comprise the majority of the audit committees that are supposed to lead the audit work in companies.

Audit regulation is shared by the MOF, CSRC, and CICPA

Regulatory disclosure shortfalls

Unlike some other markets, China does not have a single audit oversight board. Instead, the Ministry of Finance (MOF) acts as the main regulator of the accounting profession and is supported by the CSRC and CICPA. It is worth noting that accounting oversight and regulation, including supervising and providing guidance to CPAs and accounting firms, is just one of 14 major tasks assigned to the MOF. The work is carried out by its Supervision and Evaluation Bureau. At the same time, the CSRC supervises the accounts of listed companies, seeking to ensure they do not contain fraudulent information. It is our understanding that CICPA has been carrying out more of a training and educational role in recent years and has passed most of its enforcement duties to the MOF.

Audit regulators in China provide limited information on their work

The level of disclosure provided by China's audit regulators on their inspection, investigation and disciplinary work is relatively limited. When major scandals or events occur, there will usually be an announcement from the MOF. For example, in early 2017 the ministry banned two top local accounting firms, Ruihua and BDO, from auditing public companies for two months. Yet systematic disclosure of enforcement action by the MOF is not available, nor is there a comprehensive report on its inspection programme or information about the technical and professional capacity within the audit profession - all documents one typically finds in other markets.

CICPA does produce a report on its inspection process

The only public enforcement disclosure from audit regulators is a series of half-yearly firm inspection reports issued by CICPA (although the reporting frequency is not even). CICPA also publishes a yearly list of top 100 accounting firms. Firms used to be ranked based on the evaluation scores CICPA issued, but from 2018 onwards they are ranked based on revenues only. CICPA did not give a reason for the change in its ranking methodology.

MOF tightens scrutiny of overseas-listed firms

In May 2020, the MOF announced that it was conducting an investigation into Luckin Coffee's accounting fraud. This was unusual because the company is foreign registered and listed. It could be a sign that regulators are tightening their scrutiny on audit practices among overseas-listed companies.

Next steps

Requests: A more transparent audit standard setting process . . .

CICPA should make its standard-setting process more transparent to the public so that stakeholders can understand its progress in converging with international standards.

. . . more regulatory disclosure . . .

More disclosure from audit regulators on the different components of their work would be welcome.

. . . and issuers to provide details of non-audit work undertaken

Regulators should require listed companies to disclose details of any non-audit work undertaken by auditors.

US extends PCAOB powers over US-listed Chinese companies

Too little too late?

On 2 December 2020, the US House of Representatives passed the Holding Foreign Companies Accountable Act (HFCAA) which entitles the Public Company Accounting Oversight Board (PCAOB) to inspect the auditors of all US-listed Chinese companies. This is a long-standing issue that ACGA has been following and the accelerated tension between US and China in recent years once again put this under the spotlight.

Chinese firms face delisting from the US if PCAOB cannot inspect their audits

The HFCAA proposed that if the auditors of any US-listed companies have not been inspected by the PCAOB for three consecutive years, then the issuer would be delisted from the relevant US stock exchange or over-the-counter market (for American Depository Receipts). This would affect only three nations: China, Belgium and France. While the latter two are already making changes to allow PCAOB inspections, China has long prohibited the PCAOB from inspecting the work done by Chinese audit firms, including the Chinese arms of the Big Four, on US-listed companies, citing national security reasons.

But the new law may have limited impact . . .

While the bill is intended to shield investors from the huge losses suffered in cases like Luckin Coffee, it may not achieve its intended goals. Since the auditing procedures of all large firms in China, including the Big Four, already incorporate the possibility of future PCAOB inspections, the new Act will have limited impact on such procedures. The problem is not the procedures, however, it is companies lying to their auditors. It is hard to see how the Act will improve this situation.

. . . and few believe that China will back down

Pessimism was expressed for other reasons too. A source told ACGA that few institutional investors in the US believed China would back down and allow the PCAOB to inspect its firms, considering that the two sides had already signed an enforcement agreement in 2013 that had made little change to market practice. And this agreement was before the trade war and other tensions.

Hong Kong set to gain more secondary listings

It is more likely that as a result of this law more US-listed Chinese companies will delist from the US market over the next three years. Some big tech names such as JD.com and NetEase have already done secondary listings in Hong Kong, while others are talking about listing on the new tech board in Shanghai. It feels like the US House is trying to shut the stable door after the horse has bolted.

7. Civil society & media

China's score and ranking stays the same

The score for this category did not change from our last survey, staying at 22% and again ranking 12th.

More director training is available and social media highlights CG news

First the good news: More director training is being organised by regulators and listed company associations, with CAPCO doing online courses for company management starting in May 2020. And thanks to social media there is now a wider range of news on corporate scandals than appears in the mainstream press.

But tighter censorship also limits reporting on CG scandals

Conversely, tighter censorship generally on media publications (including social media) constrains what the public can see and hear, with independent voices on corporate scandals and investor abuses quite limited. In terms of policy developments, the official media still releases the news first and sets the tone, then other outlets follow.

Where are the NGOs?

Few independent NGOs working on CG

The main reason why China scored so low in this category is the lack of independent NGOs that focus on corporate governance work in this market. To our knowledge, the Shenzhen Research Association of Corporate Governance is one of the few organisations that fits into this category. However, it has limited resources.

NGOs do not seem to be engaged in policy issues

In our survey, we took into account the director training provided by CAPCO and the training of board secretaries done by the Hong Kong Institute of Chartered Secretaries (HKICS) through its Beijing office. However, the former was created by the CSRC and is not an independent organisation, while the latter has most of its members practising in Hong Kong. None of the NGOs we know in China are involved in public policy-making related to ESG or corporate governance. The lack of a sound NGO community in the ecosystem has cost regulators a good channel to understand the real concerns of the market and test their proposed policies.

Media plays a political role

Official media promotes the benefits of Party Committees

On 15 October 2019, People.cn, the online version of the official mouthpiece, *The People's Daily*, published an article to stress the importance of strengthening Party leadership in POEs in China. According to the article, two major benefits of having Party Committees in POEs include ensuring that the strategy of the company is aligned with government policy and the company has a clean governance system to secure long-term development.

Government appears to take a more subtle approach to Party Committees in POEs

The article went on to say that the position of POEs in the Chinese economy had risen from "being complementary to state-owned enterprises" to an "essential part of the socialist market economy". It is understood that after the articles of association of listed SOEs were amended between 2016 and 2018 to include Party Committees, the POE sector was next on the communist party's agenda. Given current economic conditions and the trade war with the US, however, it is believed that POEs without Party Committees are in a stronger position to decide how to respond to this policy. The government may take a softer or more subtle approach towards promoting this reform: such as the Hangzhou government's secondment of 100 officials to POEs as earlier discussed.

More than 1.5m POEs already have Party Committees

Meanwhile, according to statistics issued by the Central Organisation Department, a total of 1,585,000 POEs in China had Party Committees by the end of 2018 - a statistic that the government has interpreted to indicate that POEs are realising the importance of having Party Committees. Interestingly, this data was not disclosed in the party's communique for 2019, a further indicator that the government is taking a softer approach to the POEs.

A new era of information disclosure

Issuers now have more choice in how to communicate

A significant change under the new Securities Law is a broadening in the channels of information disclosure for issuers. In the past, listed companies in China were required to make disclosures via stock exchange websites, company websites, and through "designated media", which included only seven newspapers, one journal and one website. All these media entities were funded or established by official media such as Xinhua and the *People's Daily*, or regulators such as the SZSE. The limited disclosure routes not only allowed the designated platforms to make huge profits, but also made it difficult for readers to find useful information in the blizzard of company notices appearing on the same channels. At its most extreme, on 29 March 2018 *Shanghai Securities News* had 1,024 pages, of which 1,013 pages were disclosures made by public companies!

The new Securities Law opened up new and more efficient disclosure channels

Amid calls since the early 2010s to update disclosure methods to keep up with market developments, the revised Securities Law finally made the change by requiring issuers to make disclosures through media that fulfil CSRC's requirements and to list the name of the chosen outlet in company announcements (Article 86). As fewer investors use printed media to access information these days, this is a step towards making information disclosure in China more efficient and effective.

Next steps

Media in China still lack skill and knowledge of CG

Media in China are not sufficiently skilled at reporting on corporate governance-related issues. The focus is mostly on cases like financial fraud rather than an overview of the market structure from a macro perspective. This is because the government still has not paid much attention to corporate governance developments in the market. However, we have seen some good commentary from academics and market experts in China on social media, but their readership is limited and they are often deleted shortly after posting due to political sensitivity.

Curb your animal enthusiasm

Xinhua calls out manipulation on the ChiNext board

On 9 September 2020, Xinhua News Agency put out an article criticising the speculative behaviour of investors trading in the shares of loss-making companies on Shenzhen's ChiNext board. The article alleged that some of the trading involved price manipulation and called on regulators to take action.

Tianshan Animal surged 400% in 12 days in September 2020

Indeed, the surging share prices of some stocks - Xinjiang Tianshan Animal for example rocketed 400% in 12 trading days - appeared to suggest that manipulation might have been present. On 21 September 2020, the CSRC duly announced that it had started an investigation into Tianshan's unusual price movement.

The market plunged after the Xinhua column

Predictably, the market tanked. The day after the Xinhua article was published the shares of 50 companies listed on ChiNext plunged 20% (the maximum movement in a day) and another 343 companies dropped 10%. This was the biggest movement since 2015 and engulfed 46% of the issuers on the board.

Investors feared a crackdown was coming

The market fell because investors feared the Xinhua article signalled a crackdown by regulators. Note that this fall followed the article, not the actual CSRC enforcement action that did not come for another 12 days.

Should a mainstream media company offer investment advice?

Investors were perturbed when they discovered that the editor of the article was neither a professional investor nor held a securities trading licence. This triggered fierce discussions on the internet. Our concern related more to a piece of investment advice he delivered: That value investing over the long-term was the only way to promote healthy market development. Firstly, should a mainstream media company be offering investment advice? We think not. Secondly, the volatility, immaturity and opacity of China's stock market suggests that value investing is a risky strategy, especially for retail investors who make up the majority of traders.

If investors cannot buy shares of a loss-making company, why is it listed?

Meanwhile, although we take no position on the Tianshan case, it is a fact that speculation (hopefully calculated as opposed to rumour-driven) is a fundamental feature of any asset market. If investors should not buy shares in a loss-making company, why is it allowed to be listed? Investing in companies before they make a profit has also become more acceptable to both regulators and investors in the age of tech and biotech. Indeed, China is encouraging such investments by launching its new tech board.

What to avoid

Downgrade watchlist
Factors that could force the market score to fall in CG Watch 2022:

- ❑ No clear direction from government on corporate governance improvement
- ❑ State asset owners not taking the lead on investor stewardship
- ❑ The cost of breaking rules has not increased significantly in practice
- ❑ The revised Company Law allows dual-class shares
- ❑ No ESG disclosure guidance issued for listed companies
- ❑ No mandatory disclosure required for non-audit work in listed companies

What to fix

Quick fix list
Issues to address as soon as possible:

- ❑ Upgrade safeguards for investors of dual-class share companies
- ❑ Regulators to open a longer consultation period and make English drafts available
- ❑ The stock exchanges to make annual disclosure on budgeting
- ❑ Issue an ESG information disclosure guidance for listed companies
- ❑ Listed companies to disclose the nature and fees related to non-audit work

Hong Kong – Struggling with modernity

- Despite setting the standard in many areas of capital market regulation regionally, Hong Kong lagged on whistleblowing and anti-graft enforcement stops at its borders
- Hong Kong has some of Asia's strongest investor protection rules, yet remains excessively cautious about modernising board governance. Family businesses and concentrated ownership impeded CG development
- HKMA and SFC moved ahead strongly on sustainable finance
- Independent audit regulator finally arrived - 15 years after Japan and Singapore
- SFC's tough enforcement action continued, but HKEX remained conflicted
- Long-term CG risk rose through arrival of dual-class shares, secondary listings
- Stewardship started to sprout, but domestic investors lagged regional best practice

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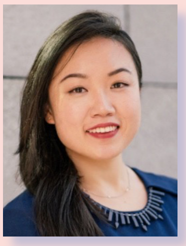

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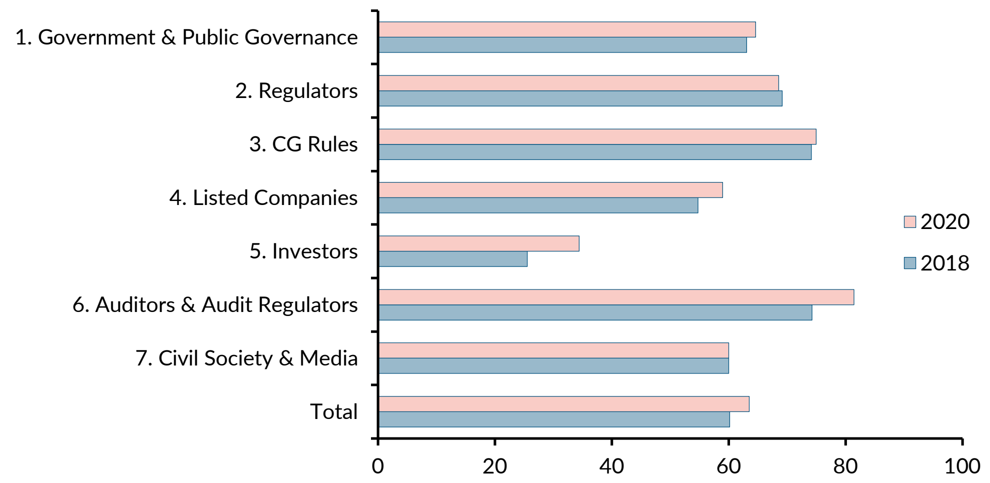
Figure 1

Hong Kong CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Hong Kong comes 2nd again with a score of 63.5%

Hong Kong once again ranks 2nd in our survey, this time on equal standing with Singapore, on a slightly higher score of 63.5% - a 3.5 percentage point increase on 2018. From an ecosystem perspective, most of the seven categories in our survey showed no dramatic change, however clear progress could be seen in two areas: Investors and Auditors & Audit Regulators. The main improvement in the former related to a higher profile taken by the Hong Kong Monetary Authority (HKMA) on responsible investment and stewardship, which in turn sparked a bit more action among domestic investors. In the latter, it was the belated arrival of an independent audit oversight board that gave a boost to the scoring.

Score would be higher if the city embraced structural CG reform

Yet as the significant gap in score with first-placed Australia shows, Hong Kong (and Singapore) is still well below where we believe it should be at this stage of its corporate governance development. At the risk of repeating themes from our last few CG Watch reports, Hong Kong is at its most determined when addressing regulatory and enforcement issues, but loses its nerve when it comes to driving fundamental improvements in company governance. Issuers are treated with kid gloves, especially when it comes to amending the CG Code. An example is the concept of the lead independent director, now commonplace in many leading markets but still seen as too difficult in Hong Kong. A higher bar could also be set on board diversity (including gender diversity), board evaluation, the definition of independent director, the degree of independence on boards, the quality of CG reporting, the nomination and election of directors - the list could go on.

Local corporates are still resistant to change and hold back Hong Kong

After more than 20 years of reform, the corporate sector has shown limited willingness to adapt to high governance standards. Compliance with the Hong Kong CG Code may be high in a formal sense, yet the cultural mindset among many family businesses is one of conservatism regarding new CG ideas. One tangible outcome is that few local companies are seen as leaders in this field - and there is little competition to be the best. Indeed, a sense of déjà vu permeates the winners' lists of local awards and surveys. At the end of each year, the Hong Kong Institute of Certified Public Accountants (HKICPA) announces the winners of its Best Corporate Governance Awards. The table below lists the main awardees for the past three years and shows how little things have changed.

The same old names keep winning CG awards

Figure 2

HKICPA Best CG Awards: The winners' circle rarely changes, 2018-2020

Company	Award	2018	2019	2020
Hang Seng Index (HSI) Category				
CLP	Platinum	✓	✓	✓
HKEX	Gold	✓	✓	✓
Link REIT	Special Mention	✓		✓
Non-HSI Category, by market cap: large (L), medium (M), small (S)				
Prudential	L - Platinum	✓		✓
Hysan Developement[1]	L - Gold	✓	✓	
	M - Platinum			✓
Hongkong and Shanghai Hotels	M - Platinum	✓	✓	
	M - Gold			✓
Li & Fung	M - Gold	✓	✓	
Pacific Basin Shipping[1]	M - Special Mention	✓		
	S - Gold			✓
Convenience Retail Asia	S - Gold			✓
	S - Special Mention	✓	✓	

[1] These companies moved between market capitalisation across years, merged for convenience
Note 1: Table includes only companies that have won more than once in the past three years. Companies that have won only once were: China Power International Development (2020, M - Special Mention), NWS (2020, M - Gold), Shangri-La Asia (2018, L - Special Mention), Socam Development (2019, S - Special Mention), Wuxi Biologics (2020, L - Special Mention)
Note 2: Table also only includes HSI and Non-HSI categories; excluded are "H-share Companies and Other Mainland Enterprises", and "Public Sector/Not-for-profit"
Source: Hong Kong Institute of Certified Public Accountants; selection by ACGA

An exclusive club also dominates the directors' rankings

This pattern is repeated in a major local survey published every three or four years by the Hong Kong Institute of Directors (HKIOD). Although its most recent Corporate Governance Scorecard found that the mean CG Index score increased from 71.82 in 2016 to 78.44 in 2020, the top 10 firms had a familiar ring about them. A more vibrant corporate approach to governance would surely produce more diverse outcomes.

There is not much originality in choosing top CG picks

Figure 3

HKIOD Survey: Top 10 firms with highest CG index score, 2020

Stock Code	Company Name	Stock Code	Company Name
0002	CLP	0388	HKEX
0011	Hang Seng Bank	0823	Link REIT
0055	MTR	0992	Lenovo Group
0101	Hang Lung Properties	1199	COSCO Shipping Ports
0257	China Everbright International	2888	Standard Chartered

Note: Companies are listed according to numerical stock code, not by CG Index score
Source: Hong Kong Institute of Directors, CG Scorecard 2020

Governance is seen to be driven by executives, not stakeholders

A clue as to why this pattern exists may reside in a 2020 survey from the Hong Kong Institute of Chartered Secretaries (HKICS). It found that the key influencers of corporate governance in its member companies were mostly insiders - the chairman, the board, the CEO, CFO, controlling shareholders - or regulators/the state. Conversely, minority shareholders, activists and civil society groups were rated as relatively unimportant. While such an outcome is to be expected in the top-down CG culture of Hong Kong, it neatly highlights a perennial problem: Most companies are relatively impervious to the views and priorities of their stakeholders.

Policy gaps and lack of remedies for minorities are also hindrances

Hong Kong's absolute underperformance in this survey cannot, however, be laid only at the feet of companies. As we say in our Singapore chapter, there have been multiple factors at play in recent years. Neither market has sought to create a group of domestic institutional investors capable of constructively working with companies to improve CG and ESG - and both have weak stewardship codes. Legal remedies available to minority shareholders are slim and have not progressed in 20 years. The fact that both places are international financial centres drives them to compete globally for IPOs, producing a race to the bottom over dual-class shares - something that has benefitted Hong Kong but not yet Singapore. Policymakers have dragged their feet over other fundamental regulatory reforms, such as: A scripless trading system; an independent audit regulator (finally completed); a more robust stewardship code; a universal whistleblowing law; and an anti-corruption agency with extra-territorial powers.

Recapping CG Watch 2018

Some policy progress has been made since 2018

On a more positive note, Hong Kong did move forward in a number of policy areas highlighted in our last survey. The more cautious approach to corporate Weighted Voting Rights (WVR) is an issue dealt with in more detail later in this chapter. The lack of disclosure around Party Committees in H-share companies remains a concern and reflects weakness in the CG Code's "comply or explain" mechanism.

A move toward corporate WVR and non-disclosure of the CCP role in H-shares is a concern

Figure 4

Hong Kong: Recap of 2018

	Recommendations	Outcomes
1.	Do not introduce "corporate WVR"	HKEX moving forward, but more tentatively than expected
2.	H-share issuers should disclose the role of Party Committees	No disclosure
3.	Local asset owners to take a lead on responsible investment and stewardship	HKMA publicly stated its support in May 2019 and joined PRI shortly afterwards
4.	Finalise establishment of an independent audit oversight board (AOB)	The Financial Reporting Council took over the role of an independent AOB in October 2019
5.	Engage issuers on the purpose of ESG reporting	HKEX revised its ESG Reporting Guide in December 2019

Source: ACGA

1. Government & public governance

Hong Kong slips to 3rd place with 65%, behind Australia and Taiwan

Although Hong Kong's score increased two percentage points to 65%, its ranking fell from 2nd to 3rd here after Australia and Taiwan, both of which scored 68% - hence not a large difference. Areas where Hong Kong scores highest include bank governance, the funding model for the Securities and Futures Commission (SFC), and the independence and capability of the Judiciary with regards to company and securities law cases. Areas where its performance is average include government support for regulators, an IPO system free of conflicts of interest, the autonomy of the securities commission, the effectiveness of anti-corruption efforts, and the governance of government-owned listed companies. Areas rated as poor include the existence of a credible and consistent government strategy on corporate governance and the availability of legal remedies allowing minority shareholders to settle disputes through the court system.

Bank governance goes green

Banking policy is focussed on stability but fintech and money laundering are big themes

Banking stability remains the key focus of government and this is reflected in a steady stream of updated guidance since 2018 on capital adequacy, liquidity, credit risk and asset quality. Anti-money laundering vigilance was ramped up ahead of the long-awaited evaluation of the city in September 2019 by the Financial Action Task Force, the global money laundering and terrorist financing watchdog. Fintech upgrades also began to take shape: The HKMA has granted eight virtual banking licences since March 2019. Cybersecurity is a topical concern, as is the ongoing impact of Covid. Some of the key HKMA documents include:

1. Update on Enhanced Competency Framework on Cybersecurity (November 2018 and January 2019)
2. Report on Review of Self-assessments on Bank Culture (May 2020) and Supervision for Bank Culture (December 2018)
3. Enhanced Competency Framework on Credit Risk Management (March 2019)

Banking and securities regulators have mapped out broad green goals

While efforts to improve bank culture meandered with a self-reflection stage concluding in May 2020, a roadmap was set out by the HKMA in respect of green and sustainable banking. Although in substance it was more of a policy commitment than a setting of hard targets, the HKMA released a white paper in June 2020 encouraging lenders to adopt greener finance practices before imposing supervisory requirements around 2022. The HKMA also teamed up with the SFC in spearheading greener initiatives: At board level, lenders are expected to weave climate considerations into general strategy and at the very least display awareness of the key issues. The SFC had in September 2018 published a Strategic Framework for Green Finance, urging greater disclosure on environmental and climate risk as well as supporting more green or ESG-related investment products. In March 2019 the regulator's CEO, Ashley Alder, described this as involving not only disclosure of how a corporation's operations directly affected the environment, but how its financial position might be impaired by climate change. Key HKMA documents include:

1. White Paper on Green and Sustainable Banking (June 2020)
2. Joint statement with the SFC on the establishment of a Green and Sustainable Finance Cross-Agency Steering Group (May 2020)
3. Common Assessment Framework on Green and Sustainable Banking (May 2020)
4. Phase-one measures to promote green and sustainable banking (June 2019)

Hong Kong's image as a clean city is waning

Whither the anti-corruption battle?

The sense of optimism that characterises the green and sustainable finance realm in Hong Kong is no longer apparent in the fight against corruption. On top of growing concerns in recent years about the impact of politics on the operational autonomy of the Independent Commission Against Corruption (ICAC), there is a perception that Hong Kong's effectiveness in this area is fraying. The city continues to lag Singapore, in the annual Corruption Perceptions Index (CPI), published by Transparency International and incorporating views from institutions and experts in the city as well as other surveys. In 2020, Hong Kong scored a less than impressive 77/100, up just one point from 2019, putting it in joint eleventh place. Transparency International dubbed the city a "transnational corruption hub" due to its shortcomings in beneficial ownership transparency and cross-border graft, as well as a business environment "where shell companies and corruption can flourish."

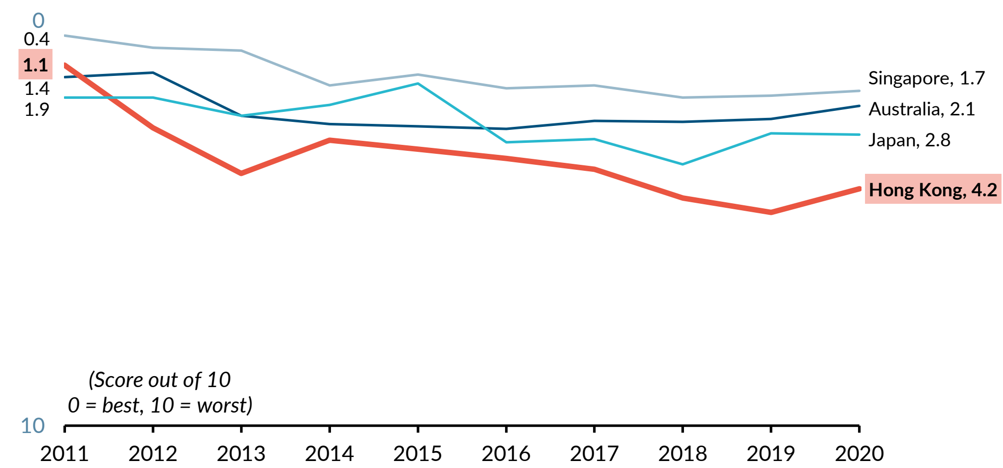
A mediocre performance in global corruption rankings

Hong Kong's rating in the last Political & Economic Risk Consultancy (PERC) survey of corruption perceptions around the region in March 2020 was no better. It scored 4.15/10, a middling performance that put it in fourth place again after Singapore (1.73), Australia (2.10) and Japan (2.83). In the PERC survey, the lower the score the cleaner the market is perceived to be. While Hong Kong's rating may have been an improvement on the 4.73 it got in 2019 - the city's worst score ever - it was a far cry from the 1.10 it earned in 2011, when Hong Kong was ranked second after Singapore.

Hong Kong's anti-graft rating has dropped significantly over the past decade

Figure 5

Erosion of respect: How perceptions of corruption in Hong Kong have changed, 2011-2020



Source: Political & Economic Risk Consultancy

Civil service is clean but private sector corruption remains an issue

While it is easy to discount perception surveys as being merely subjective, the available data in Hong Kong broadly supports the sceptical view reflected in the CPI and PERC survey results. Some issues and questions:

- **Is corruption getting better or worse?** While bribery has clearly declined in Hong Kong over the past few decades - and the city has a clean civil service - the broader picture around corruption is more complex. The ICAC still receives a large number of complaints each year (2,297 in 2019 excluding election-related complaints) and duly undertakes investigations (1,700 new investigations in 2019), but prosecutions have hovered at around 150 a year since 2018 and most cases relate to the private sector, meaning private individuals rather than companies (which are rarely charged with corruption).

This suggests that, like Singapore, the anti-corruption message is not permeating society as much as one might expect. The fact that the ICAC lacks extra-territorial powers - meaning it cannot prosecute Hong Kong citizens for bribery outside Hong Kong, including Macau and China - means that a large volume of potential corruption is never counted.

The city's anti-graft agency is selective in what it discloses

- **Charges and outcomes:** One of the most frustrating aspects of trying to track anti-corruption work in Hong Kong is the incomplete nature of the ICAC's public announcements. The agency has a formidable publicity section but it tends to be selective in what it discloses. Each new charge is announced, often with some fanfare, yet the final outcome of each case - punishment or acquittal - is not. The focus is on cases with favourable outcomes, which gives an exaggerated impression of the fight against graft. It would be helpful if the ICAC could systematically report both sides of the story.

Figure 6

ICAC cases: what happened?

	Case details	Status
1.	Tse Tin, former director of Tak Ming Metal Ware Factory found guilty on 29 July 2020 of HK$69m fraud	Sentencing was set for 18 August 2020, no further details given by ICAC
2.	Three finance directors found guilty on 21 January 2020 of conspiring to defraud New Territories small house purchasers of HK$4m	Sentencing was set for 11 February 2020, no further details given by ICAC
3.	Former China CITIC Bank International financial planner charged on 17 September 2019 with defrauding the bank of (undisclosed sum) commission	Released on ICAC bail and as yet no further details

Source: Independent Commission Against Corruption press releases

Bribery law enforcement stops at the border

- **Lack of cross-border jurisdiction:** As noted, Hong Kong lacks bribery laws that extend beyond its borders. There is no sanction for offering a bribe outside of Hong Kong and neither Hong Kong nor China have signed the OECD Anti-Bribery Convention. Given the cross-border nature of Hong Kong's economy and the influx of PRC enterprises listing in the city over the past two decades, this remains a glaring legal hole that policy-makers seem unconcerned with plugging. It did come to the attention of the Financial Action Task Force, in reporting on Hong Kong's money laundering performance in 2019, that its lack of case law involving foreign corruption and tax crimes was an issue.

Will the real ICAC please stand up?

ICAC increasingly chasing fraudsters rather than graft

"Times change. The mission continues" was the tagline adopted by the ICAC in 2019, its 45th year of existence. Times have indeed changed for the agency. Today it is more likely to be prosecuting a charge of fraud than bribery. Perhaps it would be better to say the mission has evolved.

ICAC has special powers to enforce bribery laws

Corruption in Hong Kong is narrowly defined by statute. The ICAC considers it to be where someone abuses their authority for personal gain at the expense of others. The Prevention of Bribery Ordinance (POBO) is the key piece of legislation, dealing with the soliciting and acceptance of advantages. The ICAC Ordinance sets out the agency's special investigation powers in upholding POBO and the Elections (Corrupt and Illegal Conduct) Ordinance. Under the POBO it can also make an arrest without a warrant.

But now more people are prosecuted for fraud

In 2019, the ICAC prosecuted 157 people, according to its annual report. Of these, 85 faced deception offences, while another three were prosecuted for theft and one for blackmail. Another 13 people were prosecuted under the Crimes Ordinance for false instrument offences and forgery. There were thus 98 people prosecuted for non-bribery offences. The figure is considerably higher than the 39 people prosecuted for crimes under the POBO and 20 for election-related corruption. What we do not know is how many people were prosecuted for a mixture of bribery and deception/other crimes. Such a fudge in the figures perhaps suggests a reticence to openly admit that many of its prosecutions have no element of corruption, strictly defined. A scan of ICAC press releases from 2019 and 2020 shows a number of cases where individuals are charged with standalone fraud, forgery and even money laundering, but not bribery.

Should the ICAC be prosecuting fraud if no graft is involved?

By law, when the ICAC makes an arrest it is only supposed to be in the course of an investigation for bribery or election-related corruption and, to be fair, the agency may not be sure when it receives a complaint whether there has been corruption. But when it is obviously not the case, this begs the question as to whether its special powers are being used out of context and if it has stepped beyond its mandate. There is also the wider question of whether it is ideal to have two law enforcement agencies with different powers working independently on financial fraud. Is the ICAC just a fair weather prosecutor of fraud which falls into its lap or does it engage in detection, prevention and analysis, and share intelligence with the police? While two law enforcers chasing fraudsters seems better than one, you have to wonder how many canny deceivers slip through the cracks.

No universal whistleblowing law

Hong Kong prefers to take a fragmented approach and offers limited protection

Hong Kong continues to shun a comprehensive law to shield individuals who risk losing their jobs and being retaliated against should they inform on corporate infringements. Instead, it adopts a piecemeal approach: In employment and discrimination law, bosses cannot fire a worker giving evidence in a dispute; and in the criminal context there is some protection for whistleblowers in drugs, organised crime and graft cases. The Securities and Futures Ordinance gives immunity from civil liability for reporting financial irregularity by a Hong Kong company or breaches of solvency rules. The Competition Ordinance adopts a leniency policy toward whistleblowers who report cartel activity and protects employees who give evidence in competition cases. Civil servants are given instructions on how to report illegality, but the process is top-down and does not appear to offer much legal protection. The UK in contrast has had a single piece of legislation since 1999 and Australia overhauled its protection of corporate whistleblowers in 2019, enabling identity protection, anonymous reporting and legal compensation.

No political appetite for change despite HK$97 billion rail project scandal

Despite a high-profile HK$97 billion rail project scandal in late 2018, which came to light after a contractor blew the whistle, the Hong Kong government appears committed to keeping the lid on truth-telling by insiders. At the very least, Hong Kong should have a debate as to the pros and cons of a general whistleblowing law.

Judicial independence and relevance

Judges are constantly in the political firing line

The Judiciary has come under unprecedented political pressure following the 2019 protests and the enactment of the National Security Law (NSL). Individual judges' decision-making is now regularly criticised by key political figures in Beijing and Hong Kong. At the same time, the government has seemingly realigned the judicial function as subservient to the Chief Executive in refuting the existence of a separation of powers under the Basic Law.

NSL uncertainty may make Hong Kong a less attractive place to litigate

Within legal circles there is now a sense that the environment in general has become less predictable. Ambiguity in how the NSL might be applied has fostered a general wariness, with litigators admitting they are less likely to draft contracts which would be adjudicated in the city's courts and governed by Hong Kong law. Arbitration is expected to be the big winner in the commercial domain and puts a question mark over the future relevance of the court process.

Company and securities law are not directly affected by the NSL for now

The picture is different in cases involving companies and securities law, which is what CG Watch assesses. Given that there are no immediate concerns over judicial autonomy in this area of the law, Hong Kong continues to score highly for the Judiciary in our survey. But that could change if the NSL was capriciously applied in a dispute involving a state-owned entity or private PRC firm. We think the chances of this are probably quite low, since case law involving SOEs in disputes with Hong Kong companies is not voluminous, quite a stark anomaly given Hong Kong's geographical position and the number of PRC companies listed here. Typically more litigation is apparent when companies get to the winding-up stage, an increasing phenomenon in recent times as more listed companies with their principal business activity and assets in the PRC get into financial difficulty and have to navigate Hong Kong's courts. In mid-2020, the companies judge, Jonathan Harris, noted an increase in cases involving such firms "who seem to lack any sophistication when it comes to dealing with insolvency and their more general company law obligations".

Next steps

Bank boards need better training on climate risk

A stronger focus on bank director training would support the drive to green and sustainable finance, and help to ensure that bank boards are better able to respond to climate change and other risks.

ICAC should improve its disclosure and be given cross-border powers

A clearer narrative from the ICAC on its enforcement statistics would help to make sense of the agency's effectiveness and the direction of corruption in Hong Kong. We recommend that the Commission reports the outcome of individual cases on its website, not just the charges laid at the front end of the process. The POBO should be extended to cross-border cases and applied to the Chief Executive.

A whistleblowing law is due

We believe it is time for Hong Kong to explore a universal whistleblowing law.

Whatever happened to . . . class-action reform?

Class-action reform has moved at a glacial pace

Minority investors continue to have limited access to justice in Hong Kong and attempts to rectify this have moved at a glacial pace. Legal challenges to corporate misdeeds at listed companies are rare: the only instances of note over the past 20 years have either involved activists such as Elliot Management (taking on controlling interests at Bank of East Asia) or the SFC on occasion taking action on minorities' behalf.

Third-party funding arrived in 2019 for arbitration

Third-party funding was allowed for arbitration in early 2019 and is sanctioned in insolvency cases in some circumstances, but is otherwise still illegal under antiquated champerty laws, even for big-ticket commercial disputes. Policymakers have dragged their feet on class-action reform. A 2012 proposal to roll out class actions incrementally - starting with consumer disputes - has not even proceeded to draft legislation. Indeed, a Department of Justice working party tasked with mapping out the way forward has failed to release a single recommendation in eight years. In April 2019, legislators were informed that more time was required for further in-depth analysis!

2. Regulators

Hong Kong retains the top slot with 69%

Hong Kong's score remained at 69% and it retained 1st place in this category. Once again, the biggest contributor to this good performance was Enforcement, while the sub-category of Funding/Capacity Building/Reform was less impressive. A common thread binding these two areas and their differing scores is the structural tension between the SFC, the statutory regulator whose sole responsibility is the integrity of the securities markets, and Hong Kong Exchanges and Clearing (HKEX), a listed company which is primarily interested in growing the market but also acts as the frontline regulator of the listing rules. Numerous conflicts of interest overshadow the Exchange's regulatory role and continue to drive some of the key decisions by the SFC in recent years, notably its move towards a more proactive approach to intervening in listed company transactions or IPOs that it deems abusive or fraudulent.

One market, two regulators divided over the question of quantity vs quality

Differences in character are reflected also in the way the two regulators talk about the market. Whereas HKEX likes to trumpet Hong Kong's position as a top IPO venue globally, the SFC has in the past pointed out how the market lags global peers in terms of liquidity. In contrast to the mega primary and secondary listings of mainland tech firms over the past two years, most listings are much smaller and, once listed, are less likely to be traded. This raises inevitable questions over quality. At the end of 2018, Hong Kong ranked in the top five globally in market cap and was eighth in terms of daily average turnover. It slumped to thirteenth place when comparing annualised turnover to market cap. SFC deputy CEO, Julia Leung, noted in an October 2019 speech that many of these smaller listings were prone to high shareholding concentrations, volatile price swings, dilutive capital-raising and all-out manipulation. Many had questionable rationales for listing. As Leung warned, "a consistent theme that has emerged from our research and stakeholder engagement is that the lack of turnover and liquidity in a certain segment of our stock market is related to perceived problems with the listed companies and the securities."

2.1 Funding, capacity building, regulatory reform

Hong Kong increases its score to 62%, ranking joint first with Australia and Taiwan

Hong Kong's score increased two percentage points to 62% in this sub-category and its ranking improved to equal first with Australia and Taiwan. In terms of funding and capacity building, there is clear distinction between the level of transparency provided by the SFC and HKEX. As for regulatory reform, both bodies have had quite an active couple of years.

Regulatory funding: One city, two stories

SFC is one of the region's best-resourced regulators

The SFC remains one of the best-funded securities regulators in the region, thanks in large part to its levy on transactions and the fact that its mandate extends to only one sector of the financial system - the securities market. Other regulators around the region are typically less generously endowed yet have broader responsibility, often supervising banking and insurance as well. Some act as the independent audit oversight board for accountants. In Hong Kong these functions are handled by the HKMA, Insurance Authority, and the Financial Reporting Council, respectively.

A simple levy system keeps SFC afloat

Since 1989 the SFC has been funded by a small levy on all securities transactions, as well as other fees and charges. It is a simple, elegant and painless way to ensure sufficient and sustainable funding for the Commission. The current levy on securities transactions of 0.0027%, effective from 2014, is significantly less than the 0.0125% charged when the mechanism was first set up. By law the SFC is entitled to government funding but has not taken public cash in nearly 30 years. Its budget is independent of government but must be approved by the Chief Executive and tabled in the Legislative Council. The SFC stresses that it has not revised its fees and charges since 1994 and has waived annual licensing fees five times since 2009. While its funding fluctuates depending on market turnover, the Commission's sizeable reserves of HK$6.5 billion (with HK$3 billion ringfenced for a future property purchase) can absorb the volatility.

Market volatility is a risk but SFC funding holds steady

The power of this funding mechanism was on full show in 2019/20, when the SFC's income fell about 10% to HK$1.59 billion from the previous fiscal year, mainly due to lower investment income from volatile markets, yet its expenditure increased more than 6% to HK$1.97 billion. During this period it was able to increase its total salary budget and staff numbers modestly. As of March 2020, it employed 921 people. A noteworthy fact: Two-thirds of SFC staff are women and this ratio is replicated at senior manager level and above. Average years of service increased to 8.8 years from eight in 2017/18.

Well-funded or not, SFC is still open to criticism for how it conducts its work

Under IOSCO principles, a regulator should be sufficiently resourced to carry out its functions and exercise its powers. Is the SFC sufficiently funded? It certainly believes it is. Unfortunately there is no objective and practical way to measure this, nor as yet any comparative study of securities commissions' funding around the region or globally. The evidence available supports a broadly positive view when considering the context of the SFC's responsibilities. A somewhat contrary view has been expressed by the Process Review Panel (PRP), an independent body appointed by the Hong Kong Chief Executive to scrutinise the commission's internal operations: It has been critical of the time taken to complete enforcement cases and in its 2017-18 report recommended the SFC "critically review its processes and procedures" in handling these cases as well as licensing applications. In its 2018-19 report, the PRP conveyed concern over the SFC's "fairness and transparency" in promptly notifying people of the result of investigations. These comments, however, relate to process questions rather than funding.

HKEX regulatory funding disclosure is too opaque to be meaningful

It is even more difficult to ascertain, meanwhile, whether HKEX has sufficient funding for its regulatory role as it does not divulge details of its enforcement budget or staffing. These costs are opaquely "absorbed by the Cash and Equity and Financial Derivatives segments in proportion to the listing fee income of the two segments," according to its 2019 annual report. No actual dollar amounts or employee numbers are provided. Moreover, in calculating its performance bonus policy for 2019, HKEX notably allocated only a 20% weighting for market and regulatory development, while its share award policy reduced this to 15%. In all, more than 60% of the bonus criteria relate to financial and strategic issues.

Capacity building: Going digital

SFC spent HK$78m upgrading its tech in 2019/20

The SFC has been spending more on upgrading technology: In 2019/20 it invested HK$78m in information and system services, up from HK$65m the previous year. This includes greater use of AI and other tools:

- A new investor identification system under Stock Connect to expedite investigations into suspicious trading activities.
- Development of advanced machine learning capabilities for greater efficiency in investigation and litigation work.

- ❑ A new market monitoring tool to intelligently analyse listed company publications to identify irregularities which may indicate potential corporate misconduct.

HKEX is vague on its tech spending

HKEX's disclosure on its technology investment is scant. IT and computer maintenance increased 14% to HK$580m in 2019, but this was "mainly attributable to higher maintenance expenses for new IT systems and upgraded networks". Indeed, beyond broad statements about expanding its IT systems to improve the efficiency of trading and general operations little is said about upgrading its use of "RegTech".

That review report

SFC rebukes HKEX for conflict of interest shortcomings in annual report card

The inherent tensions in HKEX's dual role come through loud and clear in the SFC's latest annual review of the Exchange's regulatory performance, released in June 2020. The report was fairly bleak and emphasised conflicts of interest in the pre-IPO process, a weak Chinese Wall between the listing department and the business division, and issues with the management of listings, the complaints process, and policy. In listings management, for example, the SFC found that while record-keeping had improved, there were minutes missing for a sub-committee on backdoor listings, the committee on WVR did not get to see its own meeting minutes, and the minutes for a Listing Committee quarterly policy meeting took more than four months to complete. The SFC was also critical of the Exchange's management of complaints.

Regulatory reform: Positives . . .

ESG sets the overall tone of SFC policy but CG initiatives are in the pipeline

Much of the SFC's policy focus since our last survey in 2018 has been on green finance and encouraging investment managers to focus more on ESG. However, it has issued some statements with a CG flavour:

- ❑ Corporate misconduct in acquisitions (July 2019);
- ❑ Backdoor listings/shell activities (July 2019);
- ❑ Use of dubious private funds (November 2019); and
- ❑ Disclosure of ultimate beneficial owners in transactions (November 2019).

It also announced conclusions on strengthening the investor compensation regime in October 2019 but these have yet to be enacted. There was no update at the time we went to press.

HKEX is busy on reform front but prone to follow SFC's lead

There has been more activity at HKEX, although some of its initiatives follow SFC priorities:

- ❑ New rules on backdoor listings (effective from 1 October 2019).
- ❑ New rules on suspension of issuers which receive an adverse audit opinion (effective 1 September 2019).
- ❑ Revised and enhanced ESG reporting guide (effective 1 July 2020) and related guidance and training materials.
- ❑ Interpretation letters on reverse takeovers and the reasons listings are rejected, as well as guidance on various accounting rules, competition with an issuer's controlling shareholder, and sufficiency of operations.
- ❑ Consultation on listing enforcement on 7 August 2020. (Deadline: 9 October 2020.)

Corporate WVR is a low point for HKEX regulatory reform

. . . and negatives: Corporate WVR

One issue stands out in particular as being a step backwards for Hong Kong: A plan by HKEX to extend its new 2018 rules on dual-class shares, called "weighted voting rights" (WVR) locally, to corporates. Having promised not to go down this route when it consulted on WVR for individual company founders in 2017, HKEX later reversed course under pressure from mainland tech firms that said they would spin off and list such subsidiaries in the US if Hong Kong did not allow these structures. A consultation was originally expected in mid-2018 but did not appear until January 2020, ostensibly to allow the market to get used to individual WVR.

Why do corporates need WVR anyway?

Unlike individual WVR, which hold only as long as the founder is living or continues as a director of his or her company, corporate WVR could in theory be perpetual. This would likely magnify the governance risks emanating from WVR. The logic for such a policy is also weaker. The founders of innovative tech companies are human beings who allegedly deserve special protection because they are essential to their firms and need to retain control for the business to prosper (not an argument ACGA accepts, for the record). Conceptually, how could the same personal relationship be held to apply between a company and its subsidiary? Both are merely convenient limited liability legal platforms through which to do business. They themselves are not innovative. Moreover, corporate WVR could lead to a situation where the people responsible for the original company's success have all died, retired or moved on to other things, yet the parent firm still enjoys WVR rights over one or more subsidiaries.

HKEX didn't get the bloc of support it hoped for

Shortly before the consultation deadline of 1 May 2020 the Exchange unexpectedly extended it to the end of May, blaming the pandemic for delays in submissions and saying the extra time would allow it to achieve a "broader consensus". Many concluded, however, that it had not got the answer it wanted. When HKEX published its consultations conclusions in October 2020, it said that 45 of 65 respondents had supported its proposals to varying degrees, some of them arguing the Exchange was being too stringent with its proposed investor safeguards. The 20 respondents not in favour included institutional investors who were almost unanimously opposed to corporate WVR in principle.

No rule change for now but HKEX is biding its time

Despite receiving two-thirds support, the Exchange decided against making major rule changes on corporate WVR at this stage. It said it recognised that "expanding the current regime to allow corporate holders would be an additional significant new development" and that "while a majority of respondents agree in principle that corporate WVR beneficiaries should be permitted, there are very diverse views and expectations as to how the proposed regime would operate in practice and whether (and if so what) modifications were required for it to operate as intended". In other words, moving ahead now will likely satisfy no one. Instead, it will give the market more time to "develop a better understanding of Hong Kong's regulatory approach towards regulating listed companies with WVR structures and their controllers, and for regulators to monitor that the existing Chapter 8A regime operates as intended, which <u>will help to inform any future amendments</u>" (underlining added). The issue has not gone away then.

HKEX will let in a select few under grandfathering deal

In the meantime, HKEX will extend the existing "grandfathering" arrangements for Greater China issuers with corporate WVR structures that have done secondary listings in Hong Kong (eg, Alibaba, JD.com) to other Greater China issuers that are controlled by corporate WVR beneficiaries and also want to come to Hong Kong. This policy is limited to issuers that were primary listed on certain qualifying exchanges (ie, mostly in the US) on or before the date of the conclusions paper. It is aimed at allowing a small number of major corporate WVR subsidiaries of Chinese tech firms to do secondary listings in Hong Kong as well.

SFC stays silent on WVR

A disappointing feature of the debate over corporate WVR in Hong Kong has been the relative silence of the SFC on the matter. In previous years the SFC was quite voluble in questioning the risks of individual WVR in public statements and briefings. It is regrettable that the Commission feels unable to put an alternative policy viewpoint on corporate WVR. Meanwhile, below is the list of WVR IPOs to date. Small in number, but big in market cap - a fact that is starting to influence the shape of the Hang Seng Index.

The WVR behemoths changing the landscape

Figure 7

Hong Kong's WVR listings, 2018-2021

Date of listing	Company	Type of listing	Market cap (HK$bn)
9 July 2018	**Xiaomi**	Primary	620
20 September 2018	**Meituan**	Primary	1,811
26 November 2019	**Alibaba**	Secondary (NYSE)	4,880
18 June 2020	**JD.com**	Secondary (NASDAQ)	935
29 September 2020	**ZTO Express**	Secondary (NYSE)	211
29 September 2020	**Baozun**	Secondary (NASDAQ)	22
2 November 2020	**GDS Holdings**	Secondary (NASDAQ)	121
5 February 2021	**Kuaishou**	Primary	1,094

Source: HKEX website, ACGA analysis. Market cap figures as of 30 April 2021

Regulatory consultations

Hong Kong generally does a good job with public consultations . . .

A new question in our survey looks at the professionalism and organisation of public consultations on regulatory matters. This is one area where Hong Kong truly shines. Its consultation papers are detailed and well-written, typically allowing the market two to three months to make submissions. Conclusions are made public and submissions can be accessed on regulatory websites. There are often soft consultations before the formal process begins.

. . . but HKEX consultations tend to be a fait accompli

If there is a weakness in the system it is that HKEX is usually determined to get the result it wants. There was never any doubt, for example, that individual WVR was coming in 2018 - investor opposition was simply steamrollered as the political juggernaut in favour took over. Meanwhile, consultations on reforms that local tycoons do not like, such as new corporate governance measures, typically set the reform bar conspicuously low. It is understandable that all regulators have to use their political capital judiciously, while stock exchanges by definition lack the authority of statutory regulators. But it would be refreshing to see HKEX take bolder steps in corporate governance reform.

Next steps

HKEX should be forthcoming on its budget spending

Over the short term, we recommend HKEX provide details of its regulatory budget and the extent to which it is investing in new enforcement technology. Over the longer term, the Exchange's role as a regulator should be reviewed. It is unlikely that the conflicts of interest between its commercial and regulatory functions will subside.

SFC should speak up on WVR

While the impact of WVR has been limited to a handful of large and mostly successful companies to date, there are concerns that over time the rules may be relaxed to allow for a wider adoption of this capital structure. The government should carefully consider the risks of moving in this direction. We would like to see the SFC play a bigger role in any future consultation or debate. It has a more balanced perspective than HKEX.

CG reform should target boardrooms

Future consultations on CG reforms in Hong Kong should be more ambitious in raising standards of board governance.

Hong Kong's response to Covid: Minimalist

Initial Covid wave was quickly controlled

Hong Kong saw its first Covid case in late January 2020 and brought an initial wave under control relatively quickly - a testament to the self-discipline of the population and the experience of Sars in 2003 as much as government policy.

Businesses muddle through with socially distanced AGMs

Hong Kong has one of the more generous deadlines for AGMs in the region - six months from the financial year-end, which for most firms is 31 December. No blanket extensions were initially given for financial reporting or annual meeting deadlines but by March the regulators made exceptions for certain companies. When it came to the holding of AGMs amid social gathering restrictions, companies were forced to muddle through. The SFC's position was that companies should try to maintain business as usual and get in touch if they had problems.

Financial reporting: Get those numbers out

Regulators issue guidance on preparing financial reports

On 4 February 2020, the SFC and HKEX issued a joint statement providing guidance to listed companies and their auditors on preparing financial information in light of the global travel restrictions that were imposed as a result of the pandemic. The message at the time was that if a company believed it could not issue its preliminary audited financials within the deadlines laid down in the listing rules - 31 March for most issuers, given December year-ends - they must "contact the Exchange as early as possible to discuss the situation". The authorities also envisaged situations where an issuer had a completed set of accounts but was, for whatever reason, "unable to obtain the agreement of its auditors". If so, the issuer should go ahead and publish its preliminary results before the regulatory deadline and the Exchange would allow trading in its shares to continue.

Annual report extensions granted under certain criteria

On 16 March, the SFC and HKEX issued another joint statement to grant an extension for the publication of annual reports to 15 May, but only for companies which met certain criteria such as publishing their preliminary results or material financial information on or before 31 March 2020. The latter comprised key financial figures and a narrative explanation of an issuer's financial position and performance during the year, including the impact of any material events and transactions. Issuers that intended to defer their publication dates also needed to announce the expected date of publication and any other updates as appropriate. HKEX also said it would consider applications for a further extension on a case-by-case basis.

Most issuers make the deadline

As it happened, most issuers were able to get their preliminary results out on time. According to HKEX, of the 1,781 companies with a 31 December 2019 year-end, more than 1,300 of them (73%) issued their results by 31 March 2020.

Confusing rules on holding AGMs in pandemic conditions

Little advice given on AGMs

Unfortunately, Hong Kong did not take the pandemic as an opportunity to embrace virtual AGMs. Instead, it took a rather muddled approach. After consulting with the government, HKEX and the SFC in April announced that companies seemed to be exempt from bans on large gatherings and could hold an AGM if shareholders were segregated into rooms hosting no more than 20 people, but they should seek legal advice just to be sure. If they went ahead with physical meetings, safety measures and social distancing would have to be in place. If possible, issuers could delay their AGM. Otherwise, they might want to consider whether the laws in their country of incorporation, or their articles, allowed virtual meetings and voting.

Companies not required to reveal impact of Covid on their operations

Lack of guidance on continuous disclosure

One other surprising feature of Hong Kong's response was that, unlike Australia and Singapore, it did not issue forceful reminders to companies to update the market with regular announcements about the impact of Covid on their operations. This light-touch approach to continuous disclosure appeared at odds with the importance the SFC has placed in recent years on the disclosure of material information.

2.2 Enforcement

Hong Kong drops points but still first with 76%

Despite dropping two percentage points to a score of 76% for this sub-category, Hong Kong remains in 1st place and comfortably ahead of Singapore and Taiwan at 70% and Australia at 68%.

No big changes in enforcement

Overall the enforcement picture in Hong Kong shows little change from our last report, with the scores on only two questions changing. The first (Q2.13) looks at whether regulatory enforcement efforts have improved and evolved: We cut a point because we felt HKEX's performance was less impressive than in 2017-18. The second (Q2.21) assesses the extent to which financial regulators receive support from other national law enforcement agencies: We added a point because of a new MOU between the SFC and the ICAC.

SFC continues its frontloaded approach to supervision

SFC gets ahead of the action

The SFC has found its stride with a frontloaded approach to supervision, taking pre-emptive action against listed companies as market irregularities become apparent. The past two years saw direct intervention by the SFC in 93 cases, a near three-fold increase since launching the strategy in 2016. The regulator has credited this approach with drastically reducing extreme volatility of newly listed stocks on the Growth Enterprise Market (GEM), the average first day price increase down from a massive 500% in 2016 to just 13% in 2019. It made less use of forced suspensions (a "Rule 8 direction") and "show cause" letters where the SFC warns a company it may be suspended, tools which seemed to gain popularity at the time of our last CG Watch report. Only five Rule 8 directions were made in the past two years, and two "show cause" letters issued.

More civil actions launched for wrongdoing

There was a bump in civil cases launched against individuals and corporates in 2019, with 129 cases compared to 90 in 2018 and 84 in 2017. The Market Misconduct Tribunal (MMT) was relatively busy although several cases have been ongoing since 2016 and relate to alleged infringements that took place more than a decade ago.

MMT is not as scary as its predecessor

MMT takes its time

The Market Misconduct Tribunal (MMT) was never going to be as punchy as its predecessor, the Insider Dealing Tribunal, which had a real fear factor: The ability to dole out fines of up to three times the profit made, or loss avoided. A HK$50m hit was not unheard of back in the day.

Cases can run for up to 13 years and counting

Today market miscreants may be more worried about legal costs and dementia than the actual outcome of an MMT inquiry. Of the 10 cases now before the MMT, the average time between the alleged offence and current state of play is more than eight years (see table below). In one case, the lag is 13 years and counting, although this takes account of an appeal and a subsequent re-hearing being ordered. In another case, Meadville Holdings, there was a 10-year delay in commencing the case. At one point it took the Department of Justice four years to issue the SFC with a single piece of legal advice. In the end, just one of the accused was found culpable, the profit made as a result of insider dealing was just HK$546,817.

Shareholders looking for restitution need patience

While some directors have faced bans of a few years, cease- and-desist orders, and mandatory training as a result of illicit trades, disgorgement of profits or losses rarely breaks the bank. When the MMT was set up in 2003 (although it did not hear its first case until 2007), the tribunal was to offer a civil route in which private causes of action could be launched based on MMT findings of culpability. But as the example of Tianhe Chemicals shows, it is a slow process. An inquiry into market misconduct by Tianhe only commenced in June 2020, six years after the IPO and three years after the stock was suspended from trading by the SFC. Tianhe was delisted in June 2020. While it is noble that the SFC is seeking restitution for shareholders at the MMT in an attempt to recover HK$3.52 billion in IPO proceeds, they are unlikely to see any resolution soon. Hearings were scheduled in May 2021.

Figure 8

A meandering market tribunal?

Case description	Date of alleged misconduct	SFC notice to MMT	Current status	Lifespan
Insider trading				
Asia Telemedia	April-June 2007	January 2014	❑ Report issued November 2015 ❑ Appealed and re-hearing ordered ❑ Hearing June 2020 (no update)	13 years +
Meadville Holdings	September-November 2009	September 2019	❑ Part I of MMT report issued December 2020 ❑ Insider dealing found for one person ❑ Two year ban from dealing in securities + cease and desist order	11 years
China Forestry	January 2011	May 2018	❑ Hearing in March 2020 (no update)	10 years +
China Gas	November 2011	July 2016	❑ Part I of MMT report issued March 2017 ❑ Retrial ordered, second report issued November 2020 ❑ Insider dealing established, awaiting order	9 years +
Disclosure breaches				
Mayer Holdings	December 2012	March 2016	❑ MMT report issued February 2017 ❑ New hearing ordered for August 2021	8 years +
Magic Holdings International	March-May 2013	March 2018	❑ MMT report issued March 2020 ❑ Culpability established, awaiting order	7 years +
China Medical & Healthcare	April 2014	October 2019	❑ Hearing set for September 2021	6 years +
CMBC Capital	October 2014	November 2018	❑ Hearing in October 2020 (no update)	6 years +
Health & Happiness International	June 2015	November 2018	❑ Hearing in March 2020 (no update)	5 years +
False/misleading prospectus				
Tianhe Chemicals	June 2014	June 2020	❑ Two preliminary conferences held	6 years +

Source: Market Misconduct Tribunal website, ACGA analysis

A few blockbuster fines for IPO sponsors

Fining Sponsors

There have been some record-breaking penalties levied against bulge bracket banks. In October 2020 Goldman Sachs Asia was fined HK$2.71 billion for serious lapses and shortcomings in relation to 1MDB bond offerings. Sponsor failures saw four Wall Street banks fined HK$787m during 2019. UBS AG and UBS Securities Hong Kong received a HK$375m penalty for sponsor failures at three IPOs, including the HK$1.68 billion offering of China Forestry Holdings in November 2009 and the listing of Tianhe Chemicals Group in 2014. UBS's securities arm was also banned as a sponsor for a year. Fellow China Forestry sponsor, Standard Chartered, received a HK$59.7m fine for its failings. As fate would have it, in a separate action UBS AG was also reprimanded and fined HK$400m in November 2019 by the SFC for overcharging clients for 10 years.

The bulge bracket banks forfeit millions in penalties

The ill-fated Tianhe IPO saw two other sponsors fined for their roles, with Morgan Stanley Asia given a HK$224m penalty and Merrill Lynch Far East having to pay HK$128m. Another notable sponsor fine was levied on Citigroup Global Markets Asia in 2018, the bank given a HK$57m penalty for failings in respect of the 2009 offering of Real Gold Mining.

A few insider dealers were jailed

On the criminal front, there were a few jail terms for insider dealers. Former group finance manager of China CBM Group, Au-Yeung Siu-pang, was jailed for four months in February 2019 for insider dealing offences while former Hong Kong Television senior regulatory affairs manager, Ken Yiu Ka-lun, received a two-and-a-half month sentence for illicit trades in the company's shares.

The SFC finally brings a case before a jury

In a first, the SFC in August 2020 commenced criminal proceedings that will be decided by a jury trial at the Court of First Instance of the High Court. Under Hong Kong securities law the regulator is only able to bring prosecutions at the Magistrates Court, where lower penalties can be imposed. The regulator referred an alleged market manipulation case involving the shares of GEM-listed Ching Lee Holdings to the Department of Justice, which will prosecute at the higher court. The maximum penalty for the offence could be jail for 10 years and a HK$10m fine. In the meantime, the SFC successfully gained an injunction freezing assets of up to HK$124.9m held by 15 local and overseas entities in relation to the alleged manipulation.

HKEX loses disciplinary momentum

HKEX hits a plateau?

There was some optimism in CG Watch 2018 that the frontline gatekeeper of the listing rules in Hong Kong might be sharpening its teeth. Although HKEX has a limited arsenal of disciplinary powers at its disposal, there were signs that it was willing to take on more infractions and issue spikier rebukes to deviant directors. This momentum over the two years since our last report appears to have slowed as the caseload plateaued in 2019 and the number of disciplinary sanctions tumbled significantly.

Investigations and sanctions flounder

It appears 2018 was a high point for enforcement work although the bar was previously set quite low. There were only 52 investigations in 2015 and by 2018 the figure had risen to 111. HKEX launched 112 investigations in 2019 and for the first half of 2020 the figure was 84, but gains it had made on the disciplinary front began to wane. For example, HKEX issued 21 public censures in 2018 but only 11 in 2019 and seven in the first half of 2020. Likewise, a total of 120 directors were disciplined in 2018 but the figure fell to 63 the following year and to 43 in the first half of 2020. Interestingly, no GEM directors were disciplined in either the first half of 2019 or 2020. HKEX did refer six more cases to the SFC in 2019 than in the previous year, when there were just 14, and it nearly doubled the number of disciplinary reports to 24. Decisions, however, still took a long time to complete, with the average case taking 9.6 months in 2019 versus nine months in 2018.

Proposed disciplinary reform nibbles at the edges

There is a policy review of the Exchange's disciplinary powers and sanctions underway at the behest of the SFC, but a consultation paper issued in August 2020 offered a series of incremental changes rather than a radical overhaul that would act as much more of a deterrent. One of the more interesting new proposals is that serious or repeated breaches of the listing rules could prompt the Exchange to issue a public statement that a director or senior manager is "unsuitable to act". It also advocates a tightening of reputational sanctions, namely where the Exchange issues a statement in response to behaviour which is prejudicial to the interests of investors (a "PII statement") by doing away with a requirement that such conduct is wilful or persistent before a statement can be issued. It seeks to extend a PII statement to former and current directors/senior management of listed issuers and their subsidiaries, as well as denying market facilities as follow-up action. Under the proposals, secondary liability could be imposed on parties subject to HKEX's disciplinary regime and independent financial advisors would be included under the definition of "professional advisor".

Next steps

Better statistical analysis would help

Greater narrative explanation of enforcement statistics would help investors and others better understand the nature and effectiveness of SFC and HKEX regulatory action.

Long delays need to be addressed

It is difficult to understand the long-time lag in some of the SFC's cases and many of the disciplinary actions by HKEX. Both agencies could try to address the reasons for this more directly in their announcements on individual cases.

Disciplinary reform should gather pace in 2021

The consultation conclusions on HKEX's listing disciplinary powers should be published in 2021. It will be interesting to see if the full package of proposed changes are adopted.

No stone unturned?

Dubious valuations are a common trick to mask corporate misbehaviour

Corporate deviance in Hong Kong has long involved dubious transactions rubber-stamped by a board to enrich family members at the expense of minority shareholders. In most cases, perpetrators seek to mask the "heist" with plausible valuations for this or that asset being transferred at an unfair price.

This company simply plunged HK$9 billion into fake gems

In the case of Champion Technology Holdings (HKEX:92) and Kantone Holdings (HKEX:1059) there was no fiction of a credible valuation when changing tack from software and IT services to gemstones because they simply didn't get one. Instead, group founder and chairman Professor Paul Kan Man-lok and his brother, executive director Leo Kan Kin-leung, went on a blind shopping spree for gems, splurging nearly HK$9 billion of the corporate coffers on what turned out to be worthless knick-knacks.

No valuations were sought prior to purchase

In their genuine form, the amber-coloured "Tianhuang" stones are revered as precious cultural artefacts. The baubles the duo acquired, however, were neither valued nor authenticated by professionals prior to purchase. Board approval was not sought until after the event. Yet the brothers, who procured the stones over a six-month period in 2015-16 and then walked away from the group, got merely a rap across the knuckles in April 2020 in the form of a censure from the Stock Exchange's Listing Committee.

Champion/Kantone group spent 92% of its assets

Back in late 2015 the Champion/Kantone group provided nuts and bolts communications software and wireless solutions to companies. That year it earned net profit of HK$13.3m on turnover of HK$5.6 billion. The Tianhuang purchases represented 92% of the firm's total assets of HK$9 billion. No mention has ever been made of which assets they realised or swapped to pay for the stones, or from whom they were acquired. They were housed in Paul Kan's museum, the executive being a "renowned collector" of cultural artefacts.

Key executives left shortly after

The purported plan was to trade in the stones. Yet neither of the Kans stuck around to see this put into action: A few months after the spree ended, Paul Kan, also a CBE, Silver Bauhinia recipient and one-time Honorary Consul for Hungary, retired from the group after nearly 25 years at the helm. A day later, the group announced that he had sold his entire 27.9% holding for HK$270m. His brother, Leo, resigned around the same time.

Auditors flagged issues and wiped 99% off the gems' value

Auditors raised a red flag over the treasure trove when preparing the group's 2016 results. A sample of the gems was valued by experts and the results were bleak: They wiped 99% off the value of the stones. The group took a HK$8.9 billion impairment hit over two years. A new board and shareholder came in and the group trundled on. Today it has reinvented itself as a gasoline trader.

Company and directors get a scolding from HKEX . . .

Were it not for the Listing Committee's censure in April 2020, the HK$8.9 billion wipe-out may have passed without a regulatory peep. A rebuke to a company for failing to exercise sufficient skill, care and diligence is at the top end of the Exchange's arsenal, but barely hits the mark in such an egregious case. Meanwhile, other former board members who did not challenge the transaction received only a criticism.

. . . but no other regulatory action was taken

If the group is not inclined to chase the former executives over their fiduciary failings (would that Hong Kong allow class actions), it would surely be a slam dunk for a well-armed securities regulator seeking to champion the cause of minority shareholders, given the scale of the write-down and disclosure shortcomings. At the very least the former directors' fitness to hold office warrants further regulatory scrutiny. It seems criminal to have the affair conclude with only a four-page scolding.

3. CG rules

Hong Kong slips two places to equal fourth despite score of 75%

Despite a one percentage point increase in score to 75%, Hong Kong's ranking here fell from 2nd to equal 4th, well behind Australia, marginally below Malaysia and Thailand, and equal with Singapore. This may seem a surprising result, given Hong Kong's reputation for having a solid CG rulebook, especially in key areas such as financial reporting, disclosure of ownership, takeover protections, insider trading, controls on director trading, share pledging (not perfect, but much better than most markets), disclosure of price-sensitive information, and so on.

Basic rulebook is sound but Hong Kong shuns CG innovation

Where Hong Kong tends to flounder is in some of the newer areas of CG reform, where reforms are seen as too intrusive on the rights of controlling shareholders, or where the government lacks the will to truly empower minority shareholders. For example, Hong Kong's approach to adopting a stewardship code for investors has so far been tame compared to other Asian markets. It consistently baulks at writing a robust definition of independent director into the listing rules and ensuring nomination committees are independent of controlling shareholders (non-independent board chairmen are permitted to chair or sit on nomination committees). Pre-emption rights for minority shareholders remain weak: HKEX still allows an annual 20% general mandate with up to a 20% discount - this rule has become decidedly long in the tooth. Unlike other leading markets, such as Australia, shareholders in Hong Kong do not yet have a unique identification number that allows them to receive general meeting notices directly and vote in their own name online.

Where CG reporting rules remain weak

Reporting still falls short

While Hong Kong ticks many of the basic regulatory boxes on CG reporting - namely having a detailed code of best practice, requiring disclosure on a "comply or explain" basis, and advising issuers against boilerplate reporting - standards still leave much to be desired. Despite an upgrade of the CG Code in 2018 in areas such as board diversity, overboarding by independent directors (ie, holding too many board positions), and more disclosure on the nomination of independent directors and their relationship to the company, overall the revision was a tentative set of changes that left important aspects of modern board governance as merely recommended best practices (RBPs) including:

- ❑ Disclosing the board's rationale for a director's independence despite the existence of cross-directorships or significant links with other directors;
- ❑ Disclosing details of remuneration paid to senior management on an individual and named basis;
- ❑ Conducting regular board evaluations;
- ❑ Quarterly reporting; and
- ❑ Establishing a whistleblowing policy and confidential reporting system.

Nine out of 10 companies ignore best practice

By definition, RBPs are voluntary and not subject to "comply or explain". Issuers are therefore free to ignore them, as the vast majority do. According to a HKEX review of corporate governance disclosure among issuers over 2017/18, just 11% of those surveyed complied with RBPs. This was a marginal increase over the 8% from its review in 2016. The most recent review, for the 2019 calendar year, does not contain a data point on compliance with RBPs, but merely says that the Exchange is pleased to note that some sample issuers have disclosed against some or all recommended disclosures.

A brighter spot

ESG reporting regime and guidelines improved

One brighter spot on the reporting front over the past two years has been the further revision to the HKEX ESG Reporting Guide. A tighter regime for listed issuers came into effect on 1 July 2020 along with an upgrade of guidance given to companies and e-training on how to comply. Companies have been required to issue an ESG report on a "comply or explain" basis since 2016, however the latest guidance raises the bar in several areas:

- ❑ Companies are required to disclose the board's oversight role in ESG reporting, including its approach and strategy and how it reviews ESG-related goals.
- ❑ The Environmental KPIs in the Guide have been expanded to include climate-related risks and disclosure of targets for a range of emissions, water and energy usage, and steps taken to achieve them.

- The Social KPIs in the Guide have been upgraded to "comply or explain" and include policy and compliance in relation to labour laws, discrimination, supply chain management and community investment.

ESG reporting still falls short of global standards

While the new ESG Reporting Guide is an important step forward, ACGA was disappointed that HKEX did not take this opportunity to incorporate references to international standards of sustainability reporting, in particular GRI, SASB and TCFD, in the Guide itself. While these standards get a mention in the ancillary educational material that HKEX has produced, one cannot help feeling that yet again the Exchange has tiptoed around a subject that it considers is too sensitive to discuss in any detail with issuers, who are likely to react vociferously if standards are raised "too quickly". Yet other markets in Asia with ostensibly less-developed governance systems are moving forward much faster on ESG reporting than Hong Kong. The contrast with the HKMA and the SFC, both of which are strong public supporters of TCFD, could not be starker. On climate-risk disclosure especially, the pace at which Hong Kong moves forward should be set by objective scientific factors and not by what suits the average issuer.

Next steps

Hong Kong's CG rules should match global norms

We recommend that Hong Kong undertake a detailed benchmarking exercise comparing its CG rules with those of leading markets around the world and this region. It is jarring to hear officials state the city is an international financial centre when aspects of its CG regime are falling behind emerging best practices in other places. Some Asian markets are starting to produce interesting ideas that Hong Kong could follow.

Independent director selection needs an overhaul

The concept of the independent director, including how they are selected and elected, needs a rethink. The next revision of the CG Code should include lead independent directors as a code provision.

Regulators should be on same page regarding climate risk

Greater alignment between the positions of the HKMA, SFC and HKEX on climate risk reporting would be welcome.

No conviction following Enigma network scandal

The Convoy enigma

In May 2017, corporate governance activist David Webb documented a notorious network of dozens of small companies with myriad cross-shareholdings, the so-called Enigma Network of "50 stocks not to own". The piece triggered a HK$6 billion sell-off, much regulatory bluster and a criminal investigation. Two years later, the anti-corruption agency charged medical doctor Roy Cho, a former director at Convoy Global Holdings, one of the alleged lynchpin members of the network, with conspiring to defraud the Stock Exchange as well as Convoy directors, shareholders and investors, out of HK$89m. But there was no blockbuster High Court trial and no jury, prosecutors opting instead for the lower-key District Court where a single judge hears the case and the maximum conviction could be a seven-year jail term. Ultimately, it was not quite the denouement regulators had hoped for: In November 2020, Cho was acquitted. The ICAC is reported to be planning an appeal.

4. Listed Companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

Hong Kong retains 7th place with a score of 59%

Hong Kong's score for this category improved from 55% in 2018 to 59% in 2020, although its ranking remained 7th. The slightly higher score was mostly due to changes in our evaluation methodology. We would also like to note that some of the most respected companies in Hong Kong from a governance perspective were not included in our survey because they are no longer in the top 50 large caps.

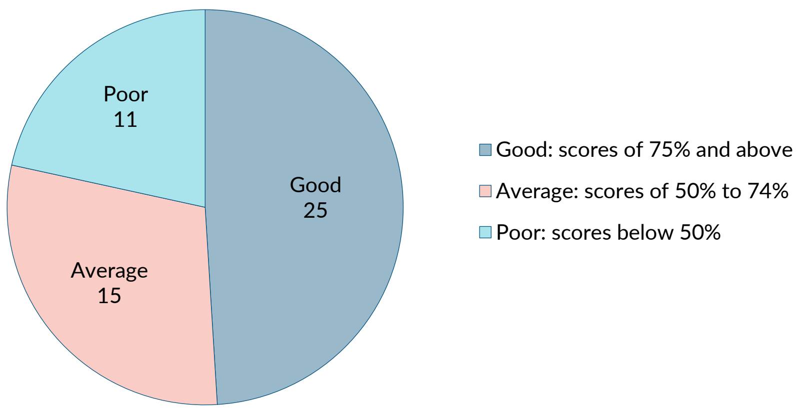
Large caps only doing the mandatory minimum

Our aggregate results showed that large caps performed well in only 25 of 51 questions, averagely in 15 and poorly in 11. As we observed earlier in this chapter, although Hong Kong's CG Code includes both mandatory requirements and best practice recommendations, publicly listed companies mostly follow only the mandatory requirements, with just a few that make the effort to implement best practices voluntarily. In addition, certain mandatory requirements are often ignored, as highlighted in HKEX's recently published eleventh review of issuer compliance with the CG Code, based on 2019 corporate governance reports (see Figure 10).

Less than half perform well

Figure 9

Hong Kong: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where Hong Kong does well

Good marks for timely announcements

Hong Kong issuers make timely announcements on corporate actions covering acquisitions, mergers, divestments, and other events, including general meetings. These announcements are published on company websites and the website of HKEX.

Financial reporting is on a par with other markets

Financial reporting compares favourably with other markets, especially when reporting on key financial metrics and items such as trade receivables and payables, and loans. Issuers typically produce useful management discussion and analysis (MD&A) reports as well. We highlight below one area of ongoing weakness in financial reporting: details on operating expenses.

Decent disclosure on board attendance, training and pay

In terms of board governance, we found that issuers disclosed detailed attendance statistics, provided basic training to most directors, and the remuneration of each director was reported by name and type (fees, salaries, pension, other benefits) as per the listing rules. Another positive was that most independent directors were not paid with stock options - Tencent and Alibaba being the biggest exceptions. Figures were given for audit and non-audit fees, though more detail on the latter would be helpful. A high proportion of the large caps we reviewed had whistleblowing policies.

Where Hong Kong performs averagely

Issuers aren't disclosing shareholder Q&A

Although Hong Kong issuers were among the first in the region to be required to publish full AGM voting results within a day of their meeting, disclosure is failing to keep pace with regional best practice in a new area - the publication of shareholder Q&A from the AGM. One of the limiting factors here is that minority shareholders in Hong Kong are generally quieter than their counterparts elsewhere. HKEX, for example, recorded "no questions from the floor" in its 2020 AGM report.

Autonomy of audit committee chairmen is an issue

We also found areas of weakness in the independence of audit committee (AC) chairmen. Although only one of the 15 large caps had an AC chairman with a connection to its auditor (he was a former partner at the audit firm), another five were quite closely related to the company (eg, they had been directors for 12 years or were sitting on another group company board as independent directors). Meanwhile, the quality of reporting on board committee activities remains formulaic in many companies - a perennial complaint and one that even HKEX seems to be tiring of making (see box, "Overlooked or incorrect").

Policy on independent director pay lacks clarity

Despite the CG Code's emphasis on the need for transparency in the setting of remuneration, Hong Kong issuers generally do not disclose clear policies on how independent director fees are derived. Also lacking is full disclosure of senior executive remuneration (ie, five highest paid managers). Although the required disclosure is limited to aggregate figures and bands only, the CG Code recommends that: "Issuers should disclose details of any remuneration payable to members of senior management, on an individual and named basis, in their annual reports." Yet only two of the 15 large caps - HKEX and MTR Corporation - did so clearly for all their five highest paid individuals.

Where Hong Kong does poorly

Issuers are vague on operating expenses

Many issuers in Hong Kong - eight out of 15 - scored badly on a question as to whether they provide a detailed breakdown of operating expenses, by function and nature, or conversely have a substantial amount of unexplained "other expenses". The good news was that six of 15 scored well here, but the aggregate score for the 15 large caps was brought down by negative scores for the poor performers.

Board evaluations don't seem to be happening

Companies continued to disappoint in the quality of reporting on newer aspects of board governance. Take board evaluation: Although the CG Code mentions this only as a recommended best practice, any well-governed issuer should do an evaluation each year and use consultants to carry out independent assessments every two to three years.

Details of a director's skills are still generic

The passage of time has also brought little improvement to the discussion of director skills and board composition. Ideally, companies should provide a "skills matrix" illustrating the broad range of skills that each director brings to the board, with a link to current business operations and future challenges.

However, issuers in Hong Kong typically disclose individual director biographies only, with just one having a skills matrix in its annual report - HKEX. This should be an activity that nomination committees perform regularly and include in reports to explain board composition.

Few codes of conduct to combat and report graft

We believe that Hong Kong companies must also improve their policies for mitigating corruption. Issuers should disclose a public whistleblowing policy, with clear procedures for complaints, as well as a public code of conduct that extends beyond members of the company, including suppliers. Many of the 15 issuers surveyed did not share their whistleblowing policies in detail: One did not mention a policy at all, while another eight only briefly referred to a policy in their annual reports or websites. Five out of the 15 did not disclose a public code of conduct.

Poor disclosure on shareholder engagement

Issuers also provided inadequate levels of information on engagement with shareholders. Most disclosed the frequency and type of such engagement, but gave no details on the nature of the discussion.

ESG reporting skims the surface

Lastly, although issuers produce ESG or sustainability reports, Hong Kong is below regional best practice in terms of the breadth and depth of disclosure. The disclosure of materiality is incomplete when compared to the SASB materiality indicators for different sectors, and there is minimal discussion on the process for determining what is material to the company. In addition, the issuers we studied had limited discussion on how to manage the material issues they identified, with either intangible or no targets set.

HKEX is aware of issuers' disclosure shortcomings

'Overlooked or incorrect'

In its review of 2019 CG reports, HKEX noted a number of areas that issuers had "often overlooked or disclosed incorrectly". A key point is that these are mandatory, not voluntary, disclosure requirements under the CG Code. As the following table shows, there is a clear overlap with our analysis of disclosure weaknesses.

It annually highlights the most common flaws . . .

Figure 10

Commonly overlooked disclosures, 2019

Mandatory disclosure requirement	Issue spotted
A summary of work during the year for the remuneration committee, the nomination committee and the audit committee	Disclosure sets out committee functions, but omits a summary of work performed by them during the year
All directors should participate in continuous professional development to develop and refresh their knowledge and skills	Disclosure confirms training has been provided to all directors, but omits to disclose the training that each director has participated in
An analysis of fees paid for audit and non-audit services should be provided by auditors, including details of the nature of services and fees paid in respect of each significant non-audit service assignment	Disclosure of fees paid to auditors for audit and non-audit services, but omits details of the nature of the underlying non-audit service assignments

Source: HKEX, "Analysis of 2019 Corporate Governance Practice Disclosure"; ACGA has edited the original table from five issues to three

. . . and seems to be losing patience with disclosure failings

Interestingly, other parts of the same report appear to reflect a degree of frustration by HKEX at the way in which some issuers approach newer elements of the CG Code. Take the re-election of long-serving independent directors: issuers should put forward a separate resolution at their AGM for any INED who has served for more than nine years and provide reasons why they still consider this person to be independent. Yet HKEX found that many thought simply stating the INED satisfied the formal independence criteria in the listing rules would be sufficient and "equivalent to confirmation of a director's ability to continue to bring in fresh perspectives and independent judgement". As the Exchange pointed out somewhat caustically: "This obviously cannot be the case as Rule 3.13 Independence Criteria sets out circumstances where an INED's independence is most likely to be questioned, without assessing the INED's mindset."

INED tenure is a perennial problem

Long-serving INEDs is a real issue in Hong Kong: As of June 2020, more than 1,650 directorships were occupied by long-serving INEDs and there were 166 issuers where all INEDs had served nine years or more.

Overview of Hong Kong's CG performance

Figure 11

Helicopter view: Rating Hong Kong's CG disclosure and governance, 2020

Good	Average	Poor
❑ Corporate actions archived for extended period (20+ years) on HKEX website	❑ AGM reports lack Q&A with shareholders	❑ Disclosure of board evaluation, including third-party assessors, limited
❑ Disclosure of trade receivables and payables	❑ Some audit committees chaired by non-independent directors	❑ Operating-cost tables often contain an "other expenses" line that is not fully explained
❑ Disclosure of loans	❑ Limited discussion of remuneration policy for INEDs	❑ Policies for mitigating corruption need a boost
❑ Detailed AGM circulars and prompt release of voting results	❑ Top five senior managers remuneration aggregated and in bands	❑ Shareholder engagement disclosure vague
❑ Director attendance statistics	❑ Information on board committee activities still boilerplate	❑ Board skills matrices are non-existent
❑ Individual director remuneration	❑ Information on individual director training lacking in many companies	❑ ESG reporting lacks discussion of material issues and process

Source: ACGA

Ways Hong Kong can improve

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Issuers to share AGM minutes or recordings, with shareholder Q&A
- ❑ Clear disclosure of INED fee policy
- ❑ Disclosure of five highest-paid executives by individual name
- ❑ Board and committee reports to include specific references to activities undertaken during the year, not just formulaic language
- ❑ Detailed disclosure of director training by individual
- ❑ More detail on the nature of non-audit fees
- ❑ Better disclosure on operating costs, with minimal aggregation of "other expenses"; if the latter are aggregated, they should be explained
- ❑ Board skill matrices to ensure an appropriate mix of skills relevant to the business

Medium to long-term challenges

- ❑ Audit committee to be chaired by an independent director with no links to the auditor or the company
- ❑ Regular/annual board evaluations and the use of external consultants
- ❑ Better public disclosure of policies for mitigating corruption (whistleblowing policy and code of conduct)
- ❑ Proactive shareholder and stakeholder engagement that is well-documented
- ❑ ESG/sustainability reports to include substantive discussion of the materiality selection process, how companies manage these issues, and how they set meaningful targets

Electronic AGMs: Techno desert

Hong Kong favoured physical meetings

In contrast to large caps in Australia, India, Malaysia and Singapore, most of Hong Kong's big companies did not use technology to webcast their meetings in 2020: Of the top 50 public companies by market value, more than 43 held physical meetings, six put on hybrid meetings, and just one organised what we consider to be a virtual meeting. (See figure below.)

State-owned firms were in no rush to blaze a tech trail

The first major contributing factor was that most of the top 50 were state-controlled enterprises from China and often dual-listed. Since they were under no compulsion to organise webcasts for A-shareholders in China in 2020, they did not do so for their H-share holders either. In previous years some of these companies, ICBC for example, organised simultaneous AGMs in Beijing and Hong Kong, with the meeting broadcast to a venue in Hong Kong. Due to Covid, the latter event was cancelled in 2020.

Tech firms go analogue

A second factor was even more disappointing: leading tech giants like Tencent, Xiaomi, and Meituan chose not to hold electronic meetings.

Firms grappled with shareholder identification

The six hybrid meetings that were held included three local firms (AIA, MTR Corporation and CK Hutchison) and three Chinese firms (China Overseas Land and Investment, CITIC and Alibaba). CITIC was the only one that allowed an online voting option and questions in real-time, while the other five permitted voting only in person or by proxy. It is understood that one of the challenges here is that Hong Kong's common nominee system and lack of individual shareholder ID numbers makes it difficult for companies to identify who all of their shareholders are, especially retail.

Only pre-meeting voting allowed at Hang Seng Bank

Hang Seng Bank meanwhile, held an electronic meeting that allowed questions in real time, but voting had to be done beforehand and minority shareholders were not permitted to attend. (Note: While fully virtual meetings are technically not permitted in Hong Kong - there must be at least one physical venue from where the meeting is webcast - we consider the Hang Seng meeting to have been virtual since the only people in the room were a few directors and staff members. A "hybrid" meeting, in our view, would allow minority shareholders to participate as well.)

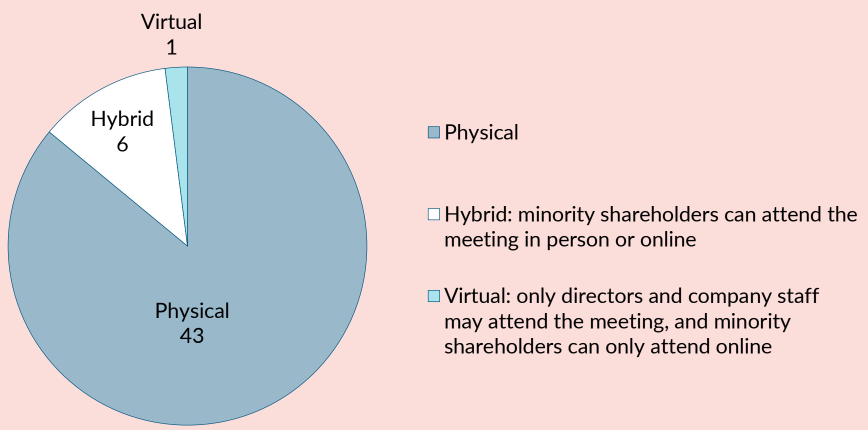
Format of hybrid meetings raises legal questions

Arguably, Hong Kong incorporated companies must allow shareholders to both ask questions and vote in real time: Section 584 of the Companies Ordinance states that a company may hold a hybrid meeting where members are able to "listen, speak and vote". But there has been much confusion over the legal parameters of hybrid meetings and both the SFC and HKEX have advised issuers to seek legal advice. It would be helpful if the regulators, including the Companies Registry, issued clear guidance on what the law intends and how practical challenges can be overcome.

Hong Kong gets physical during the pandemic

Figure 12

AGM modes in Hong Kong: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

Hong Kong still in 9th place with 34%

Hong Kong's score increased substantially in this category, albeit from a low base: 26% in 2018 to 34% in 2020. Its ranking remained a poor 9th however. While Hong Kong may be strengthening this part of its CG ecosystem, it is not moving as quickly as other markets.

What CG policy?

Domestic players remain on the sidelines

There is a distinct domestic-foreign divide in the way institutional investors put their weight behind CG in Hong Kong. The largest local asset owners, albeit a small group, keep their heads firmly down. Out of the top five, only two have a CG policy and actually publicise it: the Hong Kong Monetary Authority (HKMA) and AIA Group. Equally reticent to put their hands up are domestic asset managers, with only four of the top 10 having a CG policy and just two publicly disclosing them. Even where such policies exist, public commitments to CG by local institutional investors tend to be weak and marketing-centric. (Note: We use the term "CG policy" to refer broadly to any of the following types of statements: A corporate governance statement or set of principles; a proxy voting policy; or an ESG, stewardship or responsible investment policy.)

Foreign voices dominate the CG space

Domestic players seem content for their foreign peers to be the institutional voice of CG in the city, something that is reflected in the greater participation of foreign asset owners and managers in regulatory consultations. Of the 17 investment managers who responded to a HKEX consultation on the revised ESG Reporting Guide in mid-2019, four chose to remain anonymous while 11 of the remaining 13 were foreign investors (and all ACGA members). Of the 15 investment managers who responded to the corporate WVR consultation in the first half of 2020, one was anonymous while the other 14 were all foreign investors (and ACGA members).

The HKIFA is finding its CG voice

One domestic entity that is starting to do more on CG policy is the Hong Kong Investment Funds Association (HKIFA). Over recent years it has expressed concerns about WVR, corporate WVR, and the direction of board governance reform in Hong Kong. Indeed, in September 2020, ACGA supported HKIFA in an opinion piece published by local newspapers on the need for lead independent directors.

Few local takers on stewardship

Public endorsement is lacking

Among domestic asset owners and managers there is scant public endorsement of stewardship and responsible investment. The SFC's Principles of Responsible Ownership 2016 remains voluntary and, unlike in other markets, the regulator does not encourage or maintain a list of signatories. One positive is that the HKMA has endorsed the code and expects its external managers to adhere to these on a "comply or explain" basis. It also applies an ESG evaluation to its bond and PE investments.

HKMA builds up responsible investment profile

Indeed, the main change over the past two years has been the HKMA's decision to be more visible on issues of responsible investment (RI), principally by becoming a signatory to the UN Principles for Responsible Investment (PRI) in August 2019 after chief executive Norman Chan broached the topic at a Green Finance Forum in May of the same year. The Authority does not however appear to have an internal ESG team, nor does it issue public RI reports like asset owners in other Asia-Pacific markets. Meanwhile, some of the more prominent local asset managers who have followed the HKMA's lead and signed up to PRI include Value Partners, Zeal, and Keywise. One manager, the Link Reit, signed up in 2017, two years before the HKMA.

To vote or not to vote

Domestic institutional voting remains a mystery

We also see a marked difference between domestic and foreign investors on voting. Of the 15 largest domestic investors surveyed, none disclosed their voting records. Although not a requirement in Hong Kong, it is now required or encouraged in other markets such as Australia, India, Japan, Korea and Thailand. The HKMA demands that its external managers exercise their voting rights, although no information is available. We know that many other domestic investors vote too, but no records are provided. It is therefore hard to assess the true extent of institutional voting in Hong Kong and whether such investors see voting as a catalyst for improved issuer governance.

Foreign investors are active voters

Foreign players in contrast are generally robust in exercising their voting rights, especially on resolutions with which they disagree. While detailed voting data does not appear to be collated by custodian banks, anecdotal evidence over the past 10 to 15 years, publicly available data in responsible investment reports, and ACGA's own survey all indicate that foreign institutions representing a majority of external portfolio investment into Asia are voting most of their shares. This aligns closely with the increasingly sophisticated internal ESG and stewardship policies of foreign investors and a much clearer emphasis these days on using voting to communicate with management.

The foreign dimension

ACGA polled global investor members on voting and engagement in Q3 2020

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members in Q3 2020 to understand their level of voting and engagement in the 12 Asia-Pacific markets we cover. More than half of ACGA's investor members - 45 out of 92 - responded. At the time of the survey this group managed in aggregate more than US$26 trillion globally. As the responses showed, Hong Kong is not surprisingly an important investment destination:

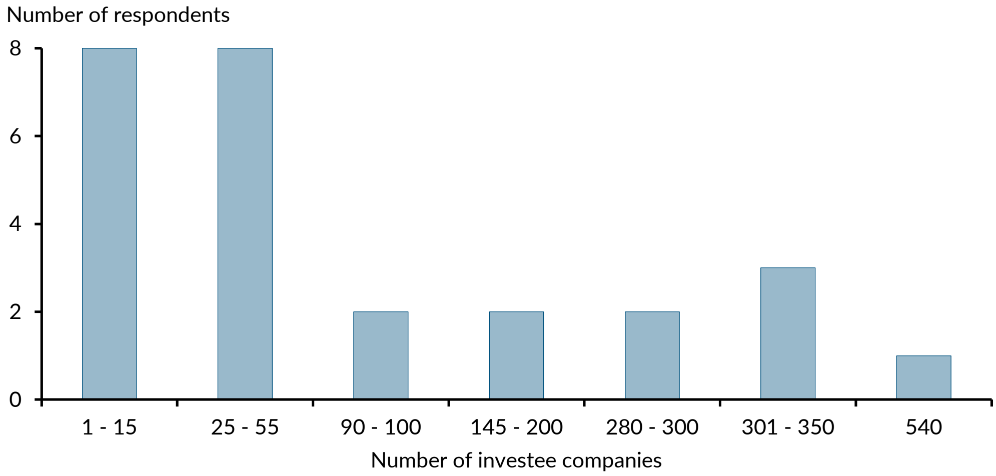
- 91% or 41 respondents indicated that they invest in Hong Kong - placing it equal second in the region with China and slightly below India (93%).
- Only 26 respondents answered the question on the exact size of portfolios. They invest in an average of 117 companies each, with a range from one to 540. The average figure is broadly in line with Korea and India in the 100 to 130 range, but well below Japan and China.

Another way to show the extent of investment in Hong Kong is to group portfolios by size. As the following figure shows, most respondents have portfolios of 55 companies or less, while a few invest in more than 300 companies each.

Size of foreign investor portfolios

Figure 13

Foreign investors in Hong Kong: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Foreign investors are not afraid to reject resolutions

Respondents take voting seriously in Hong Kong and voted against management resolutions in more than half the AGMs they participated in in 2020:

- Most respondents with holdings in Hong Kong vote in 100% of their investee-company AGMs. One votes in 97% and three said they voted in 40% to 45%.
- On average, they voted against at least one management resolution in 55 meetings in 2020. The median figure was 30 meetings, with a range from zero to 288. The average figure places Hong Kong at fourth in the region, above Taiwan and after Japan, China and Korea.
- As a proportion of their holdings, respondents voted against at least one management resolution in a mean average of 53% of meetings and a median of 61%. This ratio is comparable to Indonesia, and just above Thailand and Japan.

"General mandates" garner the most voting resistance

The largest votes against tend to be on the 20% general mandate for private placements (capital raising) - often by as much as 20% to 30% of all votes cast. There are also material votes against directors, article amendments, share award schemes and various EGM resolutions. While the impact of voting can be limited in a market dominated by large controlling shareholders, foreign investors are at least trying to drive the CG/ESG agenda through their voting policies and practices.

Company engagement

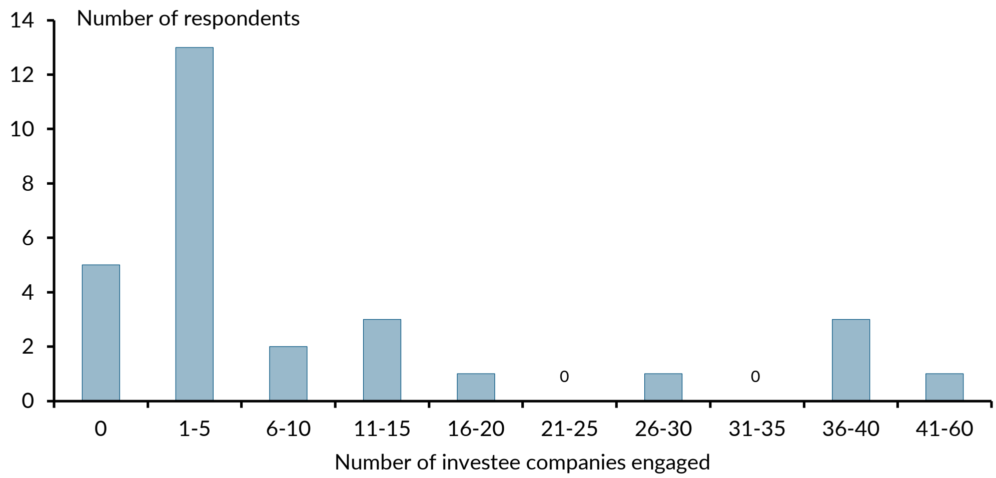
Respondents engaged with 11 companies on average over 2019 and 2020

Company engagement on CG and ESG topics is becoming an increasingly important part of foreign investor stewardship activities in Hong Kong and around the world. On average, respondents engaged in total with 11 companies over 2019 and 2020. Again, a more representative way of illustrating engagement is to show it as a distribution. As the following figure shows, most respondents who answered the question engaged with 10 or fewer companies over the two years, and a few engaged with more than 20.

A few large investors engaged with 20 to 60 companies

Figure 14

Foreign investor engagement prevalence in Hong Kong, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

In relative terms, respondents engaged with 20% or less of their portfolios

In terms of the relative level of engagement in Hong Kong (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 20% or less but rises to 30% to 40% for three institutions (one of which is within the 90-100 band in portfolio size), 56% for one and 75% for another.

Foreign investors modify CG policies for Hong Kong

An impressive 44% of respondents have adapted their CG, ESG or stewardship policies to Hong Kong - one of the highest figures in the region after Japan, and Korea and China. (By "adapt" we mean such things as translating or amending your policies to take account of local rules or governance practices.)

Domestic engagement is an enigma

Meanwhile, it is difficult to assess how actively domestic institutional investors engage with listed companies. Only a few managers have dedicated in-house CG or ESG teams and of the 15 institutions we surveyed only two were able to give compelling evidence of engagement. A handful of others may be doing so but prefer to keep it private.

Retail shareholders aren't revolting enough

Still no united shareholder front organisation

Retail shareholders are sometimes active at the AGMs of larger companies in Hong Kong, yet there has been no progress in setting up an organised group to represent their interests. David Webb, editor of Webb-site.com, mooted the idea of a Hong Kong Association of Minority Shareholders (HAMS) nearly 20 years ago. While it was supported by a wide range of market participants, it failed to get the official backing that Webb sought (for more on David Webb, see the box, "David and Goliath, Hong Kong-style").

Steep legal costs are a huge barrier to shareholder action

Collaborative action and rebellions by retail shareholders are rare, although the decision by HSBC to scrap its fourth interim dividend for 2019 amid the Covid crisis did enrage a few punters. The prohibitively high cost of taking legal action and lack of class-action lawsuits is a major impediment to anyone seeking to take wayward directors and companies to court, leaving the SFC to take on the most egregious cases on the behalf of shareholders, as it did with Tianhe Chemicals in September 2020.

Institutional rebellion is rare

Public exposure of corporate misbehaviour is more likely to emerge from a short seller or Webb-site report than an investor backlash. The only institutional revolt of note in the past few years has been Elliott Management's tussle to carve up the Bank of East Asia, and on a smaller scale, lobbying in May 2020 by Australian investment managers Lanyon Asset Management and local hedge fund Black Crane Capital to force Hong Kong-listed Cross-Harbour Holdings to sell the company yacht.

Next steps

A stewardship code with some teeth would help

One way to energise the local investor environment would be for the SFC to update its Principles of Responsible Ownership, published in 2016, and make them properly subject to "comply or explain". The SFC started looking at a revision in 2019 but has been delayed by significant changes in the influential UK Stewardship Code, which has traditionally set the benchmark for Asia, and the Covid-19 pandemic. Any new code should come with a public register of signatories.

Domestic investors should formalise CG and ESG in investment process

If they do not already have them, domestic investors in Hong Kong are encouraged to develop in-house policies for integrating governance and ESG factors into their investment process, and to publicise these documents on their websites. They are also encouraged to develop explicit policies on stewardship.

Mandate voting disclosure in the SFC's Principles of Responsible Ownership

To keep pace with regional best practice, the next iteration of the SFC's Principles of Responsible Ownership should require the disclosure of voting records down to the company and individual resolution level, including reasons for voting against. This idea may appear radical in the Hong Kong context, but is now the norm in several markets.

Domestic asset managers need to step up

Hong Kong would benefit from enhanced leadership by domestic asset owners. This group includes not only the HKMA, but entities such as AIA, a leading insurer, as well as the Hospital Authority and Housing Authority. It is also surely time for the private-sector Mandatory Provident Fund investment managers to step up and be counted.

David and Goliath, Hong Kong-style

The ex-banker who took on the tycoons

Minority shareholders have long been the underdog in Hong Kong but at least they have their David. For two decades, former investment banker David Webb has taken it upon himself to expose corporate tyranny in a city where stocks are tightly controlled by tycoons who have the ear of government. He began with a few blogs: Why the government should not have intervened in the stock market after the Asian financial crisis in the late 1990s, and a critique of the city's peg to the US dollar. In 1999, he began digging into dubious deals, sudden stock surges and boardroom antics. He took issue with the government's decision to award the Cyberport IT hub project without tender to tycoon Richard Li's Pacific Century Group, and he correctly predicted it would never become the Silicon Valley of Hong Kong. It eventually turned into a property venture.

Shaking up the status quo

In Project Poll launched in early March 2003, Webb bought nominal shares in every HSI company, then turned up at AGMs and pestered CEOs to conduct poll voting. (Six years later the Listing Rules were changed.) Later that month, in Project Vampire (Vote Against Mandate for Placings, Issues by Rights Excepted), Webb urged shareholders of all HSI companies to vote against the 20% general mandate, hoping to put pressure on regulators to tighten the listing rules.

Closing in on CG shortcomings

Webb has taken aim at "toxic convertibles" and "toxic derivatives" being peddled by investment banks. He picked holes in the takeovers code, nagged the stock exchange for greater digital disclosure and constantly reminded Hong Kong why it needed a competition law (it eventually came in late 2015).

An unconventional addition to the HKEX board

A stalwart opponent of a for-profit bourse, Webb was elected to the board of HKEX in 2003 as an INED. When he resigned from the board in 2008 - a year before his term expired - it was dogged in his view by poor management and governance issues.

Exposés that move the market

Over the years his "bubble warnings" seemed to become more frequent and he has meticulously pieced together a number of nefarious networks. One of the largest, a faction of around 50 stocks with myriad cross-holdings and overlaps, saw HK$6 billion wiped from the market upon Webb's publication of his findings in 2017. The "Enigma Network" exposé led to a criminal probe.

Webb is meticulous, much to his targets' chagrin

An Oxford graduate and former investment banker, Webb's work is highly detailed and rarely challenged. He may have made a few tycoons and investment bankers froth at the mouth over the years, but you won't see him on the libel circuit or drawing the ire of regulators who take aim at short seller research. Webb is also a keen advocate for freedom of information, greater corporate transparency and competition. In November 2018 he put the spotlight on the Companies Registry, which has a monopoly on company searches and had overcharged users to the tune of HK$3.6 billion at a time when other jurisdictions are offering the service for free.

Stay well David, Hong Kong needs you

In the summer of 2020, the 55-year-old revealed to his readers that he had been diagnosed with metastatic prostate cancer and would not be dedicating much time to research in future. His Facebook posting became an emotional read. The words of support, encouragement and optimism underscore a recognition and appreciation among Hong Kongers of the indispensable role he plays. We hope he makes a full recovery.

6. Auditors & audit regulators

Hong Kong is equal 3rd with a score of 81%

One of Hong Kong's best performing categories, it boosted its score here from 74% in 2018 to 81% in 2020 and rose one spot to place equal 3rd with Singapore. Changes in methodology and scoring played only a small part in the higher score; the big story was the arrival at long last of an independent audit regulator. It also did better on a question relating to the independence of auditors, but slightly worse on one about audit quality.

Hong Kong joins the club

Late to the party, Hong Kong finally gets an audit regulator

After a lack of urgency on the part of policymakers for many years, followed by a war of attrition with the local accounting industry (in particular the smaller CPA firms, aided by some members of the Legislative Council), the Hong Kong government successfully pushed through an amendment bill in early 2019 to turn the Financial Reporting Council (FRC) into a fully-fledged audit regulator on 1 October 2019. This made Hong Kong one of the last markets in the region, indeed globally, to form such a regulator.

A decent system but shame about the autonomy

Prior to this time the FRC, a statutory body, had been responsible for investigating auditing irregularities by auditors of public interest entities or PIEs (mostly listed companies) in Hong Kong, then passing its findings to the Hong Kong Institute of Certified Public Accountants (HKICPA) for disciplinary action. In the new system the FRC takes over the inspection and disciplinary powers of HKICPA in relation to PIE auditors and leaves the Institute with registration, education and, significantly, standard setting. Although HKICPA's standing-setting process is subject to FRC oversight, the new structure in Hong Kong is still less independent than other major markets: Australia has two independent statutory boards with responsibility for setting accounting and auditing standards, respectively, while in Japan the work is done largely by an entity under the Financial Services Agency, the country's securities commission.

Hong Kong gets to join a global audit body

This development means that Hong Kong can finally join the International Forum of Independent Audit Regulators (IFIAR), a body formed in 2006 and comprising audit oversight boards from 55 countries and jurisdictions. It is understood that Hong Kong's application to join IFIAR is in process.

Runs on the board

A promising start to industry oversight

The new-look FRC should be able to bring much more verve and efficiency to the system of audit regulation, something that Hong Kong has underperformed in relative to other markets for a long time. What has it achieved in its first 16 months? On 11 December 2020, it released two reports on its work. The larger one described in detail its assessment of HKICPA's performance in its ongoing regulatory functions and made a number of recommendations. One of the more interesting was a suggestion that the Institute rethink how it appoints the three committees responsible for overseeing its registration, education, and standard-setting duties. Although HKICPA had issued "general internal guidance" for the appointment of committee members, it had "not set out the specific knowledge and skills expected from committee members in discharging their duties".

Finding familiar audit quality control issues

The second report focussed on the FRC's new inspection work in relation to individual audit engagements and quality control systems in CPA firms. Although only an interim report, it found a range of deficiencies in audit engagements. Sadly, these are all the usual suspects. For example:

- One or more instances of a **lack of professional scepticism** in 16 out of the 18 engagements inspected.
- Deficiencies relating to **"key audit matters"** in seven of the 18 engagements, and by both the largest and smallest CPA firms.
- Deficiencies in evaluating the application of accounting standards in areas such as **revenue recognition** and **credit loss impairment**.

Time for a proper overhaul?

The prevalence of these recurring problems suggests that Hong Kong may wish to take a leaf out of the audit regulatory book in other markets and explore ways to tackle audit quality head on. For example, developing an audit firm governance code (as in Japan) or a set of audit quality indicators (as in Singapore).

Disciplinary environment in transition

No disciplinary action yet

On the disciplinary front, things may appear to be moving more slowly. The FRC provides statistics on the number of complaints it responds to annually and how it deals with them. It also gives figures for investigations. But nothing as yet for sanctions. There is a logical reason for this however: Cases relating to auditing irregularities in financial statements prior to 1 October 2019 are still dealt with under the old system (ie, by HKICPA); the FRC can only sanction auditing failures in accounts published after its formation. In practice, the first set of audits for which it is fully responsible relate to 2019 calendar-year accounts, signed off by auditors in Q1 2020 (though some were delayed due to Covid). It is understood that the FRC will be passing some new cases to its disciplinary department in 2021. Watch this space.

Cross-border collaboration

China is beginning to share audit working papers

One other recent milestone in Hong Kong's auditing regime was the May 2019 signing of an MOU - again after quite a long delay - with the Ministry of Finance (MOF) in Beijing on the sharing of audit working papers. This is important because 11 mainland CPA firms are accredited to audit the financial statements of mainland firms listed in Hong Kong. If the FRC cannot access their audit working papers, then its regulatory scope and effectiveness will be constrained. As of late 2020, the MOF had passed over the first seven of 11 working papers requested. In future, the FRC would like to collaborate with the MOF in a wider range of regulatory activities, including inspection, investigation and disciplinary actions.

Efficient standard setting

Hong Kong is on top for auditing standards

While the process for updating accounting and auditing standards in Hong Kong may not be as independent as some other markets, one cannot fault the speed with which HKICPA goes about this work. We tightened the questions in this part of our survey (Q6.1 and Q6.2) and gave Hong Kong 5/5 for each. Unlike Singapore, which takes longer to amend auditing standards, we could not find any major discrepancy between Hong Kong standards and either International Financial Reporting Standards (IFRS) or International Standards of Auditing (ISA).

Ethics code was quickly adopted

One area where Hong Kong has been noticeably faster than Singapore was its adoption in November 2018 of the revised Code of Ethics from the International Ethics Standards Board for Accountants (IESBA). This includes stronger provisions on independence and an exhaustive section on responding to non-compliance with laws and regulations (NOCLAR). In contrast, Singapore adopted the new IESBA Code of Ethics in January 2021.

Fraud reporting standards have been upgraded

HKICPA also updated the Hong Kong Standard on Auditing in September 2019 in relation to reporting fraud. While it still gives auditors a fair amount of latitude, it is an improvement on the general language of the previous version and a new appendix gives additional local guidance on how to make a report.

HKICPA is broadly up to scratch on setting standards

The FRC's assessment of HKICPA's standard setting work was broadly positive and said it was satisfied that the members of the Ethics Committee and the Auditing and Assurance Standards Committee were "aware of their roles and responsibilities". It noted that the Institute omitted to send out one IESBA consultative document for public comment during the assessment period (1 October 2019 to 31 March 2020), although other consultations were handled promptly. One further criticism was that HKICPA did not have policies in place to "proactively review" standards after they have been issued for some time. It should put such procedures in place.

Capacity is anyone's guess

Audit capacity is not being disclosed

One thing lacking in Hong Kong's audit ecosystem in recent years has been any report from the regulator on audit industry capacity. While other markets seek to report on the breadth and depth of skill and experience in their accounting industry, touching on such things as the average number of partners, directors, managers and associates per firm, the ratio between partners and staff, the hours spent by partners supervising audits, and how this is changing over time, nothing similar exists in Hong Kong. We only know that there are 44,269 HKICPA members, their average age is 43 and the oldest member is 100!

Next steps

Hong Kong joining IFIAR soon

We look forward to Hong Kong becoming a member of the IFIAR.

It may be time for some soul searching on audit quality

Ideas for raising audit quality in Hong Kong, including concepts adopted in other Asian markets, would be worth considering.

Disclosure on professional capacity would be helpful

A report from the FRC on professional capacity within the accounting industry, in particular the level of skills and experience among PIE auditors and the resources applied to audit engagements (such as Singapore requires through its Audit Quality Indicators programme), would be beneficial. Among other things, it would allow for a comparision of audit quality/strength in Hong Kong and other Asian markets.

7. Civil society & media

Hong Kong falls to 6^{th} place with a score of 60%

Hong Kong's score remained flat here at 60%, while its ranking slipped one place to 6^{th}. It did better on whether business associations and non-profit organisations were doing more to promote CG and ESG, but worse on questions looking at the independence and skills of the media. While Hong Kong has quite a vibrant civil society and its media is still relatively free to report, it pales in comparison to the higher ranked markets in this category, especially Australia and India.

A familiar story among the professions

Professional groups active on consultations but fragmented on promoting CG

Professional groups continued to be prolific in responding to regulatory consultations and are active participants on government and regulatory committees. Yet their efforts to raise awareness of good CG in Hong Kong are somewhat patchy and fragmented. Most include CG topics in their professional development programmes and keep abreast of core developments, but stop short of strong advocacy. It was disappointing to see a lack of public support on the WVR debate from these groups, with the exception of the Hong Kong Investment Funds Association and the CFA Institute.

A minority produce original research on CG and ESG

In contrast to higher ranked markets, there is less in the way of original research on CG and ESG issues from professional associations. However, a few are making a contribution. HKICPA produces useful reports, but they are largely auditor-centric. The Hong Kong Institute of Chartered Secretaries carries out surveys of its members on governance and capital market topics. In October 2019, for example, it published "Taking the temperature - The state of corporate governance practices in Hong Kong and the Mainland", based on a member survey. And the Hong Kong Institute of Directors, as also noted at the beginning of this chapter, publishes a corporate governance scorecard every three or four years.

The FSDC stood out for its sustainability and ESG reports

Although not a professional association, the ESG sub-committee of the Financial Services Development Council (FSDC) produced a well-regarded report on a sustainability strategy for Hong Kong in late 2018. It followed this up with further reports in 2020, one of which had the ambitious title, "Hong Kong - Developing into the Global ESG Investment Hub of Asia".

Business and NGOs step up

Hong Kong chamber shows some CG mettle

Although business chambers in Hong Kong are generally conservative in their outlook on CG reform, one taking a more balanced view of late has been the Hong Kong General Chamber of Commerce. It submitted a measured letter on corporate WVR to HKEX in April 2020 and took a constructive approach towards the review of the ESG Reporting Guide in a letter of July 2019. These submissions contrast with a much less enlightened one from June 2015 on the SFC's Principles of Responsible Ownership.

China Water Risk bolsters environmental governance advocacy

There has been no change on the NGO front as far as Hong Kong having an independent retail shareholder body goes - at this rate it will never have one. But some of the city's other NGOs have been active in the environmental governance and sustainability space. China Water Risk held a global water stewardship forum in November 2019 and hosted a conference on sustainability in January 2020. It publishes articles and reports aimed at companies and investors, including an evaluation of water risk in credit/equity portfolios, and in November 2020 published a series of "Survival Guides to Avoiding Atlantis", which benchmarks flooding risks from climate change for 20 coastal cities in the region.

Green finance group advances ESG topics

The Hong Kong Green Finance Association, set up in September 2018, features major ESG topics at its events, including one on green bonds in August 2020 and responsible investment/ESG during Covid in May 2020.

Nobody researches better than academics

Academics are still beavering away on CG research

In contrast to professional groups, Hong Kong academics are prolific in researching CG topics although increasingly the work is focussed on China. Still, in the past two years academics have covered most topical issues including WVR, board independence and corporate fraud.

The fifth estate needs to dig deeper

Local media skims over CG issues

Despite recent political threats to press freedom, Hong Kong still has a vibrant media scene and on the whole adequately covers CG issues as they emerge, including corporate misbehaviour, new laws, policies and regulations as well as consultations. What is lacking is original investigative work and broader coverage of Hong Kong corporate conduct. The city's main English-language daily, the *South China Morning Post* (SCMP), has been focussed on China companies for the past decade and gives only cursory coverage to the local corporate scene. Regional media is more proactive in delving into Hong Kong CG issues, but the local press tends to skim the surface. In part this is a reflection of resources, reporters being young, inexperienced and notoriously underpaid. The past year in particular has also seen media resources focus on the political developments in the city. Still, where there is coverage on CG issues the local press tends to give a bigger voice to local experts and business leaders who are inherently opposed to reform than non-establishment and international voices. Indeed, the coverage of WVR in the SCMP has been stark in omitting pro-CG voices entirely.

Next steps

Research could be broadened

Hong Kong civil society groups, including professional bodies, could expand their range and volume of original research on governance and ESG topics.

Time for a minority shareholder association

It would be nice to see Hong Kong develop its own minority shareholder association, especially to represent retail shareholders.

Scope for collaboration around sustainability governance

Locally based non-profits working in corporate governance, ESG and sustainable development could share resources and work together more collaboratively to help Hong Kong companies prepare for the advent and challenges of climate change.

Scope for investigative articles

Media could delve more deepy into governance issues in Hong Kong and provide investigative articles on local trends and corporate behaviour.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- ❑ Further rule changes or policies to extend WVR.
- ❑ No progress on universal whistleblower legislation and extra-territorial anti-corruption powers.
- ❑ Amendment of CG Code does not introduce lead independent directors, stronger disclosure standards, some element of sustainability governance
- ❑ New independent audit regulator fails to make progress on raising audit quality
- ❑ No revision to the SFC's Principles of Responsible Ownership
- ❑ Domestic institutional investors move slowly or not at all on stewardship

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ More closely align CG Code with ESG Reporting Guide and stewardship code. "Sustainability governance" is about more than ESG reporting.
- ❑ Domestic asset owners and managers could play a much more active and public role in prompting responsible investment, including reporting on their activities
- ❑ HKEX to introduce the lead independent director concept
- ❑ ICAC could produce clearer narrative on its enforcement actions and outcomes
- ❑ Extend third-party funding to litigation, not just arbitration
- ❑ HKEX to provide details of its regulatory funding and capacity building

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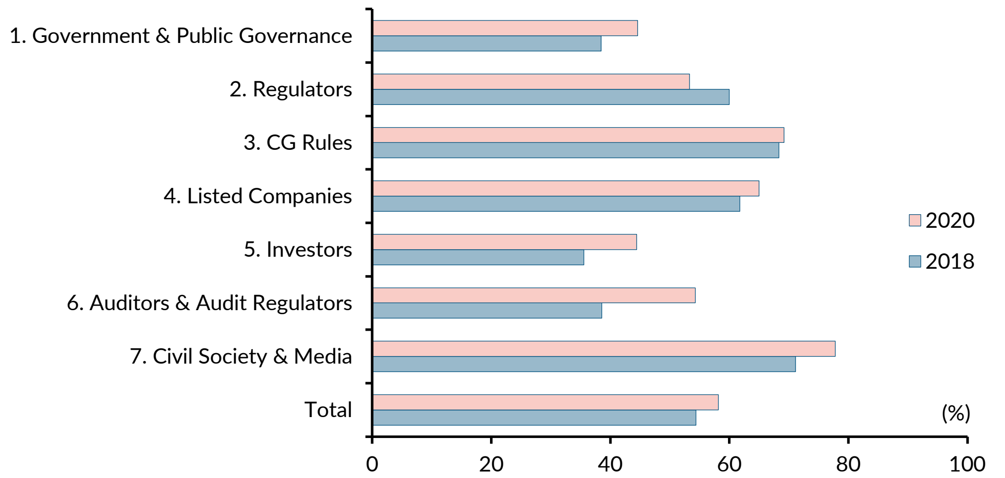
India – Lost in translation

- Corruption continued to plague the ordinary citizen
- Regulators failed to provide adequate information on their work
- Superior voting rights arrived, but with a hard sunset clause
- Stewardship code for mutual and alternative investment funds arrived, while the code for insurance companies became mandatory
- MCA and SEBI pushed for better ESG disclosure, but are they asking listed companies for too much data?
- There are too many chefs in the independent audit regulator kitchen
- Civil society, including media, continued to add to the dialogue, but the government did not brook opposition

Figure 1

India CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

India comes 7th again with a score of 58%

India continued to occupy 7th place overall in the rankings, improving its score by four percentage points to 58% in 2020. There are a number of reasons for its seeming lack of progress, the most significant being lack of transparency, from regulators not providing annual reports on time or at all, to the media either being censored or self-censoring. Meanwhile civil activists, including academics and environmentalists, find themselves arrested and being charged with either sedition under the Indian Penal Code or terrorism under the Unlawful Activities (Prevention) Act. Regulators argue that without transparency investors cannot make rational, balanced decisions nor can they trust the companies, yet the government does not seem to think that same logic applies to it.

Modi wins a second term

The year 2019 was a watershed for Prime Minister Narendra Modi and his Bharatiya Janata Party (BJP), landing a resounding victory for a second term in office. In May that year, the BJP won 303 seats in the Lok Sabha (lower house of Parliament), a larger mandate than it had in 2014, ensuring a super majority and the ability to push through its agenda, regardless of opposition. It was a remarkable feat for a man who had failed to keep most of his 2014 campaign promises, including minimum government and maximum governance, the creation of 20 million jobs every year, and a booming economy. In an opinion piece in the *Washington Post*, journalist Barkha Dutt noted that Modi's first national election "was built on aspiration", promising "acche din" (good days) and "vikas" (development), but the 2019 campaign had "little or no conversation about the performance of his government, the economy or jobs". Modi campaigned on a nationalist, populist platform, with the February 2019 airstrike on Pakistan playing a prominent role.

A strong mandate has led to less legislative scrutiny

In his second term, much of his policies have been coloured by nationalist rhetoric: Overnight revocation of special status of Jammu and Kashmir while a security lockdown and communications blackout was imposed, and the controversial citizenship amendment act. But as others have pointed out, given the strong mandate that the country awarded him, Modi 2.0 means he is essentially free to do what he wants. Most legislation has passed without adequate debate in Parliament, while select committees seem to hardly be referenced on detailed examination of legislative proposals. A case in point is the passing of three agriculture acts in September 2020 that set off large protests by farmers, leading to an impasse with thousands of farmers from Punjab and other neighbouring states building little townships on the outskirts of Delhi as they demand the repeal of the laws.

Tardy disclosure by regulators is a concern

Regulators proved to be the most disappointing as many failed to publish their annual reports on time, including the Lokpal (the Ombudsman), the Securities and Exchange Board of India (SEBI) and the National Stock Exchange of India (NSE). More concerning is the politicisation of government bodies, highlighted by the standoff between SEBI and the central government, with the Centre wanting the regulator to transfer 75% of its surplus cash to the government's coffers. Further, amendments to the Finance Act also requires SEBI to seek government approval of its annual budget. Even the push to extend the dual-class or "differential voting rights" framework by SEBI was rumoured to be because the government aggressively sought it. The Centre also chose to cut into the Right to Information Act, with amendments which critics say compromises its impartiality and independence. The central government now controls the tenure of the Chief Information Commissioner and information commissioners as well as having the authority to fix their salaries and other terms of service, compromising their impartiality.

The new audit regulator gets to work, but its powers are questioned

One of the few silver linings with regulators was that the independent audit regulator, the National Financial Reporting Authority (NFRA), began its work, but challenges remain as its powers are questioned both in and out of the courts. Meanwhile the Institute of Chartered Accountants of India (ICAI) continues to push to curtail the NFRA's powers. It is unsurprising that the courts are being used to question the regulator's powers as the government has been wont to push back on all its detractors, from environmentalists to the media, especially during the pandemic. The government took the media to court for publishing information on Covid that had not been officially sanctioned. Even as the government looks to jail those who question its authority as terrorists or seditionists, one judge decided to remind the Centre that "difference of opinion, disagreement, divergence, dissent, or for that matter, even disapprobation, are recognised legitimate tools to infuse objectivity in state policies" and "the right to dissent is firmly enshrined under Article 19 of The Constitution of India".

One positive is a mandatory stewardship code for mutual funds

Despite all this, there are glimmers of positivity: A mandatory stewardship code for mutual funds; a more comprehensive business responsibility reporting framework for companies that will provide meaningful data on sustainability; and investors becoming more willing to vote against resolutions that discriminate against minority shareholders.

Governance issues with the administration and judiciary remain

However, for India to really move forward, it needs to fix its governance mechanisms: The bureaucracy and its judiciary. While the country has moved up the rankings of the World Bank's Ease of Doing Business, the corporate governance environment remains very much a work in progress.

Recapping CG Watch 2018

Little progress made on 2018 suggestions

To what extent did India implement our recommendations from 2018? Unfortunately, only the appointment of an ombudsman was in line with our suggestions. Gaps in enforcement disclosure remain, state-owned enterprises continue to avoid CG rules and the release of AGM notices 28 days before meetings is still an aspiration.

Creation of ombudsman is the only positive

Figure 2

India: Recap of 2018

	Recommendations	Outcomes
1.	Appoint an ombudsman ("Lokpal")	Established in 2019
2.	Improve enforcement disclosure on regulatory websites and annual reports	No change
3.	Ensure public sector units (state enterprises) comply with all CG rules	No change
4.	Release AGM notices 28 days before date of meeting	No change

Source: ACGA

1. Government & public governance

India climbs to 7th place with a score of 45%

India increased its score by seven percentage points to 45%, boosting its rank from 9th to 7th place, trailing Japan, Korea and Singapore, all of which scored 60% - showing that India has much to do. The area where India showed marked improvement was in bank governance, while it achieved marginal progress in other sections: Ethics of civil servants, the governance of listed government-controlled companies, public sector enterprises (PSEs), government support for regulators, and a credible and consistent government strategy on CG. Areas where the performance remained static included the IPO system, the funding model for SEBI, how well the judiciary is handling securities cases and the availability of legal remedies for minority shareholders. Meanwhile, India fared poorly in the effectiveness of anti-corruption agencies and the autonomy of the securities commission.

Bank governance improves, on paper

Bank failures define the landscape

Banks have been at the centre of a number of failures over the past decade, which has brought into question not only the efficacy of the Reserve Bank of India (RBI) but the rules and regulations governing lenders. RBI's reputation has also been rocked by public spats between the central government and two previous RBI governors who resigned, Dr Raghuram Rajan in June 2016 and Dr Urjit Patel, his successor, in December 2018.

Damage control is underway after spats

In contrast, the past two years have been fairly quiet vis-à-vis public disagreements between the regulator and the central government after Shaktikanta Das, a career civil service officer who has served in various posts and departments, took over the reins from Patel in December 2018. In the calm, the RBI has been trying to repair its image in the face of the numerous scandals that have engulfed the financial sector over the past few years, while also trying to bring stability to the market following the economic upheaval of Covid. Cybersecurity, liquidity, director compensation and measures to align the regulatory framework with global best practices with regard to CG and risk management were just some of the issues that the central bank has worked on. Others include:

- A tightening of fit and proper criteria for Public Sector Bank (PSB) directors (August 2019 and June 2020);
- Guidelines on compensation for Whole-Time Directors/CEOs/Material Risk Takers and Control Function Staff (effective 1 April 2020); and
- New directions for lenders on a Prudential Framework for Resolution of Stressed Assets (July 2019).

The Reserve Bank beefs up its powers

The past two years, though, have not been without controversy. Supervision remains a huge issue. Three bank failures: Punjab and Maharashtra Co-operative Bank (PMC) Bank, Yes Bank and Lakshmi Vilas Bank (see box below), cost their depositors and investors dearly. This has the market questioning why RBI is continuously playing catch up, especially when it comes to banks that they are auditing regularly. Meanwhile, RBI has been busy shoring up its powers. Key changes include:

- Amendment to the RBI Act in 2019 to enhance its regulatory and supervisory powers of the Reserve Bank over non-banking financial companies (NBFCs);
- Strengthening the risk management system at NBFCs with asset sizes of more than Rs50 billion (US$690m) by mandating the appointment of a chief risk officer (May 2019);
- Releasing the Technology Vision for Cyber Security for Urban Co-operative Banks 2020-2023 (September 2020); and
- Merging the three supervisory departments for banking, co-operative banking, and non-banking into one department of supervision (November 2019).

Governance continues as a Reserve Bank theme

Governance and the regulator's goal of aligning the regulatory framework with global best practices continued to be a theme the Reserve Bank pursued in 2020 as it released its Discussion Paper on Governance in Commercial Banks in India in June 2020. The paper included a number of far-reaching proposals, including:

- Empowering the board of directors and spelling out their overall responsibilities: To be responsible for the culture and values of the banks by setting the "tone at the top"; recognising and managing conflicts of interest; risk appetite, management and assurance; and oversight of the board.
- Improving board structure and practices, including the composition and role of board committees, role of the board chair, and the need for board evaluation.
- Qualification and selection of board members, including a stringent set of disqualification criteria in addition to those already in the Companies Act, 2013 and the Banking Regulations Act.
- The role, expectations and selection of senior management, which included directions on succession planning of whole-time directors and CEOs on the board.

Proposed cardinal change at private banks draws ire

Following this clarion call to improve the governance framework at banks, the RBI then took a big step backwards. On 12 June 2020, it published for consultation the Report of the Internal Working Group to Review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks. This contained recommendations that would radically alter the banking landscape by allowing large corporate or industrial houses and large NBFCs, even those owned by corporate houses, to operate banks. Even though this was only one of the proposals, it was definitely the most contentious - with one exception, all the experts consulted by the working group disagreed with the idea. In its annex, the working group said the experts believed such entities should not be eligible for bank licences because the prevailing CG culture was not up to international standards, making it difficult to ringfence the non-financial activities of promoters (controlling shareholders) with that of the bank. Although the group recognised numerous risks involved with allocating licences to such organisations, including potential misallocation of credit, connected lending and extensive anti-competitive practices, it still saw fit to endorse the proposition as one of the best means of mobilising capital for the country's growing economy.

Shades of green

Climate disclosure policy drifts

Despite the progress the RBI has achieved, an area it has not made as much progress in is climate-related financial disclosure policy. The central bank often likes to point to its 2007 notification, Corporate Social Responsibility, Sustainable Development and Non-Financial Reporting - Role of Banks, which emphasised the need for non-financial reporting and advised financial institutions to take note of global initiatives and adhere to sustainable development practices. However, beyond that, no structure has been provided for climate risk disclosure. India may be a signatory of the Paris Agreement on Climate Change, but the RBI has not yet become a member of the Network for Greening the Financial System, an alliance of global central banks committed to scaling up green finance. Moreover, it gives no indication that it will do so any time in the near future.

A nod to green finance

Green financing has nevertheless gained some traction over the past few years: The RBI noted in its 2018-19 annual report that India had made progress in terms of green bond issuance and green financing, with the central bank's inclusion of lending to social infrastructure and renewable energy projects within its priority sector lending guidelines. It also stated that green finance faced many challenges and that policy action was needed to establish an enabling framework, but there did not seem to be any follow-through. In its latest annual report, however, the regulator once again affirmed the need for central banks and regulators to show leadership in promoting ESG principles through standardised terminology, standard disclosures format for firms, and by incorporating ESG principles in financial stability assessments. Additionally, one of the goals it has identified for supervision at commercial banks in 2020-21 is the assessment of risk and compliance culture and business strategy, with special attention to the unique risks posed by climate change and implications for the supervisory framework.

RBI sometimes has to use its moratorium powers to manage failed banks

RBI plays doctor

One powerful regulatory tool at the RBI's disposal is the moratorium. This allows the regulator to take control of a bank's board, curtail lending, investments and withdrawals until such time as the financial situation can be stabilised through an amalgamation or a reconstruction plan that usually involves roping in various white knights to infuse capital into the stranded bank. It is a hand that has been played by the RBI three times in the past two years and is a big deal. However, at the end of the process, the market is often left asking one question: Why did the regulator not see this coming?

PMC Bank was under moratorium for six months in 2019

In September 2019, the Punjab and Maharashtra Co-operative (PMC) Bank was placed under moratorium for an initial six months, with depositors only allowed to withdraw Rs1,000 (US$13.93) per month, later increased to Rs40,000. PMC Bank's case was due to alleged fraud: Senior bank officials gave loans to financially troubled Housing Development & Infrastructure Ltd (HDIL) totalling more than Rs60 billion, 73% of its loan book, and were accused of creating more than 21,000 fictitious accounts to hide them. Senior PMC officials and HDIL's founders and controlling shareholders, Rakesh and Sarang Wadhawan, were arrested by the Economic Offences Wing (EOW) of the Mumbai police. The moratorium continues while a revival plan is being worked out.

Yes Bank also runs into trouble

Six months later, RBI placed Yes Bank, the fourth-largest private sector bank, under moratorium on 5 March 2020. It was unable to raise capital to address potential loan losses and resultant downgrades. There were also serious governance lapses and practices in recent years and a failure to provide a credible revival plan. Its moratorium was lifted on 18 March, following the approval of the Yes Bank Limited Reconstruction Scheme, 2020. The scheme was a public-private sector partnership, including among others State Bank of India, Housing Development Finance Corporation and ICICI Bank, infusing capital into the bank. The story, however, did not end there as one of the founders, and former MD and CEO, Rana Kapoor, was arrested by the Central Bureau of Investigation on 7 March for purportedly entering into a criminal conspiracy in 2018-19 with the promoter director of the Dewan Housing Finance Corporation (DHFL), another housing finance company, to provide it with loans, while Kapoor and his family members were allegedly given Rs6 billion in kickbacks. On 9 March, the Enforcement Directorate added to Kapoor's woes by registering a money laundering case against him.

A swift moratorium at LVB breaks records

To round off 2020, Lakshmi Vilas Bank (LVB) was also put under moratorium in November 2020, but it was the shortest moratorium in history. The RBI announced the moratorium on 17 November, followed a few minutes later by the disclosure of LVB's amalgamation with DBS India, a fully-owned subsidiary of Singapore-based DBS Bank. LVB had been under the RBI's Prompt Corrective Action (PCA) framework since September 2019 due to high non-performing assets (NPAs), insufficient capital and negative return on assets breaching the PCA thresholds. Again, absent a credible revival plan, the RBI took matters into its own hands and made the moratorium and amalgamation. The amalgamation became effective on 27 November and LVB began functioning as branches of DBS India. Here too, fraud is alleged to have occurred with the EOW arresting two senior LVB officials in September 2020 for having a role in the misappropriation of fixed deposit receipts worth Rs7.29 billion held in the account of Religare Finvest.

Still waiting for a clean slate on graft

Corruption: No end game in sight

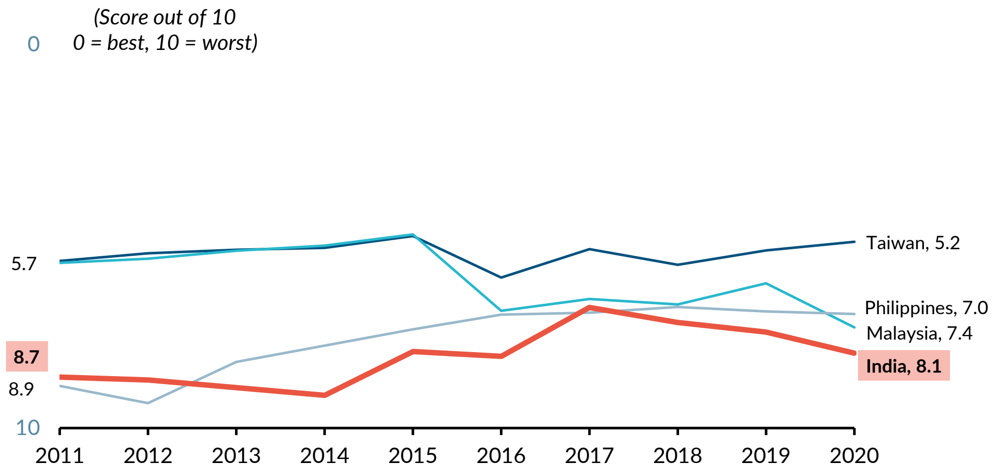
The bank frauds suggest that Modi's campaign slogan in his first term, "Bhrashtachar mukt bharat" (Corruption Free India), is far from being a reality. There are divided opinions on how successful he has been in delivering on this promise. His biggest and most contentious move was in 2016, removing all Rs500 and Rs1,000 bills, which accounted for 86% of the currency in circulation, from the market on the basis that it would combat "black money", corruption and counterfeit cash used to fund terrorism. As India enters the halfway mark of the Bharatiya Janata Party's (BJP) second term, it has become clear that corruption is not at the top of its agenda as banking fraud escalates and the common man continues to be a victim of graft. However, what has continued to be a boon for citizens is the digitalisation of services, cutting out the middleman, although that has a long way to go.

India is falling in global graft rankings

Two international surveys that highlighted the downward slide were the 2020 Corruption Perceptions Index (CPI), published by Transparency International, and the latest Political & Economic Risk Consultancy (PERC) survey, published in March 2020. India fell six places in the CPI rankings to 86th, alongside Morocco, Burkina Faso, Trinidad and Tobago, Turkey and Timor-Leste, while PERC rated India dead last in its ranking of 16 countries, including the US, Australia, Cambodia and Indonesia. The CPI pointed to the dangers of opaque campaign financing as one of the reasons why India slipped, but PERC also cited the increasing bank frauds, property registration, land issues as well as bribes to police as reasons for the fall to the bottom. The year was capped by the Global Corruption Barometer, also published by Transparency International and released on 9 December 2020, which found that India had the highest bribery rate in Asia: Nearly 50% of those who paid bribes were asked to do so.

Figure 3

Bad and getting worse: Perceptions of corruption in India, 2011-2020



Source: Political & Economic Risk Consultancy

An unusually potent weapon hits the mark

The power of information

One of the few means that Indians have to fight corruption is through the Right To Information (RTI) Act, enacted in 2005. For activists and ordinary citizens, the law is a lifeline to obtaining information, with certain exceptions, from public authorities. In 2011, Yale University did a study on whether the RTI Act actually helps to reduce levels of corruption. The study concluded that an RTI request was as effective as paying a bribe to an official to get service.

Legal amendments water down Information Act

According to the 2019 state transparency report, published by Transparency International India, more than 30 million RTI applications had been filed between October 2005 and October 2019. And when changes were introduced to the RTI Amendment Bill 2019, activists pushed back but to no avail. The bill was passed in July 2019, with observers citing certain clauses that effectively hobbled the Act. Prior to the amendments the Chief Information Commissioner and information commissioners in Delhi had parity with the Chief Election Commissioner and election commissioners in the terms and conditions of their service and tenure. However, the amendments empowered the central government to make rules to decide the tenure, salary, allowances and other terms of service not only of information commissioners of the Central Information Commission but also of state information commissioners. To the states this feels like federal infringement on their rights.

The BJP has a poor record on appointing information commissioners

While no government can claim to have been a friend of the Act, RTI activists say the BJP government has had a particularly poor record when it comes to appointing information commissioners. In fact, not a single appointment to the Central Information Commission, a statutory body set up to enforce RTI complaints, was made unless citizens went to court.

Lokpal appears

An ombudsman finally appears . . .

On the upside, the BJP finally appointed a Lokpal, or Ombudsman, in March 2019 after five years of inaction. It was a welcome move and one that we give points for, having stated in our last survey that establishing it would be a quick fix. But that is where the good news ends.

. . . but is slow off the mark and not fully functioning

While the institution is less than two years old, the government has had more than five years to ensure that its implementation would be seamless. The rules for filing complaints were only notified a year after it was formed, but its inquiry and prosecution wings have still not been established. No annual reports have been issued since its inception even though it is supposed to present a report annually to the president. The only real information over the past two years has been a set of statistics on the number and type of complaints against public servants, including members of parliament, as well as complaints pending with other agencies, such as the central vigilance commission (CVC) and Central Bureau of Investigation (CBI), and some actions taken throughout the year. Most surprisingly, the Lokpal did not explain why complaints had collapsed from 1,427 in 2019-20 to a mere 95 in 2020-21, not to mention the fact that 1,218 complaints received in 2019 were deemed beyond its jurisdiction.

A judiciary under pressure

India has a backlog of nearly 40 million court cases

For anti-corruption efforts to work, a country needs a functioning judicial system, but India's is stymied by lack of resources, a low judge/population ratio and corruption, especially in the lower courts. In answer to a question in the Rajya Sabha (upper house of parliament) on 22 September 2020 on the total number of pending cases in the Supreme Court, high courts and the various district courts, the Ministry of Law and Justice wrote that it totalled almost 40 million! Factor in that there are four vacancies on the Supreme Court and 414 vacancies in high courts as of 1 December 2020, and the idea of receiving timely dispensation of one's case becomes moot.

There are calls for reform in appointing judges

A major problem is the manner in which judges are appointed to the Supreme Court and High Court: Many consider the collegium system (whereby the Chief Justice and the four senior most Supreme Court justices recommend judicial appointments and transfers) is broken because it is not transparent, open to nepotism and favouritism, and can be decidedly political since the government can send names back for reconsideration, with or without reasons. Names have been in the loop for more than three years at a stretch since there is no time limit on how long the government should take to review judicial appointments.

The legal system deflates a pro-business bubble

Even lawmakers have questioned the government on how this state of affairs affects Modi's ease of doing business dreams. The World Bank's Ease of Doing Business ranking, which scores countries on how conducive the regulatory environment is to start and operate a local business, is central to Modi's plans of encouraging foreign investment in the country as well as regulatory reforms that might be needed. The government uses the indicators to drive legislative changes. So when the country jumped 14 places to land in the 63rd spot in the 2020 overall rankings, it was a moment of celebration. However, being ranked 163rd out of 190 nations in a sub-topic on enforcing contracts showed how far the government has to go in terms of judicial reform.

Next steps

Tangible action on climate risk is needed

The Reserve Bank needs to provide a credible climate-risk disclosure framework for financial institutions. Merely stating that central banks and regulators need to provide leadership without taking action itself is insufficient. It is imperative that the RBI works with its peers on this issue.

Come clean on work of the ombudsman

The Lokpal has to be far more transparent about its work. An annual report should not just be tabled in parliament, which has not happened so far, but should also be available for the public. Its various departments, including the inquiry and prosecution wings, should already be implemented.

Appoint more judges more quickly

Courts need to be working at full capacity: How judges are appointed, and how long it takes for appointments to be approved should be reviewed and modified.

State-owned and not loving it

SOEs historically given a free pass on many key CG rules

Historically, India has given its state-owned listed companies a free pass on several key CG requirements: The 25% public float, minimum number of independent directors, and even the groundbreaking 2014 requirement for one woman director (converted to one woman independent director in May 2018). The State Bank of India, generally regarded as one of the better governed public-sector undertakings (PSUs), has even invoked the State Bank of India (SBI) Act to excuse itself from electronic voting regulations, claiming the SBI Act required its shareholders to be physically present. Predictably, the pandemic and ban on in-person meetings as well as a May 2020 directive from the Ministry of Corporate Affairs (MCA) to hold virtual AGMs and EGMs, shifted that storyline.

SEBI has removed some exemptions, but still there are SOE rule-breakers

Although SEBI has over the years tried removing some exemptions provided to PSUs, even on the public float, that has not ensured compliance. In the first quarter of 2019, the National Stock Exchange fined more than 250 companies, of which 30 were PSUs, for non-compliance with various regulations of the listing rules.

In November 2020, however, with the proposed listing of the Life Insurance Corporation of India (LIC) in the air, SEBI released a consultation paper reviewing the requirement of the minimum public float for large issuers with market cap of more than Rs100,000 billion, proposing that such companies should achieve the 10% public float within two years and 25% public float within five years from date of listing. As one observer noted, if this rule goes through, as is expected, then what is to stop this exception being extended to all other PSUs?

Investors call time on rule flouters

However, sometimes regulatory action is not enough and the market needs to push back. This is what happened during the 2020 voting season on the issue of women independent directors. Although SEBI had mandated that the top 1,000 companies in India must have at least one independent woman director by March 2020, local proxy advisor Institutional Investor Advisory Services (IiAS) noted in April 2020 that about 45% of PSUs had not complied. During the 2020 voting season, more than a quarter of 188 resolutions on director re-appointment at 45 PSUs attracted votes against from 20% or more of institutional investor votes cast. Some resolutions received votes against of 40% to 50% or more. Institutions also voted against the appointment of directors at PSUs that did not have an independent woman director, and against executive directors who were appointed to audit committees or nomination and remuneration committees, according to data from IiAS.

The government needs to step up its game on SOE boards

A large part of the blame for this state of affairs lies with the administrative ministry of the government that has responsibility for all board appointments. All listed companies have nomination and remuneration committees, including PSUs, and we believe should be permitted to use them. If the government allowed these committees to nominate independent and non-executive directors to their own boards, decentralising decision-making and giving a signal to the market that governance mattered, this would benefit not only the PSUs but the government in its disinvestment strategy.

2. Regulators

India drops to joint 6th place with a score of 53%

India had its steepest fall in this section, losing seven percentage points to score 53% in 2020. It dropped three places to rank joint 6th with Korea and Malaysia. The biggest contributor to this spectacular fall was lack of information: From SEBI not publishing its 2020 annual report (as of November 2020 when we completed our scoring) to poor enforcement data from the exchanges.

Numerous government agencies have a role in securities regulation in India

India's securities market is regulated by SEBI, which comes under administrative control of the Ministry of Finance (MOF). The two stock exchanges, NSE and BSE, perform a frontline regulatory role for listed companies. Other entities have a role in the securities market: The Ministry of Corporate Affairs (MCA) enforces the Companies Act; the RBI acts as the central bank; and the Insurance Regulatory Development Authority (IRDA) plays a role in promoting investor stewardship. Like many securities commissions in Asia, SEBI has limited decision-making autonomy from government and its board of directors includes representatives from major state entities, in this case MCA, RBI and the Department of Economic Affairs (DEA), a department under the MOF.

Data gaps and dual-class shares drag down score

Within India's score, the sub-category of Funding/Capacity Building/Regulatory Reform fared worse than Enforcement because of the lack of information from the regulator that also gave rise to questions about political interference, which was noted even in our 2018 survey. India has gone down the same road as other jurisdictions by introducing dual-class shares, called "differential voting rights" (DVR), while the future of the SEBI chairman has been a point of speculation since 2019. SEBI's website is chockful of information but it is not easy to glean essential data, so an annual report is vital to understanding enforcement, regulatory issues, and the staffing structure at the regulator. Its fiscal 2020 report (to March 2020) was finally published in February 2021, but lacked details on funding. The regulator does publish a useful monthly bulletin that provides data on regulatory developments for the month, but it lacks a narrative explanation for changes in the data and is not a substitute for an annual report. The BSE, meanwhile, publishes a fairly comprehensive annual report but its enforcement data is not descriptive enough, while the NSE provides no data on its role as a frontline regulator in its annual report.

Scant progress in key CG areas

Unfortunately, this section did not see any major improvements except with regard to the regulator's powers. Areas where scores did not change included the extent to which the IPO regime requires companies to implement meaningful CG prior to listing (we think it fails in this regard) and disclosure by stock exchanges of enforcement data and supporting explanations of their enforcement activities. In addition, there was no progress on the management of conflicts of interests between the commercial and regulatory functions of the two exchanges.

2.1 Funding, capacity building, regulatory reform

India drops to 7th place with a score of 51%

India suffered a precipitous drop of nine percentage points to score 51% in this sub-category, with its rank falling five places to 7th. This was largely due to uncertainty about SEBI's financial independence and concerns about political interference in the regulator's operations. There was also a lack of clarity about funding and capacity building, not just with the securities regulator but also at the more dominant exchange, the NSE.

No decent data from NSE

While the BSE produced annual reports for 2019 and 2020 in a timely manner, the same could not be said of SEBI and NSE. In terms of enforcement and capacity building at NSE, there is little information to glean as it discloses the bare minimum in its annual report. We know for the fiscal year ended 31 March 2020 it had 1,101 employees, of which 29% were female (although just one of the nine top managing directors was female) and that staff received 11,250 hours of training. Its annual report does not have a section on enforcement.

Regulatory funding uncertainty

The government wants SEBI's money

There has been growing tension since CG Watch 2018 between the government and SEBI regarding funding. SEBI has, until now, had financial autonomy by means of a separate fund under Section 14 of the Securities and Exchange Board of India Act. This is primarily comprised of grants and fees on stock exchanges and brokers, as well as the processing of IPOs, debt issues, and mutual funds. But the surplus that it holds in its general fund is one that the government would like to get its hands on, while SEBI believes that financial independence is vital to its function as a regulator.

A legal redraft to funnel surplus back to the government

The long-brewing disagreement between the two came to a head in 2019 at finance minister Nirmala Sitharaman's maiden Union Budget speech when she announced that the SEBI Act would be modified. The Finance Bill 2019 proposed that after transferring 25% of the general fund that SEBI maintains under section 14 into a separate reserve fund, the surplus should be moved to the consolidated fund of India, basically back to the government. Beyond the money, the changes would also require the Centre to approve its capital expenditure plans. The Finance Act 2019 was passed in August 2019 but SEBI had, as of end 2019, not transferred the funds.

SEBI fights on

According to media reports, SEBI had written to the Department of Economic Affairs to review the matter. The SEBI Employees Association had also written to the government opposing the move. SEBI had in excess of Rs40 billion (US$560m) in the general fund as of 31 March 2019, but the market continues to be in the dark about the conclusion of discussions. Since the Finance Act has been passed, one wonders what can actually be done because it seems highly unlikely that the government will back down. As of early Q2 2021, there had been no new reports on this issue.

Ham-fisted handling of top SEBI appointment

The uncertainty was further compounded in January 2020 when the government, a few weeks before SEBI chairman Ajay Tyagi's term ended at the end of February, put out an advertisement inviting eligible candidates to apply for the post. It had been expected that the government would offer Tyagi a further two years in office, but on 29 February the MOF extended Tyagi's term by just six months and then in August further extended his tenure by 18 months to February 2022. This gave the impression of a government attempting to weaken the market regulator, first through its fiscal policy and secondly through piecemeal extensions for the SEBI chairman.

MOF holds up release of SEBI annual report

The central government also had a hand in the long delay in the publication of SEBI's fiscal 2020 annual report. Although Tyagi forwarded it to the MOF on 25 June 2020, the ministry sat on it for more than eight months.

SEBI appears understaffed

SEBI meanwhile has yet to release its annual accounts for the 2019-20 financial year and there was no estimate of its expenditure in the 2021-22 budget announced on 1 February 2021. SEBI's income in the financial year ending 31 March 2019, according to its accounts, was Rs9.64 billion (US$135m). Salaries, allowances and bonuses as well as recruitment expenses all increased from the previous year while total expenditure rose approximately 16% to Rs4.92 billion. The sizeable surplus generated remains in the general fund, which accounts for the large reserves held by the regulator. Nevertheless, as we have argued in our previous CG Watch reports, the market regulator appears woefully understaffed given the size and complexity of the Indian market. As of 31 March 2020, total staff numbered 868, up from 785 staff in 2019 and 794 in 2018. This is about half the number of staff working on securities supervision in Japan and also below Hong Kong, Korea and Taiwan.

The exchanges fare better

Funding for the exchanges is much more straightforward. They have always been self-funded mainly through transaction charges, listing fees, and book building fees. In 2019, NSE's total income increased by approximately 17% to Rs30.3 billion, while BSE, which is the only listed exchange, reported a decline in income to Rs6.3 billion in FY2019-20 from the previous year's Rs6.87 billion. It explained that the fall in income was mainly due to lower investment income, down 29% on account of buying back its own shares.

Data on regulatory resources at bourses lacks detail

To promote transparency, stock exchanges in India are required by the securities regulator to disclose the resources committed to regulatory functions and compliance, backed by activity-based accounting. NSE's annual report, however, only states that it has dedicated resources to its regulatory work. BSE does disclose an actual figure: For the 2019-20 financial year, it spent Rs211.6m on regulatory oversight and compliance. Meanwhile, the Multi Commodity Exchange of India (MCX) went further in disclosing not only resources allocated to its regulatory role but specific costs involved, as well as the headcount in each of the departments dealing with regulatory compliance. To India's credit, it should be emphasised that it is the only market in the region that requires this level of transparency from its securities exchanges - a policy we would like to see extended to SEBI itself, properly enforced in India, and applied by all regulators and exchanges around the region.

The exchanges get a pep talk from SEBI chair

SEBI chairman Tyagi's speech at the 2019 SEBI-OECD Asian Roundtable on Corporate Governance in Mumbai in November 2019, noted that the regulator had advised exchanges to boost their capacity and manpower to meet their responsibilities as frontline regulators. He added that while exchanges needed to have sufficient resources to meet their regulatory obligations, their own conduct should always be above board as well.

Capacity building

Tech revolution takes shape at SEBI and the two bourses . . .

For a number of years, the securities regulator and exchanges have been embracing technology. In its 2019 annual report, SEBI talked about its new four-year IT roadmap, which included:

- Building a private cloud to cater to SEBI's infrastructure needs;
- Building a progressive "data lake" solution (ie, repository for raw data) to leverage advanced algorithms and artificial intelligence to address critical challenges in data analytics;
- An enterprise-wide security and network operations monitoring solution;
- Regulatory collaboration for data;
- Permitting a regulatory and innovation sandbox; and
- Facilitating the use of artificial intelligence and machine learning in the securities market.

. . . but cost of tech upgrades hard to fathom

The regulator noted that it was developing a project that would allow it to gather data from various intermediaries into its own database and develop algorithms that would help detect breaches of regulatory guidelines along with alerts on possible non-compliance. What has been difficult to surmise is how much has been spent by the regulator towards these projects, or how much it has budgeted for them.

AI is used by BSE to verify rumours

In 2020 BSE enhanced its RegTech processes by scaling up its big data platform and improving social media analytics through AI. It also used AI to capture news and help with rumour verification. There is no information in NSE's annual report about any technological improvement for regulatory matters besides generic statements that it deploys a robust supervision and enforcement mechanism and introduced surveillance and supervisory initiatives.

Regulatory reform achievements

A raft of CG upgrades takes place

SEBI's regulatory reforms have been a melting pot of governance and sustainability, with a number taking place against the backdrop of fraud in the market. In its 2019 annual report, SEBI noted that in the coming year it would be reviewing issues around CG, specifically ESG disclosure. Reforms included a number of amendments stemming from the 2017 Kotak Committee on Corporate Governance report, produced by SEBI to upgrade the CG of listed companies, to be implemented in 2019 and 2020. These included:

- A requirement that the top 500 listed companies (as opposed to the top 100) have a risk management committee;
- Mandating that two-thirds of all directors on nomination and remuneration committees be independent;
- Disclosure by issuers of a "skills matrix" for the board by 31 March 2019 and list the skills of individual directors by name in their 2019-20 annual reports; and
- A requirement that an independent female director be appointed to all listed companies by 1 April 2020.

Other recent reforms instituted by SEBI have included:

- The extension of business responsibility reporting (BRR) to the top 1,000 listed companies in December 2019 followed by a new and much more complicated and lengthy business responsibility reporting framework to be introduced for FY2020-21.
- Listed companies mandated in November 2019 to disclose loan defaults within 24 hours of failing to repay principal or interest amount beyond 30 days.
- Companies must disclose if a forensic audit has been initiated, who initiated it and reasons why, from October 2020. A final forensic audit report must be disclosed with comments from management.

SEBI delays key board reform . . .

A split of key board roles is mandated

One of the key recommendations in the 2017 Kotak Committee on Corporate Governance report which SEBI accepted was the splitting of the role of chair and managing director. This particular issue gained prominence in 2009 after the Satyam corporate governance scandal and then found its way into the amended Companies Act, 2013. In 2018, SEBI announced that by 1 April 2020 the top 500 listed entities would have to split the roles, that the chair must be non-executive, and the chair could not be related to the managing director or CEO. It is worth noting that SEBI's diktat is stricter than the Companies Act, which states that the chairman and CEO or MD of a company should be separate unless allowed by the articles of a company or if the company does not undertake multiple businesses.

Some boards do a shuffle to comply

On 20 November 2019, Ajay Tyagi, chairman of SEBI, stated that only about a third of the top 500 listed companies still needed to separate the two roles. On 20 December, multinational Mahindra & Mahindra announced its succession plan for director and key managerial positions, including Anand Mahindra moving from executive chairman to non-executive chairman on 1 April 2020. According to Mahindra & Mahindra's announcement, its managing director, Dr Pawan Kumar Goenka, would be re-designated as MD and CEO for a period of a year from 1 April 2020. Dr Anish Shah, then Group President (Strategy), would become CFO for the same time period and an additional director until the next AGM. He would then take over from Goenka as MD/CEO on 1 April 2021.

SEBI bows to pressure amid backlash

However, in late November 2019, two industry bodies, the Federation of Indian Chambers of Commerce and Industry (FICCI) and the Confederation of Indian Industry (CII), wrote to the finance minister, Nirmala Sitharaman, asking her to reconsider the move. They argued that India was "different" and the decision to separate the two roles should be left to a company and its shareholders. On 13 January 2020, SEBI bowed to pressure and extended the deadline on the rule coming into effect from April 2020 to April 2022.

A mixed response to the U-turn emerges

Still, some market observers agreed with the decision and presumed it was a reaction to a slowing economy. SEBI itself never provided any reasons as to why it chose to postpone the regulation but did state categorically that it was only a postponement. The market is still waiting to hear more, a state of affairs unlikely to change until 2022.

. . . and joins the bandwagon on dual-class shares

India joins the regional race to the bottom on DCS

This was not the only issue where SEBI weakened: It fell prey to the lure of dual-class shares or differential voting rights (DVR) as they are known in India. Unlike other jurisdictions, India already had a DVR framework in place, but one with an unusual twist: Listed companies have been allowed to issue shares with fractional voting rights (ie, less than one vote per share) since 2009. A March 2019 Consultation Paper on Issuance of Shares with Differential Voting Rights was to extend that framework to include superior voting rights (more than one vote per share) for companies coming to market. Superior voting rights had actually been banned by SEBI in 2009 due to concerns over their misuse. Hefty lobbying was however at play, including by advocacy group IndiaTech, based in Gurgaon. A couple of high-profile ecommerce companies had purportedly also threatened to list elsewhere.

Here we go again . . . the justifications are familiar

Arguments put forth in the consultation for allowing superior voting rights had a familiar ring to them: Helping new technology firms retain control in case of a hostile takeover bid, and assisting promoters and founders to maintain control because having them at the helm was of great value to all shareholders. It is noteworthy that hostile takeover bids are extremely rare in India, with only one reported case in more than a decade. As for majority shareholders, capital market history in India has shown that they have rarely had problems keeping control of their companies.

We say DCS conflicts with other key SEBI policies

In ACGA's reply to the consultation, we noted that the move to allow superior voting rights was at odds with SEBI's principal CG policies to date, including pushing mutual funds to becoming better stewards at their investee companies. The voting history of mutual funds showed that India did not have an institutional investor base with the breadth and depth needed to counteract the negative effects of DVR, including misalignment of interests among shareholders, excessive compensation of management, and management entrenchment and expropriation - all risks highlighted in the consultation.

To its credit, SEBI imposes stronger restrictions on who can access DVR

The good news, however, was that just two months after the consultation concluded, SEBI approved a new framework that addressed certain risks ACGA had highlighted in our submission:

- DVR would only be available for tech companies, defined as those which were intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition, coming to market. In other words, DVR is not an option for all IPOs, a positive in our view because such an outcome would inflict long-term damage on investor protection in the Indian market.

Significant limits on the scope of DVR in India

- To ensure that big industrialists were kept out of the game, the net worth of a founder or promoter could not exceed US$70m (not including the value of their shares in the company coming to IPO). According to SEBI, this was done by design because the framework was only intended for first-generation entrepreneurs whose main asset was most likely intellectual capital. This is an innovative rule by regional standards and significantly limits the scope of DVR in India.

- A proposed five-year sunset clause could only be extended once by a further five years, and shareholders with superior rights would not be allowed to vote on the resolution. Again, a refreshing and stricter approach than regional standards: Other markets that have introduced dual-class shares such as China, Hong Kong and Singapore have not set firm sunset clauses, which is the key investor safeguard that institutional investors want to see.

Other than the above measures, the framework quite closely followed the one adopted by Hong Kong and Singapore in 2018, including:

- DVR shares could only be issued to promoters or founders who have held an executive position in the company for at least six months prior to the filing of the red herring (ie, draft) prospectus.
- After the public issue, DVR shares would be subject to a lock-up until they are converted to ordinary shares. The transfer of these shares will not be allowed, nor are promoters allowed to pledge them.
- Companies with DVRs must have enhanced corporate governance by ensuring that at least half of the board and two-thirds of all mandatory committees be comprised of independent directors. The audit committee, however, must only be made up of independent directors.
- Post-IPO, shares with superior rights will be treated as ordinary shares when voting on things such as: The appointment or removal of independent directors and/or auditors; a willing transfer of control to another entity; any related-party transaction which involves the controlling shareholder; a voluntary winding up of the company; and the initiation of a voluntary resolution plan under the insolvency and bankruptcy code.

There have been no takers yet

Once the framework was announced, SEBI told ACGA that it had received queries at the end of 2019 but that the market felt the conditions were too stringent to attract listings. There were even certain corners of the market asking the regulator to relax the US$70m net worth qualification. But as of early Q2 2021, SEBI had made no changes to the rules.

Selling shareholders short

It is understandable that the government wants to broaden the appeal of the local capital market, but it is regrettable that in the face of continuing corporate scandals, a framework the regulator had in the past discovered was being misused by promoters is suddenly considered a good solution to raise capital.

2.2 Enforcement

India ranks joint 7th with a score of 56%

A lack of transparency was the single biggest reason for India's four percentage point drop in this sub-category to 56%, ranking it joint 7th with Thailand. In 2018 India ranked equal 3rd with Australia and Taiwan. While the stock exchanges carry out frontline regulation, SEBI steps in with both criminal and civil enforcement action where there have been serious securities law violations such as insider dealing or market manipulation. The securities regulator publishes annual data and monthly details of individual cases, but in lieu of an analytical narrative, it is difficult to get a sense of the latest twists and turns on enforcement. For example, large swings in figures from one year to the next are not explained and SEBI presents its regulatory data in patchwork fashion. Its annual report for 2019-20 was, as noted, not available for public view until February 2021, eight months after it was passed to the MOF. Meanwhile, the stock exchanges provide either no information on enforcement or bare bones.

Tighter rules for insider trading

New insider dealing rules come into force

SEBI amended its 2015 Prohibition on Insider Trading Regulations (PIT) on 31 December 2018. The amendments, based on the recommendations of SEBI's committee on fair market conduct, became effective on 1 April 2019. They were long overdue, according to market participants, but still left a lot of the regulating of insider trading in the hands of corporates, which is likely to prove challenging in the long run. According to SEBI, the amendments were "to strengthen transparency, enforcement mechanism and to ensure institutional responsibility". Besides defining key concepts, the amendments also provided for:

- Additional new defences for insider trading including:
  - Exemption of off-market transfers now to include all insiders, not just promoters;
  - Trades executed through block deal window mechanism between people in possession of the same unpublished price-sensitive information (UPSI);
  - Trades undertaken in the exercise of stock options;
- A separate code of conduct for listed companies, intermediaries and fiduciaries; and
- A structured digital database to be maintained by the company. The database must contain all the names and identifiers, such as the permanent account number of all people and entities with which information is shared. The database was to be secured through internal controls such as time stamping and audit trails to prevent tampering.

Tips for tipoffs

Another PIT change that became effective from December 2019 was the introduction of a reward mechanism for incentivising informants to report violations of insider trading rules to the regulator.

Tightening up data on inside information

Further amendments to the PIT regulations were notified in July 2020 and mandated that the digital database must also contain details of the type of UPSI and the details of the person who shared that information. Additionally, the database cannot be outsourced and must be maintained for a minimum of eight years. How these changes will address insider trading in the marketplace and ensure SEBI's success in prosecuting such cases is too early to tell.

Shedding a half light on shady dealings

Big drop in number of new insider trading investigations, but completed investigations increased in 2019-20

Insider dealing continued to keep SEBI busy in 2019-20 but there was a significant drop in the number of new investigations compared to the previous financial year, as the following table shows. During the year to 31 March 2020 it took up 49 new cases related to insider dealing (30.4% of all investigations), compared to 70 the previous year. It did complete more investigations however: SEBI closed 57 probes into insider trades in 2019-20, up from 19 the year before. A further 35 of new investigations (or 21.7%) related to market manipulation and price rigging. This was a huge drop on the previous year's figure, which totalled 84. Unfortunately, the regulator does not explain the reasons for the rise and fall in these figures, making it hard to draw firm conclusions about its regulatory effort.

Figure 4

SEBI investigations by category, FY2019-2020

Particulars	New investigations		Completed investigations	
	2018-19	2019-20	2018-19	2019-20
Market manipulation and price rigging	84	35	60	39
"Issue" related manipulation	2	2	1	1
Insider trading	70	49	19	57
Takeovers	6	2	3	1
Miscellaneous[1]	32	73	27	72
Total	**194**	**161**	**110**	**170**

[1] Includes alleged breaches of listing conditions and disclosure requirements, and violations by statutory auditors.
Source: SEBI Annual Report (2019-20)

Being civil

The regulator prefers the civil route

Enforcement action by SEBI for securities market violations takes different forms: From administrative warnings and inquiries into intermediary conduct to financial penalties and prosecutions. Proceedings under section 11 of the SEBI Act refers to directions or prohibitive orders, where the regulator can suspend trading, restrain persons from accessing the securities market, prohibit individuals from buying, selling and dealing in securities, and direct an intermediary not to dispose of an asset.

Penalties and proceedings

As the table below shows, SEBI's regulatory response was overwhelmingly civil in nature in 2019-20, with the number of prosecutions filed dropping from 399 the previous year to 94.

Figure 5

SEBI enforcement action by category, FY2019-FY2020

Enforcement action taken	Number of entities against whom action was taken	
	2018-19	2019-20
Prohibitive directions issued under s11 of the SEBI Act	672	766
Adjudication orders	2,099	1,818
Cancellations/deemed cancellations	5	2
Suspension	2	0
Warnings issued	3	22
Administrative warnings/warning letters issued	481	325
Deficiency observations issued	100	50
Advice letters issued	54	55
Prosecutions filed	399	94
Conviction by courts	19	66
Total	**3,834**	**3,198**

Source: SEBI Annual Report (2019-20)

Dissemination of data by SEBI can be confusing

The two tables above present a number of problems for anyone trying to make sense of SEBI's enforcement work:

1. **Investigations - what happened next?** While there is a broad sense of where SEBI focusses its investigative efforts, it is not clear how many of the investigations in Figure 4 led to sanctions and whether these sanctions were administrative, civil or criminal in nature.

2. **Enforcement action - over what?** As shown in Figure 5 above, SEBI categorises its enforcement action by type of sanction: Adjudication orders, prohibitive directions, administrative warnings, suspensions and so on. But what was the nature of the offences that led to these sanctions? While we were able to discern that in 2019-20 four insider dealing cases were dealt with by way of prohibitive orders, suspended trading or restrictions on access to the market, and 11 cases resulted in adjudication proceedings where financial penalties can be imposed, there is no indication as to how many insider trading investigations led to prosecution.

3. **Prosecutions - for what?** Figures on prosecutions are not broken down by the type of offence, nor does the regulator state how many cases filed actually went to court or were settled beforehand.

4. **Convictions - for what?** As for prosecutions, the statistics do not break down convictions by type of offence. Nor do they explain what the penalty for each case was.

Information dumps are cumbersome

In fairness, the securities regulator does disseminate regulatory decisions in its monthly SEBI Bulletin. The enforcement section of its website, however, organises information according to the relevant securities appellate tribunal, adjudicating officer, appellate authority or chairman (or members) giving judgment. While many cases could involve multiple violations, making definitive classification difficult, even a broad indication of the main charges involved would be helpful when wading through the information.

Exchanges fail to deliver

A revisit of listing rule misdemeanours takes place

In January 2020, SEBI issued a circular revising the standard operating procedure that exchanges must follow for non-compliance of relevant provisions of the listing rules: From imposing fines ranging from Rs1,000 to Rs50,000 (US$14 to US$700), followed by freezing the promoter's and promoter group's entire shareholding; to suspension of trading if non-compliance continues. Delisting is the final nail in the coffin once a company has been suspended for more than six months.

Data on listing rule breaches is patchy

SEBI's data on this however provides very little context, either from the annual report or its website. NSE does not provide anything in its annual report, though BSE does. It shows that 30,794 surveillance alerts were generated during 2019-20, of which 624 alerts were taken up for snap investigations. As of 31 March 2020, 130 cases were taken up for preliminary or detailed investigations, of which 97 reports were forwarded to SEBI. Meanwhile, as of 31 March 2020, BSE had delisted 1,108 companies which had been suspended for a period of more than six months for non-compliance with the listing rules and had failed to meet the requirements within stipulated timelines. NSE has better information on non-compliance, fines levied and paid, as well as circulars on its surveillance and investigation of different parties on its website, but there is a distinct lack of information. It provides SEBI's case files where necessary and the regulator's instructions.

Regulatory consultations

A new question on public consultations

A new question in our survey measures how well regulators manage their public consultations. This looks at the time provided for the public to respond and whether the consultations are well-written, specific and provide a complete background on the topic concerned. We also consider whether written submissions and the regulator's conclusions are all publicly available on a regulatory website. India did not do well for a number of reasons.

There is not enough time to respond

All regulators, including SEBI, provide consultations for public commentary, but within a limited time period, which is usually 28 days. Yet in the case of SEBI as well as MCA and RBI, which usually requests input from foreign institutional investors, more time is definitely needed. SEBI has always given extensions, but it would be better if all the regulators considered extending such deadlines to at least two to three months. Additionally, they do not publish a consultation conclusions document or allow the public to view others' written submissions. In this regard, regulators argue that many do not want their submissions made public, but they could simply publish those from entities that have not requested anonymity.

SEBI is responsive to feedback

The consultations that SEBI releases are comprehensive, and the regulator has been open to speaking with institutional investors and ACGA on the issues and taking our views on board. This was especially true of the DVR consultation, where concerns expressed, not just by our members and ACGA, were taken up and reflected in the final rules. This enabled the closing of a loophole that would have potentially allowed companies to continue extending their superior rights indefinitely. Explaining the regulator's approach to consultations, SEBI chair Tyagi said in a speech to the CII 11th Financial Markets Summit in October 2020 that its approach was two-fold: Through committees that provide input on major policy reforms and through consultation papers for public comment. In 2020 alone, the regulator issued 27 consultation papers.

CG proposals are underway

Among those consultations which are CG-related but yet to be finalised are:

- A consultation paper on re-classification of promoter or promoter group entities and disclosure of promoter group entities in the shareholding pattern (November 2020);
- A report on disclosure pertaining to analyst and investor meetings and conference calls (November 2020); and
- A consultation paper reviewing the minimum public offer requirement for large issuers (November 2020).

Next steps

Better quality data and more of it

All three main regulators - SEBI, NSE and BSE could improve their disclosure of enforcement work. NSE should provide enforcement statistics along with better details of its regulatory resources during the year in its annual reports. Both the exchanges could do a better job of providing a clearer picture of investigations and non-compliance by its regulated entities. SEBI could look into revamping how it delivers its enforcement data.

More time is needed to comment on consultations

In terms of consultations, regulators could provide longer consultation periods, especially for foreign institutional investors, and make submissions publicly available.

A brokerage used client securities to raise money

Local bourses ban the brokerage firm

The transfers emerged after a tightening of rules on the pledging of client shares

Clients raised the red flag

The securities regulator plans sanctions

The Rs23 billion Karvy scandal

Karvy Stock Broking is facing action by the markets regulator for breaches of securities law after it transferred Rs23 billion of client shares to itself and pledged them to raise cash.

Karvy has been barred by SEBI from taking on new clients since November 2019 and was expelled from local bourses after the unauthorised transfers came to light. At least 95,000 client accounts were initially thought to be affected, but this number more than doubled.

The transfers emerged just months after SEBI tightened rules on the pledging of client shares. A June 2019 circular, titled SEBI (Stock-Brokers and Sub-Brokers) Regulations, mandated that client securities could not be pledged to raise funds, even with client authorisation. Any pledged securities should be returned to clients by 31 August 2019.

It became apparent, however, that the brokerage used clients' powers of attorney to transfer their securities into a depositary (demat) account of Karvy's real estate arm. By mid-November 2019, clients began complaining that their securities and trading profits were not being directed back to their accounts. On 22 November, SEBI passed an ex-parte interim order barring Karvy from taking new clients and instructing the two exchanges, NSE and BSE, to suspend the brokerage's membership. A forensic audit by Ernst & Young was ordered by the NSE.

In November 2020, the ex-parte interim order issued by SEBI was extended and the regulator announced that "appropriate action" against the brokerage and its directors would be taken for breaches of securities laws which were identified in the EY forensic audit. Meanwhile, the NSE informed SEBI that funds and securities worth Rs23 billion belonging to about 235,000 Karvy clients had thus far been settled. Both the NSE and BSE declared the brokerage firm a defaulter.

Breathing room for issuers

Deadlines are extended for issuing financials

AGMs are pushed back

India's response to Covid: Breathing space

Similar to other markets in the region, India responded to Covid with a mix of deadline extensions for financial reporting, relaxed rules for capital raising and encouragement of virtual AGMs. Unlike some of its peers, it also took a very tolerant tone on public floats, relaxing its 25% requirement and advising exchanges not to take enforcement action for non-compliance.

Financial reporting and AGMs

The Securities and Exchange Board of India (SEBI) issued its first Covid-related circular on 19 March 2020, relaxing certain listing obligations, most notably deadlines for quarterly and annual financial results: Issuers were given 45 additional days for quarterly results and a month for annual results for the year ended 31 March 2020. In addition, companies were allowed an extension of a month to issue their corporate governance report, which is published on a quarterly basis.

On 26 March 2020, SEBI allowed AGMs due to be held on 31 August 2020 to be delayed by a month for the top 100 listed companies by market capitalisation. Deadlines for quarterly CG compliance reports, and related-party disclosure were also extended, while issuers with a December 2019 year-end received an extra month to publish their first quarterly report for 2020. This latter gesture led some business groups to lobby SEBI to dispense of a blackout period following the end of Q1, a proposal the regulator rejected (see box below, "Blackout kerfuffle"). There was also a three-month extension to 30 June 2020 for nomination, remuneration and risk management committees of all issuers to meet. On 27 March 2020, a temporary relaxation on disclosure requirements under the Substantial Acquisition of Shares and Takeovers Regulations was announced, giving an additional two weeks to file information on consolidated shareholdings.

Additional time to file financial results

As lockdowns in India continued, timelines were further extended. On 23 April 2020 the top 100 issuers with year-ends of 31 March 2019 were given until 30 September to hold AGMs. Restrictions on virtual meetings meanwhile were relaxed by the Ministry of Corporate Affairs (MCA) in March 2020 (see box on virtual AGMs in the Listed Companies section), and by May, companies due to hold AGMs in the 2020 calendar year could do so electronically. Further extensions were given in June for submitting financial results for companies with a 31 March 2020 year-end: issuers were given a further month. Likewise, on 29 July 2020 issuers were given an additional month until September 15 to submit financial results for the year ended 30 June 2020.

Public floats: all is forgiven

No penal action for floats

On 14 May 2020, SEBI made life much easier for issuers who failed to keep a 25% public float, as required by listing rules. Non-compliance would normally result in fines or even a freeze on acting as a promoter of listed companies, but the regulator directed that stock exchanges not take any action for non-compliance, while penal action initiated from March 2020 could be withdrawn.

Capital raising

A loosening of rights issue rules

Amid market calls to relax rules on fund raising, SEBI responded with temporary amendments to rights issues regulations: on 21 April 2020 it allowed companies listed for at least 18 months, rather than three years, to apply for a fast-track rights issue if they had an average market capitalisation of Rs1 billion (US$13.2m), down from Rs2.5 billion. On 9 June 2020 similar relaxations were introduced for further public offers (FPO) through the fast-track route.

Buyback relaxations

On 23 April 2020, SEBI relaxed the rule on buybacks restricting issuers from raising further capital 12 months after a buyback: This time frame was reduced to six months. The relaxation applied until 31 December 2020.

Blackout kerfuffle

SEBI says "No" to demand for blackout waiver

When SEBI in March 2020 decided to give companies more time to publish their first quarter reports, it attracted an unwanted response: an attempt by certain corners of the business community to waive a blackout period on director trades. According to media reports, the Confederation of Indian Industry (CII) and the Federation of Indian Chambers of Commerce and Industry (FICCI) lobbied on behalf of their members for an exemption which would disapply the blackout period (when directors cannot trade) from the end of the first quarter on 31 March until the end of June 2020. Several corporates also petitioned the regulator. SEBI responded, via the exchanges, with a firm "No". While corporates pleaded that the measure would help with fund raising, the regulator's concern - quite rightly - was insider trading.

3. CG rules

India's ranking falls to 6th on a higher score of 69%

India's score rose one percentage point to 69% in this category, but its ranking fell from equal 4th to 6th place behind Australia, Malaysia, Thailand, Singapore and Hong Kong. This was one category in our survey where most markets enjoyed a boost in scores, in part due to methodological changes in our survey. Singapore and Thailand, which ranked equal with India for CG Rules in 2018, were two beneficiaries of our more granular scoring approach that broke each question down into more sub-components. But scores also increased as a result of genuine improvements in rules and here other markets outpaced India. Singapore saw increases in score for 11 questions in CG Rules in 2020, Thailand eight and India just three.

Tough in parts, India's financial regulators can be softies too

Although regulators in India can be quite tough and impose mandatory regulations in areas such as board evaluation, ESG spending and women directors - for which they receive a great deal of kudos regionally - they also show a high degree of flexibility in most other areas. Indeed, SEBI says that it tries not to make regulations overly restrictive because a regulator cannot and should not have to regulate everything. It is only as time goes by and it finds regulations are being flouted, that it will come back and amend the rules.

Ticking the compliance box

SEBI chair questions director independence

In his speech at the November 2019 SEBI-OECD Asian Roundtable on Corporate Governance, SEBI chairman Tyagi noted that despite having a strong definition of "independence" for an independent director, there remained "concerns of independent directors not being truly independent, especially in promoter-dominated companies". He explained that while these directors met the "regulatory requirements on paper, their independence in conduct and decisions is often under the cloud".

Material disclosure can be inadequate

Another area Tyagi highlighted was material disclosure: A number of companies had been caught out because they had not made adequate disclosures of material events, including a whistleblower complaint. Tyagi stated that while SEBI had provided a list of material events, it was not possible to provide "all possible material events" and companies needed to "take a proper and prudent call on what is a material event". This was a response to the typical reaction from companies in India when asked why they have not disclosed something important: "But the rules don't say I have to".

Details on committee work is often lacking

A box-ticking culture is also evident in how companies disclose what their audit and nomination and remuneration committees do during the year. Usually one is regaled with a boilerplate page or two on what the listing rules state the committees should be responsible for. Very rarely do companies make the effort to provide some detail on what their board committees have done that particular year. Business responsibility reports (BRRs), another sore point, are usually an exercise in box ticking too. Tyagi acknowledged that regulators were aware and concerned about companies adopting this approach to "certain aspects of corporate governance".

Questionable independence

A registry of independent directors is created

The Ministry of Corporate Affairs (MCA) decided to tackle the independent director issue in October 2019 and mandated that a data bank of independent directors be created and maintained by the Indian Institute of Corporate Affairs (IICA). The body would charge individuals a fee for registering and companies for gaining access to the data bank. The new system introduced a number of firsts for the corporate sector in India:

- All independent directors must register;
- Companies must select their independent directors from the data bank; and
- Everyone who registers is required to pass an "online proficiency self-assessment test" within one year of registration.

An exam is introduced for independent directors

The test, administered and conducted by IICA, would cover companies law, securities law, basic accountancy and other areas relevant to being an independent director. A person can take the test as many times as they want but needs to get 60% in order to pass, with all listed companies required to disclose each independent director's test result in their annual reports. The test was designed to plug a gap evident from a growing number of corporate governance scandals in India, in which independent directors claimed they were unaware of laws or other procedures. An exemption to the test would be granted for people who have been directors or key personnel managers in a listed company or in an unlisted public company with paid-up share capital of Rs10m (US$134,000) or more. Therein lies the major problem with this initiative: Training should be mandatory for all directors. Some of the most egregious scandals in the past few years have occurred on the watch of boards manned by "eminent people" with many years of experience under their collective belts.

Auditors may not be blood hounds but . . .

A ban on an auditor is being challenged

In September 2019, the Securities Appellate Tribunal (SAT) uttered the memorable phrase "the auditor is a watchdog and not a blood hound" and sought to shoot down a landmark 2018 decision by SEBI to ban Price Waterhouse Coopers from auditing listed companies for two years as a result of its role in the Satyam accounting scandal of 2009. The tribunal tried to put SEBI's jurisdictional reach into question, but the regulator appealed the decision to the Supreme Court, which stayed the SAT order, reaffirming SEBI's position that it can take action against auditors and audit firms. The case is ongoing and scheduled to be heard in March 2021.

SEBI tightens norms on auditor resignations

Meanwhile, in October 2019, SEBI amended its listing rules to tighten norms on auditor resignations. This was due to a number of resignations by statutory auditors from companies due to lack of cooperation or information provided by the company. Key amendments included:

- Auditors of listed companies are now required to sign the audit report of a financial year before resignation if the auditor had signed the audit report for all quarters except the last quarter in that financial year. Otherwise, the auditor would need to provide a limited review or audit report for the quarter in which they resigned.
- The role of the audit committee has been enhanced.

A proposal to improve the audit landscape

Auditors have also been a focus for MCA, which published a consultation paper in February 2020 on enhancing auditor independence and accountability. If accepted, these proposals would radically change the audit landscape.

A new format for audit reports

MCA also issued the Companies Audit Report Order (CARO) 2020 in February 2020, which superseded CARO 2016 and is the new format for the auditor's report that applies to every company. The report includes 21 broad items that must be reported on and is far more detailed than the previous version. The new version requires more from the auditor, enhancing due diligence and disclosure. The revisions also put greater onus on companies to be more transparent, including sharing information with auditors on whistleblower complaints received during the year, and requiring auditors to determine how the company has dealt with such complaints.

A brave new ESG reporting framework

A new format for ESG reporting

India's version of ESG reporting, called business responsibility reporting (BRR), was originally based on the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business, issued in 2011. Initially applicable only to the 100 largest listed companies, BRR became mandatory for the top 500 in 2015 and the top 1,000 companies in December 2019. Then in August 2020, following MCA's release of a report on a new framework for business responsibility and sustainability reporting (BRSR), SEBI issued a consultation paper on a major revamp of BRR reports designed to make them more quantitative and useful to investors and other stakeholders. Previously they were quite qualitative and full of formulaic ESG disclosure, hence were derided by investors as providing little useful information.

More details but no global benchmark in the format

Now called BRSR reports, the new format is certainly more comprehensive, data-rich, and specific to companies. It asks for detailed statistics on a range of environmental, social and governance matters, including energy and water consumption, emissions, and employee metrics including gender diversity. While more substantive than its predecessor, the problem for many international investors is that the BRSR framework does not follow any international standards of sustainability reporting, such as the Global Reporting Initiative (GRI), SASB and the Task Force on Climate-related Financial Disclosures (TCFD). If a company uses such standards it should say so, but then this makes it difficult to compare companies within a sector in India. Moreover, MCA envisions this as a "one-stop source on non-financial disclosure", so that further down the line these reports can be used by credit rating agencies, banks and other financial institutions that need to determine the ESG credibility of a company. Efforts are being made to map the BRSR standards to international ones, though it remains to be seen how successful this will be.

Mutual funds get a stewardship code, at last

A stewardship code for mutual funds gets the green light

In late 2019 SEBI finally signed off on a stewardship code for mutual funds after years of delay. While insurance companies and pension funds in India have had their own stewardship codes since 2017 and 2018, respectively, mutual funds had to wait until December 2019. A mandatory stewardship code for mutual funds and all categories of alternative investment funds became effective on 1 July 2020 after a three-month delay due to the pandemic. Some larger mutual funds, such as SBI Mutual Fund, put their stewardship codes in place earlier in the same year.

SEBI last to promulgate its own code

SEBI was late to the game having failed to convince the Insurance Regulatory and Development Authority of India (IRDAI) over the past two years to sign on to a single code for all domestic institutional investors. IRDAI issued "comply or explain" guidelines in 2017, making it the outlier since the Pension Fund Regulatory and Development Authority (PFRDA) adopted the proposed SEBI stewardship code almost word for word in 2018. This meant that SEBI was the last to promulgate its own code.

Insurers struggle to vote on all AGM resolutions

So why the three codes? The insurance industry claimed that the number of investments their companies held were too large for them to be able to vote on all AGM resolutions meaningfully, and additionally they lacked the bandwidth to do so. However, in February 2020, IRDAI published a revised version of its stewardship guidelines, essentially following the new SEBI code more closely, while ownership thresholds were set for when voting would become compulsory. Beyond that, IRDAI also made its code compulsory, keeping the insurance industry in lock step with its mutual fund counterparts.

Here are the key principles

SEBI closely followed the format of the original UK stewardship code of 2010, with three main differences: It is mandatory, provides focussed and practical guidance on certain principles, and uses firmer language than other regulators regarding investor engagement with companies. The principles are as follows:

Figure 6

Principles of SEBI's Stewardship Code For Mutual Funds and Alternative Investment Funds

	Principles
1.	Institutional investors should formulate a comprehensive policy on the discharge of their stewardship responsibilities, publicly disclose it, review and update it periodically. Guidance included the suggestion for "a training policy for personnel involved in the implementation of the principles is crucial".
2.	Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it. Guidance for managing conflicts of interest included instituting blanket bans on certain investments; setting up a "Conflict of Interest" Committee; segregating the fund's voting function from client relations and sales; ensuring that people with an interest in a transaction are recused from decision-making; maintaining minutes of decisions taken to address conflicts.
3.	Institutional investors should monitor their investee companies. Guidance offered included areas to monitor, such as company strategy and performance; quality of company management, board, leadership; risks; and shareholder rights, as well as different levels of monitoring at different investee companies depending on how much the fund had invested in the company. Guidance included circumstances for active intervention, such as poor financial performance, CG-related practices, ESG risks and leadership issues.
4.	Institutional investors should have a clear policy on intervention in their investee companies. Institutional investors should also have a clear policy for collaboration with other institutional investors where required, to preserve the interests of the ultimate investors, which should be disclosed.[1]
5.	Institutional investors should have a clear policy on voting and disclosure of voting activity. Guidance included a list of action items that such a policy should include.
6.	Institutional investors should report periodically on their stewardship activities.

[1] The original 2010 UK Code split the issues of intervention and collective engagement into two "Principles".
Source: SEBI

Next steps

Extend training to all directors

Training, offered by established and accredited institutions, should be extended to all directors. What the training is, who provides it and how many hours has been spent on such courses should be disclosed in annual reports.

Benchmark ESG standards

Greater alignment to international sustainability standards in the new BRSR would be welcome.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

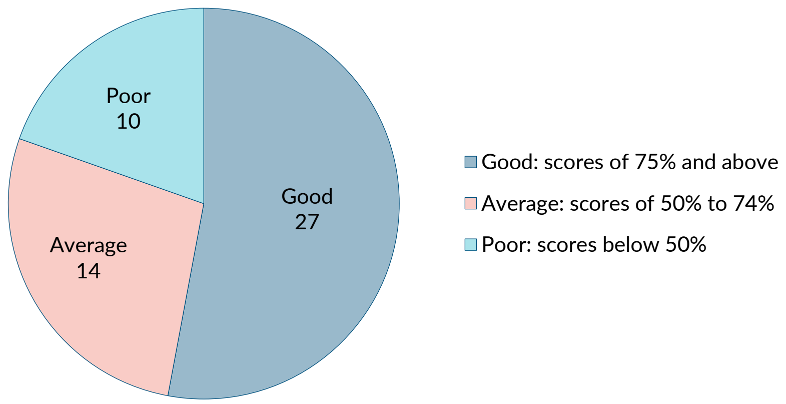
India ranks 3rd with a score of 65%

India ranks reasonably well in this section, moving up by three percentage points to score 65% and rising by one place to sit in 3rd position in the region, just behind Malaysia at 66%. This was driven by well-written reports and the ability of corporates to mostly adhere to the letter of the law. Our aggregate results showed that large caps performed well in 27 of 51 questions, averagely in 14 and poorly in 10 (see figure below).

How the large caps fare

Figure 7

India: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where India does well

Large caps perform better than mid caps

Overall, large cap companies performed better than their smaller peers, the latter still having a way to go. Mid caps tended to do better in basic areas such as providing a dedicated contact for investor relations, but failed miserably on details of shareholder engagement, diversity policies and the issue of materiality in their ESG reports.

Firms are upfront on management discussion and analysis

Still, some mid caps managed to outdo their large cap brethren in providing detailed management discussion and analysis. In India, companies have always been fairly robust in offering a credible overview of their business and strategy going forward. Companies also provide comprehensive and quick access to financial information and corporate announcements. However, as the regulator has noted, companies do not always disclose material events in a timely manner. And while AGM notices and agendas are available with detailed circulars, AGM results are only shared with a breakdown of votes, but no record of Q&A with shareholders in the meeting (an emerging best practice around the region).

Regulators tend to drive disclosure efforts

When the disclosure is good, it is mostly regulatory driven. CG reports provide detailed attendance statistics of directors, and companies have become better at providing details on numerous activities but there is definitely room for improvement. Only five of the 15 large caps have extended their codes of conduct to suppliers. Regulators have mandated board evaluations, but 11 of the 15 large caps did not mention the use of third-party assessors or disclose their evaluation conclusions. And while board committee activities are reported, most of the discussion is of a generic nature and not specific to the reporting year.

There are more details on director pay

Another area of improvement over the years is remuneration policy, which has become more detailed. Comprehensive disclosure on director pay is available in accordance with listing rules, which also mandate that independent directors are not given stock options or restricted share awards amid regulatory fears these would compromise independence. Of interest is another regulation that companies provide a skills matrix on the expertise and competencies of each director on the board, but this is a work in progress. Some companies provide a matrix showing the skills of each director and providing a link to the business, while at the other end of the spectrum others only discuss the skills in the directors' biographies without any clear link to the business.

Where India performs averagely

Board independence fails to excite

Board independence is an area of mediocrity. Most of the 15 large caps that we studied had independent chairmen for audit committees but not for the board chair. Seven of the 15 had executive chairmen but failed to appoint lead independent directors, while another two had designated "independent" chairmen who on closer inspection failed to pass the test. As noted above under Regulators, SEBI tried to mandate companies to have a separate chairman and CEO/MD but the requirement has been postponed until April 2022.

Stakeholder engagement tends toward the generic

It is also a mixed bag when it comes to stakeholder and shareholder engagement, as well as non-financial or ESG reporting. About half of the large caps we studied discussed stakeholder engagements in detail with specific information for the financial year, while the other half would only have a generic discussion on the engagements. As discussed in our previous CG Watch, we noted that if a company was listed abroad or if it had a large foreign institutional presence, the better its ESG disclosure tended to be. Large caps did well reporting on the SASB framework, such as addressing physical risks of climate change, especially for companies that had the issue identified as a material one based on the SASB template, while many mid caps faltered here. However, large caps still have room for improvement in areas such as utilising materiality matrices, discussing the materiality process and providing targets on material issues.

Where India does poorly

Financial disclosure is weak in some key areas

Where Indian companies failed to impress was on specific areas of financial disclosure. Items such as trade receivables and payables were generally reported in aggregate with no ageing analyses, and many companies also aggregated operating costs such that "other expenses" amounted to more than 2% of total expenses. Information on loans was either difficult to find or companies provided scant detail. Some companies meanwhile provided limited or no rationale for material acquisitions and divestments.

Diversity policies are bland

As mentioned above, regulators have pushed for skills matrices, but the quality of diversity policies were quite poor with no targets or plans for any of the 15 large caps we studied. When reading policies in India, board diversity tends to be focussed on gender and this reflects a regulatory push on the issue. Companies could do with broadening the scope of diversity.

Where Indian companies can improve

Figure 8

Helicopter view: Rating India's CG disclosure and governance, 2020

Good	Average	Poor
❑ MD&A provides useful information on business ❑ Corporate actions disclosed on exchanges and company websites ❑ Detailed AGM circulars ❑ Director attendance statistics ❑ Remuneration reports	❑ Policies for mitigating corruption easily available, but less than half of public codes of conduct extend to suppliers ❑ Board evaluation lacking third-party assessors ❑ Information on board committee activities, but not specific to year ❑ Board skills matrices with limited link to business, and no plans or targets for improving diversity ❑ AC chairmen mostly independent, some related to company ❑ Mixed quality of disclosure on stakeholder and shareholder engagement	❑ AGM reports lack Q&A with shareholders ❑ Lack of board independence: limited use of lead INEDs ❑ Limited discussion of materiality issues and materiality process in ESG reporting ❑ Poor financial disclosure: aggregate disclosure of trade receivables and payables with no ageing analyses, aggregated costs, limited information on loans or rationales behind corporate actions

Source: ACGA

Next steps

Key ACGA advocacy suggestions for listed companies in India

Key advocacy points flowing from the above include:

Quick wins

- ❑ Timely disclosure of material events
- ❑ Shareholder Q&A should be disclosed in AGM reports
- ❑ Appointing third-party assessors for board evaluations and better disclosure of details
- ❑ Reporting committee activities specific to the year
- ❑ Financial disclosure: disclosure of trade receivables/payables with ageing analyses, information on loans and discussion of rationale behind corporate actions

Medium to long-term challenges

- ❑ Codes of conduct should extend to suppliers
- ❑ Improve board independence: Stricter definition of independence and mandate independent chairmen or appointment of lead INEDs
- ❑ Proactive shareholder and stakeholder engagement that is well-documented ESG/sustainability reports to include substantive discussion of the materiality selection process, and how they set meaningful targets
- ❑ Board diversity disclosure and planning could be improved with a further requirement for linking skills matrix to the business

Electronic meetings come under the spotlight

Virtual AGMs: A perfect 50

The Covid lockdown in India raised urgent questions as to where, when and how shareholder meetings could be conducted. While the Companies Act did not have specific provisions to allow meetings via video conference (VC) or other audio visual means (OAVM), it did allow for e-voting at general meetings. On 19 March 2020, the Ministry of Corporate Affairs (MCA) allowed companies to hold electronic meetings for certain matters, such as approving financial statements and approving the board report. It broadened this on 8 April 2020 to EGMs, enabling meetings by two-way teleconferencing or webex. Members should be allowed to issue questions concurrently or be given time to submit questions in advance via email to the company.

Virtual AGMs get the regulatory nod

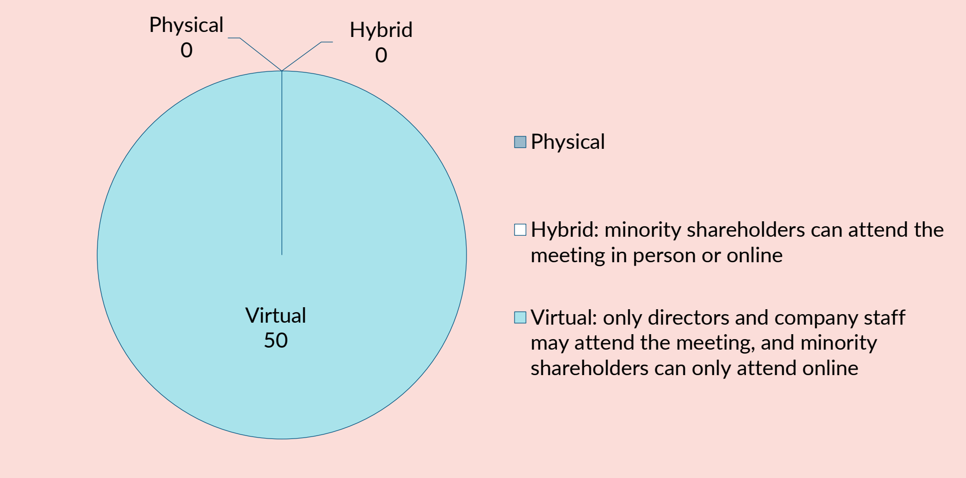
Electronic AGMs were allowed by MCA pursuant to a 5 May 2020 circular and issuers were excused from sending printed annual reports to shareholders. Companies unable to conduct an AGM electronically were required to submit an application to the Registrar of Companies to extend the annual meeting to another date. In January 2021, the MCA further extended the ability to hold AGMs electronically until December 2021.

Issuers embrace the electronic

All top 50 public companies by market value in India held virtual meetings up to December 2020, as the following figure shows. The majority were held in July, August and September.

Figure 9

AGM modes in India: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

India ranks joint 3rd with a score of 44%

India also did relatively well in this category, increasing its score by a substantial eight percentage points to 44% in 2020 and climbing one place to rank joint 3rd with Korea. Still, this remains a low score in absolute terms and is noticeably lower than India's score in every other category except for Government & Public Governance. The same story applies to most markets in our survey, making Investors the lowest scoring category on average.

There were gains from voting disclosure by domestic institutions

Institutional investors helped boost the score with in-depth disclosure from domestic players on how they vote at investee companies. They also show a greater propensity for voting against resolutions that affected minority shareholders as well as engaging with their investee companies. Meanwhile, the advent of the stewardship code for mutual funds and alternative investment funds also helped boost the score.

Retail investors lag their regional peers

Retail investors, however, continued to lag behind their regional counterparts. For the most part, they failed to engage with senior management during AGMs, with only a handful choosing to challenge controlling shareholders and senior management on controversial issues in 2019. This lack of a voice from the retail segment largely suppressed the score in this section, but it must be noted that during the pandemic, as more people were forced to stay at home and AGMs and EGMs became virtual, there were signs that retail investors were becoming more mindful of voting as well as raising concerns at virtual meets.

Room for improvement in domestic engagement

There is much room for domestic institutional investors to become more vocal with their investee companies regarding ESG issues, as well as providing clarity on how they will deal with conflicts of interest as the stewardship code demands. It would also help if they published their responses to regulatory consultations and foreign institutional investors could better articulate whether they implement and adapt their CG, ESG, voting and stewardship policies for India.

Not so quiet on the domestic front

Domestic players are voting and engaging more

While the stewardship code for mutual funds and alternative investment funds only came into effect in June 2020, mutual funds have been mandated by SEBI since 2011 to disclose both voting policies and votes cast on each resolution at individual company AGMs. In the early days after the rule change, funds had a tendency to abstain from voting on a large number of resolutions, but this forced the regulator to amend the rules and require mutual funds to disclose the rationale behind each vote cast. Voting disclosure has become more comprehensive as a consequence and not merely a box-ticking exercise. It has also made domestic investors more engaged as shareholders because they are now likely to vote with their shares rather than with their feet, the usual practice in the past when they disagreed with a company proposal that hurt minority shareholders' rights.

A new industry of proxy firms emerges

Another positive byproduct of the mandatory vote disclosure policy was the emergence of local proxy advisory firms that not only delivered voting recommendations on resolutions at more than 500 listed companies, but also undertook independent research on capital market issues, company research and in many cases helped institutional investors to collectively engage with companies on more egregious resolutions. But it has proven to be a dangerous field to operate in, as one of the proxy advisory firms has been sued by a company.

An emboldened narrative on resolutions

Over the years, voting regulations and proxy advisors have helped to shift the narrative and emboldened domestic funds to vote against resolutions that are not in the interest of minority shareholders. According to primeinfobase.com, a subsidiary of Prime Database that provides information on the Indian capital market, domestic mutual funds voted against 2,591 resolutions in FY20 as opposed to 2,422 in FY19.

Stewardship code helps with engagement

These changes have also pushed domestic institutional investors to adopt more stewardship-like behaviour than would have been the case if they had been left to their own devices, including engaging either individually or collectively with their investee companies. This has been strengthened with the advent of the stewardship code for mutual funds and alternative investment funds (see CG Rules section).

Activists turn up the heat

Rebels do take a stand

While shareholder activism from domestic investors is not as prevalent as in other parts of the world, the local boys are conscious of their stewardship duties. During the 2020 voting season, a number of companies found resolutions being rebuffed by public shareholders. Shareholders said no to resolutions running the gamut of related-party transactions at Petronet LNG and Texmaco Infrastructure to the re-appointment of independent directors at Mahanagar Gas and Kirloskar Brothers.

There are a few wins

An analysis by the *Economic Times* newspaper of 30 resolutions in August 2020 found that nine had been defeated by domestic and foreign institutional investors. The article also noted that institutional investors had voted against a number of reappointments of directors. But it was not merely independent or executive directors that institutional investors were voting against, the article stated, but related-party transactions and royalty payments too, defeating at least six in August with the help of retail investors.

AGM attendance is scant

Surprisingly, both domestic and foreign institutional investors have attended AGMs - not many, but a few have. One domestic fund told ACGA that on resolutions that are important to them, their analysts will attend AGMs.

The foreign dimension

Foreign players are voters

Foreign institutional investors, according to the India Brand Equity Foundation, invested approximately Rs2.17 trillion (US$30 billion) in the country in 2020-21 (as of 7 January 2021). Foreign investors are a significant source of investment in the Indian capital market, investing a net US$7.75 billion in equities and US$472m in debt instruments in December 2020. Unlike their domestic counterparts, data on foreign investor voting is not as readily available. But evidence from company announcements and anecdotal data from proxy advisory firms shows that foreign institutional investors do vote their shares. And they have been known to ruffle quite a few feathers in the past with their votes.

The global take on India - results of ACGA survey

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As the responses showed, a very high proportion of respondents invest in India and the average number of investments is higher than all Southeast Asian markets:

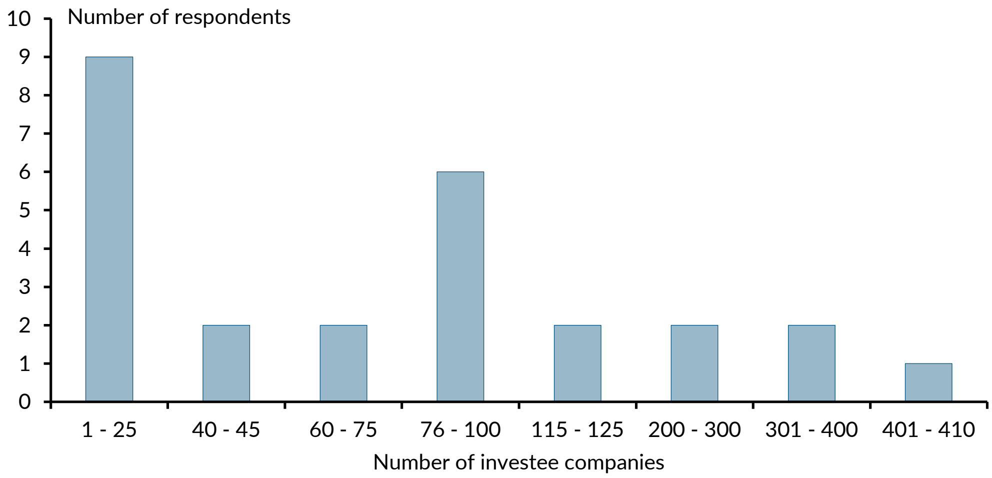
- 93% or 42 respondents indicated that they invest in India, the highest proportion in our survey, marginally above China and Hong Kong at 91%.
- Only 26 respondents answered the question on the exact size of portfolios. The average number of investee companies per respondent was 102, with a range from four to 410. This average is about double the figure for most Southeast Asian markets, slightly above Taiwan, somewhat below Hong Kong and Korea, but well below Australia, China and Japan.

Another way to show the extent of investment in India is to group portfolios by size. As the following figure shows, respondents divided evenly into those holding close to or more than 100 companies in their portfolios and those holding less than 75 (most of which held less than 25):

Foreign investor portfolios

Figure 10

Foreign investors in India: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Global investors vote against in 25% of Indian AGMs on average

As India is an important market, it is not surprising that respondents take voting there seriously:

- Nearly all respondents with holdings in India vote in 100% of their investee-company AGMs. One votes in none, one in 31%, one in 70% and another votes in 90% of meetings.
- On average, they voted against at least one management resolution in 26 meetings in 2020. The median figure was six meetings.
- As a proportion of their holdings, respondents voted against at least one management resolution in an average of 25% of meetings. By respondent, however, the proportion ranged from 0% to almost 70%.

General reasons for voting against in Asia

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

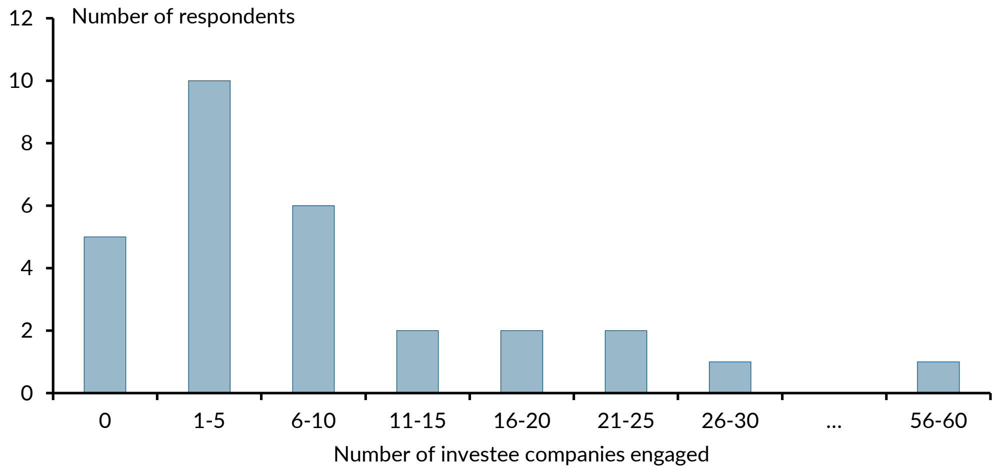
Company engagement is occurring, but mostly in single digits in India

Company engagement

Many of our foreign investor members do engage individually, with 57% of the 42 respondents with investments in India saying they did so. Of the 29 members who answered this question, 18 said they engaged with 15 or fewer companies over 2019 and 2020 (most engaged with less than 10) and another five said they undertook no engagement at all. Of the remaining six, five engaged with around 20 to 30 companies and one with 60, as the following figure shows.

Figure 11

Foreign investor engagement prevalence in India, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

In terms of the relative level of engagement in India (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 10% or less, but rises to 20% for one institution, around 40% to 50% for another four, and 90% to 100% for two funds (both of which have quite small holdings by number).

Rise of the retail investor

Retail revolution

According to a survey by Prime Database, there was an upsurge of retail investors in the market in 2020, with retail investor shareholdings hitting an 11-year high in 1,605 listed companies. Retail investors are difficult to track in terms of their voting or why they vote in a particular way. However, 2020 saw a rise in retail investors into the market as well as increased voting and questions being raised at virtual AGMs.

Regulator vows to make voting easier

In terms of voting, SEBI noted in its 2018-19 annual report that retail participation was "at a negligible level" even with e-voting open to all. It then announced that it would be looking into making the process seamless for the retail segment. In December 2020, SEBI said that all dematerialised (demat) account holders could enable e-voting through a single login in their accounts or the websites of depositories, without having to reregister with an e-voting service provider.

Questions can be woolly

Getting retailers to raise pertinent questions at AGMs or EGMs, however, has continued to confound the market. There has been the occasional moment, such as a corporate lawyer at Reliance Power's 2019 AGM threatening Anil Ambani, founder of Reliance Group, with India's first class-action lawsuit if he did not provide answers to certain questions within two to three months. The lawyer stated that Ambani's pledge of 80% of his shares in Reliance Power was "bad signalling" and had eroded his investment. Ambani has seven listed companies but they and his group as a whole are in dire financial straits.

A virtual boost for shareholder activism?

Virtual AGMs might be the answer for a form of retail activism at AGMs. Proxy advisor IiAS noted in an article published on its website in December 2020 that a couple of retail investors had asked good questions to the management of Tata Consultancy (TCS) and Bharat Petroleum Corporation (BPCL). An investor questioned TCS on cybersecurity as its employees worked from home, while the management at BPCL were asked about gender diversity on its board as well as the depletion in the size of the board.

Next steps

Domestic voices need to get louder

Domestic institutional investors should take advantage of e-voting apparatus and vote their shares as well as become more vocal at AGMs and EGMs.

More targeted voting by foreign players

Foreign investors should better articulate their voting at investee companies as well as their stewardship and CG/ESG policies in India. Institutional investors should make public any responses they have submitted to regulatory consultations.

6. Auditors & audit regulators

India's score jumps to 54% but it still ranks 11th

India made huge strides in this section, moving up 15 percentage points to 54% in 2020 but continued swimming at the bottom, ranking 11th overall. The surge was due in large part to the implementation of and actual work being done by the country's new independent audit regulator, the National Financial Reporting Authority (NFRA). However, there have been complications with the advent of the regulator, including incredibly slow uptake of both IFRS and IAS standards, continued pushback from the Institute of Chartered Accountants of India (ICAI) and mixed signals from the Ministry of Corporate Affairs (MCA) as to who the regulator actually is.

The audit regulator gets to work

A new audit regulator is finally up and running - but not the last in Asia

First, the good news. The cabinet approved the establishment of the NFRA in March 2018, it was set up in October 2018, the rules governing it were published in November of that year and it started investigations in 2019. Although one of the last markets in Asia to have a properly independent audit regulator - as opposed to the local accounting industry body doing the job - India has the distinction of beating Hong Kong to the finish line. Hong Kong's audit oversight board did not start its work until October 2019.

NFRA's jurisdiction covers audits of listed companies, large unlisted firms, and banks and insurers

When the regulator was first announced, it was to have a chairperson, three full-time members and nine part-time members - one each from the MCA, the Comptroller and Auditor General of India (CAG), RBI and SEBI, two external experts and the ICAI president and the chairpersons of the ICAI's accounting and auditing boards. The NFRA only has jurisdiction over auditors that audit a specific class of companies, including all companies listed inside or outside India, large unlisted public companies and insurance and banking companies. The rules stated that its functions would include:

- Recommending accounting and auditing policies and standards to be adopted by companies for approval by the Central Government;
- Monitoring and enforcing compliance with accounting standards and auditing standards;
- Overseeing the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service; and
- Performing other functions and duties as necessary.

An audit failure at IL&FS is investigated in 2019

With all that in place, the regulator started formally investigating an audit failure at Infrastructure Leasing & Financial Services (IL&FS) in 2019. IL&FS, an unlisted non-banking financial company (NBFC), or shadow bank, that funded infrastructure projects, defaulted on several payments in 2018. This had a domino effect on its myriad subsidiaries. The government stepped in on 1 October 2018 and installed a new board, whereupon the market learned that the infrastructure financier had more subsidiaries than was initially known, and therefore the debt on the books could amount to more than US$12 billion. As of January 2021, the debt stood at more than US$13 billion.

Adverse findings from an audit quality review of Deloitte Haskin and Sells

The NFRA began quality reviews of the statutory audit of IL&FS Financial Services (IFIN), a subsidiary of IL&FS, for the financial year 2017-18. It did two audit quality reviews (AQR) for Deloitte Haskin and Sells (DHS) and BSR Associates, a member firm of KPMG, both of which were joint auditors for the firm when IL&FS defaulted on its debts. DHS resigned in 2018 but BSR remained as one of the auditors until June 2019. Moving quickly, NFRA issued its first AQR on DHS in December 2019, finding that DHS had cut corners on a number of issues. It concluded that the audit firm had failed to comply with the requirements of the standards of auditing (SA) and stated that the failures were of such significance that it appeared to the NFRA that DHS did not have adequate justification for asserting that the audit was conducted in accordance with the SAs. Specifically, its findings included:

- The auditor's independence was compromised because it provided non-audit services for substantial fees, and these services were clearly prohibited by the Companies Act. Moreover, approval of the audit committee had not been obtained if such services were to have been permissible.
- The engagement partner had signed the audit report without discharging most of the key duties required. DHS had also contravened SAs and standards on quality control by naming two partners as engagement partners, thereby leading to a loss of accountability.
- The firm failed to question the management and challenge the inflation of profit by over Rs1.8 billion through inclusion of the value of a derivative asset which was entirely unjustified.
- The engagement quality control review, as DHS says it was carried out, had been shown to have been a "complete sham".

The regulator may dig further

The AQR also stated that it had not covered the entire scope of work involved in the statutory audit and reserved the right to follow up on issues that had not been covered.

Results of the BSR review are also adverse

The second AQR on BSR was published on 17 August 2020, which again found the firm guilty of failing to uphold auditing standards and quality controls. The government stated in a press release that appointing BSR as a statutory auditor of IFIN had been illegal and void from the beginning and failure to comply with standards included dealing with:

- Material misstatements of major magnitude and fundamental importance;
- Going concern assumption by the management;
- Complete absence of the required communication with those charged with governance; and
- Determination of materiality amounts on the basis of non-relevant factors.

DHS appointment is dubbed illegal

It further found that the IT processes or platform used by BSR had structural and systemic deficiencies. Five months later, in December 2020, a supplementary report on DHS was issued also stating that the appointment of the firm had been illegal. It was found ineligible to be appointed as the auditor due to existing business relationships on the date of appointment and because it provided non-audit services directly or indirectly to the company.

Partners face disciplinary action

Finally in July 2020, the regulator issued orders against three senior Deloitte partners for their roles in the IL&FS scam: Udaya Sen, engagement partner at IFIN and senior partner and former chief of Deloitte; Shrenik Baid, partner in the statutory audit of IFIN and partner at Deloitte; and Rukshad Daruvala, engagement quality control reviewer for the IFIN audit and partner at Deloitte. Baid and Daruvala were banned from practicing for five years and fined Rs1.5m and Rs500,000 respectively, while Sen was fined Rs2.5m and barred from practicing for seven years.

Murky waters

Auditors fight back

However, it did not end there. All three Deloitte auditors and the BSR auditors took the regulator to court stating that it did not have jurisdiction over the case. They argued that the NFRA was not established at the time these irregularities took place and any penalties against them would be retrospective. The Delhi High Court, which is hearing the cases, has stayed the orders against the Deloitte auditors and hearings are ongoing. In the case of the BSR auditors, in December 2020 the high court allowed the regulator to continue its investigations but said it must ask the court's permission before making reports public. Regardless of how the rulings go, it appears likely the cases will end up in front of the Supreme Court.

Regulatory confusion ahead?

Potential for regulatory overlap and confusion

This has not been the only challenge to the NFRA and its ability to function properly. In the division of regulatory labour, the story is straightforward: ICAI continues to have disciplinary powers over companies not covered by the NFRA - a common feature of audit regulation in other markets - and the Quality Review Board continues to look at the audit quality of private limited companies and public unlisted companies below a certain threshold, as well as those companies that the NFRA delegates to it. While the government argues that neither regulator steps on the other's toes, what happens in practice is less likely to be so clear-cut. One issue is that the NFRA is significantly understaffed, which will impede its ability to be an effective regulator for the large number of listed and other company audits it has jurisdiction over.

There may also be confusion whenever there is overlap between listed and unlisted audit supervision. IL&FS is a good example. It is a large unlisted company, its listed subsidiaries were the ones that the NFRA issued reports on, yet ICAI wants to be the one who decides how their auditors are sanctioned. Market tittle-tattle suggests that ICAI does not have a great deal of respect for the NFRA's ability to do its job properly.

The powers of the audit regulator are under threat

It appears that the MCA is already considering curtailing the power of the regulator to debar audit firms. A November 2019 report from the Company Law Committee, which makes recommendations on provisions and issues relating to implementation of the Companies Act, noted that chartered accountants are simultaneously regulated by the ICAI as well as many other authorities, which could lead to significant regulatory overlap.

Power to disbar may be shifted to the professional body

It further opined that the regulatory body in charge of regulating a profession, namely the ICAI, should be the ideal body to make key decisions relating to debarment and the right to practice by a professional. It must be noted that three of the 11-member committee were chartered accountants, accounting for more than 25% of the committee.

The issue is on hold

The recommendation for the moment was that debarment of a firm may be an exception rather than a rule, while further changes, including those to various laws, could only be tackled at a later time. This appears to leave the independent audit regulator in a precarious position. Central government support is clearly crucial in view of the pressure from the accounting profession to rein in the NFRA's powers.

The regulator's board composition raises eyebrows

Lastly, it is worth noting that the part-time ICAI members on the NFRA's board could potentially undercut the independence of the body. The MCA assured ACGA in 2019 that these members were only part-time and would not have anything to do with investigations. They are purportedly there to help with accounting and audit standard setting. Furthermore, the MCA stated that the NFRA was already moving to join IFIAR, the global member organisation of independent audit regulators. That was until 2020, when a senior member of ICAI informed ACGA in November that the idea had been dropped mid-year.

Standard stalemate

New standards are overdue

On the topic of standard setting, the time cycle for India to adopt new ISAs and IFRS has increased exponentially since the advent of the NFRA. According to an ICAI member, it can take anywhere between two to three years to adopt new standards: The institute constitutes a task force by either the board for ISA or the board for IFRS, after which the task force goes through the standards and sends it on to the central committee, which will then send it to the NFRA. The regulator checks it before forwarding it to the MCA. According to the institute, the ministry wants to give at least a year's time to adopt the standard. For example, the revised IESBA Code of Ethics 2018 only became effective as of July 2020, while other standards such as the revised ISA315 and ISA540 have not been adopted as yet in India.

Teething troubles

Government support is needed for regulator

The regulator is still in its infancy, is understaffed and continues to have teething problems. The government needs to be far more supportive of this regulator and help to bolster its powers. The NFRA in turn should join IFIAR and reach out to other audit regulators in the region to see how they work. One of the NFRA's roles is to advocate and educate on audit quality, and it can learn a lot from regional audit regulators like Malaysia's Audit Oversight Board on reporting of audit quality in the market.

ICAI

The profession is good at training

The professional institute does not have a good reputation as a regulator but does score points on the educational front. A new initiative that it launched in May 2020 was a Centre for Audit Quality that would research and develop a systemic audit quality framework and had started its 29-day executive master programme on new age auditors in November 2020.

Next steps

India needs to join global accounting body

India should become a member of IFIAR. It could benefit from reaching out to regional audit regulators and learning from them.

Timely annual data would be a boon

Much like other regulators, the NFRA should publish a timely annual report similar to the one that was done for the audit regulator by the MCA in 2018-19.

Details of audit capacity would help

A report from the NFRA on professional capacity within the accounting industry would be beneficial, with details of audit quality and strength in India, along with suggestions on improvements that could be made.

7. Civil society & media

India stays in 2nd with an improved score of 78%

This is an area where India always does well and, despite concerns, its score rose by seven percentage points in 2020 to 78% while remaining in 2nd place behind Australia.

Non-profits steal the show . . .

Non-profit organisations were the star in this section. While there are a number of national and international associations and NGOs that work on improving CG and awareness of ESG, it is the regional grassroots organisations who are the real backbone of such work in the country. This is also true of the media. Regional media tends to report on corruption and governance lapses with a far more critical lens, and while media outlets continue to cover corporate abuses, it would be fair to say that there are not many journalists who are sufficiently skilled at reporting on CG.

. . . while business groups tread water

Meanwhile, our score for the involvement of business associations in CG/ESG awareness raising remains stagnant. This is not because they do nothing, rather that they tend to undermine their good work with contradictory demands and statements. For example, in February 2020 CII released its Guidelines on Integrity and Transparency in Governance and Responsible Code of Conduct, a constructive contribution to improving governance practices among companies in India (see table below). At the same time, however, both CII and FICCI were lobbying the Ministry of Finance and SEBI to remove a new rule requiring separation of the role of chairman and CEO/managing director, a key obstacle to improving corporate governance in India and a reform deemed critical by the Kotak Committee of 2017.

New CII Guidelines

CII revises its 1998 code of corporate governance

On 14 February 2020, CII released a 15-point guideline, titled "Guidelines on Integrity and Transparency in Governance and Responsible Code of Conduct", which served as a revised version of its initial 1998 code of corporate governance. The 1998 code was not only the first institutional initiative in India that prescribed corporate governance standards but one of the first CG codes regionally. It was the blueprint for the subsequent SEBI code on corporate governance, Clause 49, in 2000. We understand that CII did not publish a revision for many years, because it did not want regulators to once again mandate its recommendations.

When it released the revision in 2020, it stated that the 1998 code needed to be updated if the country was to "move to a leadership position in the global corporate space". The association added that "self-regulation would be a key factor in greater responsibility, integrity, and accountability for rebuilding and sustaining trust". A table summarising the guidelines follows:

Figure 12

15 Principles of New CII Guidelines on Integrity and Transparency in Governance and Responsible Code of Conduct

	Principles
1.	**Integrity, ethics and governance:** Companies should document their commitment to these three principles. Training should be provided to employees on company culture.
2.	**Responsible governance and citizenship:** Organisations need to integrate ESG principles into their business and establish clear policies that show zero tolerance for corruption and market manipulation. Anti-money laundering steps should also be instituted.
3.	**Role of high performing board:** Balancing roles of supervision and stewardship, allowing for dissenting views and creating key result areas.
4.	**Balancing interest of stakeholders:** Recommended mandating disclosure of actual or potential conflict of interest of directors, senior management and employees beyond what is prescribed by law.
5.	**Independent directors and women directors:** Companies should choose independent directors that have industry expertise and strive to improve gender diversity.
6.	**Safe harbours for independent directors; easier settlement norms and amnesty provision:** Regulatory authorities and enforcement agencies should put in place safe harbours that would ensure independent directors are not held personally liable as long as they did their duty. Laws need to be changed accordingly along with decriminalisation of laws.
7.	**Risk management:** It is essential to constitute a risk management committee that will assess various risks including IT, financial and cyber.
8.	**Succession planning:** The company should institute succession planning not only for the chairman and managing director but also key management personnel.
9.	**Role of the audit committee:** Audit committees should formalise their briefings to the board, spend sufficient time on integrity of financial statements, internal controls, exercise a level of oversight of the company's subsidiaries and develop a "risk-based approach to its role involving proactive, engaged oversight beyond the board room and understanding issues".
10.	**Improving audit quality and enhancing accountability of other third parties who play a fiduciary role:** Management, audit committees and boards should work closely with auditors to understand the audit process and financial statements.
11.	**Disclosure and transparency related issues:** Companies should establish a social media policy that focusses on how to deal with information responsibly.
12.	**Vigil mechanism:** The board may formulate a whistleblowing policy and have periodic updates on its implementation.
13.	**Stakeholder, vendor and customer governance:** Organisations need to extend their concept and principles of governance to stakeholders, including bankers, creditors, lenders, customers and employees. Companies should also devise a gifts policy.
14.	**Investor activism:** Companies should proactively address governance concerns of all investors, as well as educating stakeholders about their rights, responsibilities and encourage their shareholders to exercise their vote on all matters.
15.	**Start-ups and Micro, Small and Medium Enterprises (MSMEs):** It is important that they adopt good governance requirements from the start. They should consider appointing non-executive directors with appropriate skill sets that may not be readily available with the founders and executive directors on the board.

Source: CII

Are companies towing the line?

Solid accomplishments despite run-ins with government

Some of the most compelling work being done at grassroots level on CG and sustainability is by non-profits and NGOs: Oxfam's ResponsibleBiz, Shakti Sustainable Energy Foundation, the Alliance For an Energy Efficient Economy (AEEE), and Corporate Responsibility Watch. This is despite the fact that some NGOs have run afoul of the government, such as being accused of working against national interests, reducing the country's GDP and receiving foreign funds in contravention of the Foreign Currency Regulation Act.

Business responsibility reports are scrutinised

In the last CG Watch, we mentioned the India Responsible Business Index, which analysed the disclosure of the business responsibility reports of the top 100 companies listed on the BSE on inclusive policies. Led by Corporate Responsibility Watch, the index is produced by a voluntary network of 14 organisations and independent consultants. The premise behind their report is that disclosure matters and if corporates are not monitored on their business responsibility reports' compliance, then there would be no challenge to "the growing power of large corporates". While a report was not prepared for 2019, the Status of Corporate Social Responsibility in India Report 2020 was due to be released in March 2021, but has been delayed. It is supposed to focus specifically on such issues as human rights in businesses.

Think tank is a rare voice on dual-class shares

The Vidhi Centre for Legal Policy, a non-profit that describes itself as an independent think tank which engages in legal research to promote better laws and improve governance, was one of the few organisations that made its response to the SEBI consultation on dual-class shares public, voicing its opposition to the proposal. Its submission concluded that permitting DVRs, especially in the context of India, is not only untenable but unwarranted. It pointed to the fact that the governance risks and agency costs that flow from capital structures with DVRs, coupled with the inadequacy of optimal sunset provisions in serving as protective mechanisms, outweigh the advantages that the efficiency of such structures are believed to yield at the time of the IPO. However, the submission stated that should SEBI go forward with its proposal, the regulator should take into account the additional safeguards that the submission proposed to make the proposal relatively tenable.

Media

Press freedom is facing several challenges

India's press is prolific, especially when you take into account all the regional publications, and has enjoyed a great deal of freedom for the most part. That is increasingly coming under pressure with this administration, as journalists have met with increased violence and found themselves charged with sedition, among other things. The pandemic was a watershed moment for the government as it asked the Supreme Court to direct the media not to publish Covid news without first ascertaining the true factual position from the separate mechanism provided by the central government. In its ruling on 31 March 2020, the Supreme Court couched its order with, "We do not intend to interfere with the free discussion about the pandemic, but direct the media to refer to and publish the official version about the developments". In 2020, Reporters without Borders ranked India 142 out of 180 countries in its World Press Freedom Index. It has been steadily dropping in the rankings: 138 in 2018 and 140 in 2019.

Media reports on scandals are voluminous

While this is a worrying trend, these issues have so far not impacted CG reporting and there is a plethora of media that reports on all the scandals and frauds that occur. There are even specialists that do offer more than a list of the facts.

Next steps

Avoid self-censorship

Media needs to stop self-censoring, which might be difficult in these times.

More training for INEDs

Independent director training, with certification, to be provided by institutes.

Big business could help SMEs

Business associations to work more closely with companies, especially SMEs, to improve CG and ESG standards.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- Non-performing assets of banks continue to rise
- Government erodes independence of the NFRA even more
- DVRs are expanded to include companies other than tech firms
- Corporates fail to provide meaningful sustainability metrics
- Courts continue to work below capacity and cases continue to accumulate

What to fix

Quick fix list

Issues to address as soon as possible:

- The NFRA should join IFAIR
- Improve enforcement disclosure on regulatory websites and annual reports
- Ensure public sector units (state enterprises) comply with all CG rules
- Release AGM notices 28 days before date of meeting
- RBI to provide guidance on climate-related disclosures
- Map BRSR standards to international ESG reporting standards
- Extend regulatory consultations to two to three months
- Review accounting and auditing standard setting to reduce time cycle for adoption of new standards

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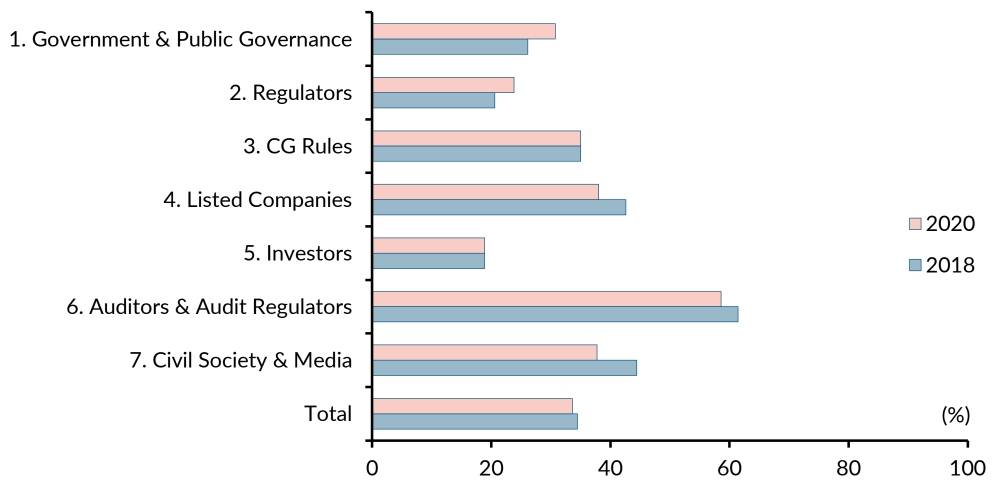
Indonesia – Cut adrift

- Indonesia came last in our 2020 survey with an overall score of 33.6%, a drop of just under one point and making it the only market to fall in score
- Indonesia's CG impetus seemed to be drifting with the financial regulator, the OJK, under-resourced and overwhelmed, ploughing a lonely regulatory furrow
- IDX has outsourced its CG responsibilities to the OJK and replaced them with a headlong pursuit of commercial goals
- Political will to push better CG standards by supporting and funding the OJK and other stakeholders has waned as Jokowi's second administration has become increasingly politicised
- The emasculation of the KPK, Indonesia's anti-corruption commission, is a poster child of the current Indonesian zeitgeist

Indonesia ranks 12th with a score of 33.6%

Figure 1

Indonesia CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Indonesia has lost its CG mojo

Indonesia seems to have been cut adrift at the bottom of our league table after our 2020 survey, with the Philippines improving its scores sufficiently to put some daylight between it and its perennial peer at the foot of the rankings. It is difficult to pinpoint exactly what has gone wrong with Indonesia's CG efforts, which started brightly with the publication in 2014 of a new CG Roadmap, but the overwhelming sense is one of drift and lost focus.

OJK too big and too alone

The Otoritas Jasa Keuangan (OJK), Indonesia's key financial regulator, has done a decent job in trying to promote better CG standards, with some sensible regulation in past years and a laudable effort to implement genuine e-voting in 2020 in part as a result of the pandemic. But the OJK is a behemoth of a regulator which oversees securities, banking and insurance as well as performing some central bank functions. It just seems to be trying to cover too much ground with too little resources.

Political will for CG has stalled

Meanwhile, political impetus for CG reform seems to have stalled under the current administration of President Joko Widodo. The country has some serious systemic issues, such as institutionalised corruption, government waste, budgetary constraint and tackling rising Islamism. The Indonesia Stock Exchange (IDX) is focussed almost exclusively on new listings. Meanwhile many local listed companies, inured to the system of corruption and politics, see little benefit in challenging the status quo. This is especially so, given the strong economic growth of recent years, which often gets confused as evidence of good governance standards. Beneath all these conflicting priorities and issues lies CG.

Recapping CG Watch 2018

Indonesia was the only market in our survey whose score fell

Indonesia scored a total of 33.6% in our 2020 survey, placing it last. It was the only market in our survey to see a reduced score from 2018, although the fall was less than a percentage point. Most markets managed modest increases. Scores for Indonesia increased in the areas of Government & Public Governance, largely because we felt we had perhaps been harsh in our scoring for the previous survey. Our score for the Regulators section also increased, mostly due to the OJK's successful introduction of electronic voting.

Civil society and audit scores fell furthest

Scores dropped in every other section except for CG Rules and Investors, which remained the same. The biggest falls were for Civil Society & Media, Auditors & Audit Regulators and Listed Companies.

A worrying gap between Indonesia and other Asian markets

All of this means Indonesia has been cut adrift at the foot of the table, a bit more than five percentage points behind the next lowest scorer, the Philippines, and a 41-percentage point gap from top-ranked Australia. Renewed and combined political and regulatory impetus is sorely needed if Indonesia is going to stay in touching distance of the rest of the Asian markets. Currently it is not clear if, and from where, that impetus will come.

Little progress since 2018

Figure 2

Indonesia: Recap of 2018

	Recommendations	Outcomes
1.	Improvement in enforcement regulation and activity	No discernible progress: resource constraints
2.	Increased participation by IDX in promoting better CG	No progress
3.	Revised rules on RPTs and other major areas of shareholder rights	No progress: RPT rules remain far behind best practice
4.	Implement blackout rules for insiders	No progress: still no rule
5.	Improve the OJK website, especially availability of timely data in English	Very limited progress

Source: ACGA

1. Government & public governance

Indonesia ranks 10th with a score of 31%

Indonesia's score for Government & Public Governance rose five percentage points to 31% in 2020, placing it at 10th in our survey, ahead of the Philippines and China and just behind Malaysia and Thailand. The current administration of President Joko Widodo has multiple challenges on its agenda and CG reform does not rank high as a result. Capital markets development is still in its infancy with extremely low levels of public investment in the capital markets. Early optimism over the emergence of the Otoritas Jasa Keuangan (OJK), Indonesia's market regulator, and the establishment of the Komisi Pemberantasan Korupsi (KPK), the anti-corruption commission, seemed to offer hope for significant reform, yet the sense now is of some drift and a lack of focus, especially at ministerial level.

New CG manual but CG code update is needed

The government issued the second edition of its CG Manual in June 2018 (the first edition came out in 2014), but that was principally the work of the OJK supported by the International Finance Corporation (IFC). The manual included several important regulatory reforms, including improvement in notices of meeting, some tightening of material transactions and the requirement of shareholders to disclose the ultimate beneficial ownership behind companies. While the document is well-structured and helpful, much of the existing regulatory framework with respect to CG remains on a "comply or explain" basis and standards are still well behind international best practice. The CG Code has not been updated since 2006 and the OJK's helpful CG Roadmap, issued back in 2014, is also overdue a revamp.

OJK still answers to government which is increasingly politicised

As the super financial regulator (it supervises banks, capital markets and insurance among others), the OJK is largely left to its own devices. Independently funded via levy and functionally separate from executive government, the OJK is the main driver of CG reform: There are few other serious proponents. However, the OJK still ultimately answers to the government. The second (current) Jokowi administration is heavily politicised and this has led to a weakening in support and initiatives for CG reform. Witness the emasculation of the KPK (see box below, Anti-graft watchdog succumbs to politics). There have been some attempts by government at state-owned enterprise (SOE) reform and some enforcement in the most egregious cases involving these companies, which serve to demonstrate just how serious the problem is.

Full foreign ownership

OJK's key focus is on bank and NBFI regulation . . .

Our score for central bank governance guidance remained unchanged from 2018. The OJK remains focussed on the regulation of banks and non-bank financial institutions (NBFIs) rather than the market in general and it has issued more than 50 separate regulations relating to lenders over the last two years. Bank consolidation, a key OJK initiative, continues, although more slowly than it would like. One of the key banking regulations passed in 2019 was to permit full foreign ownership. Meanwhile, regulations on ownership for foreign investors in insurance were also relaxed.

. . . financial literacy, IT security and digital innovation, not CG

The OJK has previously published a 2017-2022 Destination Statement, a kind of roadmap and vision of the financial services sector and its key reform objectives. These focus principally on increasing the financial robustness of banks and NBFIs, improving financial literacy among the investing and general public, strengthening IT security systems and improving digital innovation within the sector. So the OJK is still dealing with a lot of big picture aspirational issues and much less with detailed regulations to improve the CG environment. There is still no law passed on cybersecurity despite much talk over the last two to three years.

IDX's focus is on profitability

The financial system in Indonesia leans very heavily on the OJK for regulation, guidance and enforcement. There is little to no role played by the Indonesian Stock Exchange (IDX) other than as a for-profit commercial vehicle to promote market listings and share ownership. From that perspective, the IDX does not have a conflict of interest between its commercial and regulatory functions. The regulatory philosophy in Indonesia appears to remain that it is something for which the OJK is solely responsible. IDX does enforce some of its rules, but mainly against securities firms for market manipulation: Enforcement against companies is far more limited.

Political oversight problems

Government exerts hidden control over the OJK . . .

The OJK is fully and separately funded from government via market levies and has been for some five years. However, the OJK is still influenced politically: All of its commissioners (Indonesia operates a dual board structure of commissioners and directors) are still appointed by presidential decree for fixed five-year terms. The current board of commissioners comprises two ex-officio members: One from Bank Indonesia (the central bank) and the other from the Ministry of Finance. Meanwhile just two of the eight current members have any commercial experience: The remainder have backgrounds in academia and/or government institutions.

. . . as well as control over its spending

While the OJK receives no funding from government, its budgeting process is influenced by government via its board of commissioners. The 2019 OJK annual report states: "OJK charges levies on entities operating in the financial services sector. Entities operating in the financial services are obligated to pay levies imposed by OJK . . . If the levy revenue received in the current year exceeds the OJK requirement for the following fiscal year, the surplus is paid into the State Treasury." While companies and other market practitioners are obliged to pay OJK levies, it seems that they do not pay with alacrity: The 2019 accounts state that more than 61% of levies are more than six months past due; 37% are more than a year past due.

KPK powers seriously circumscribed

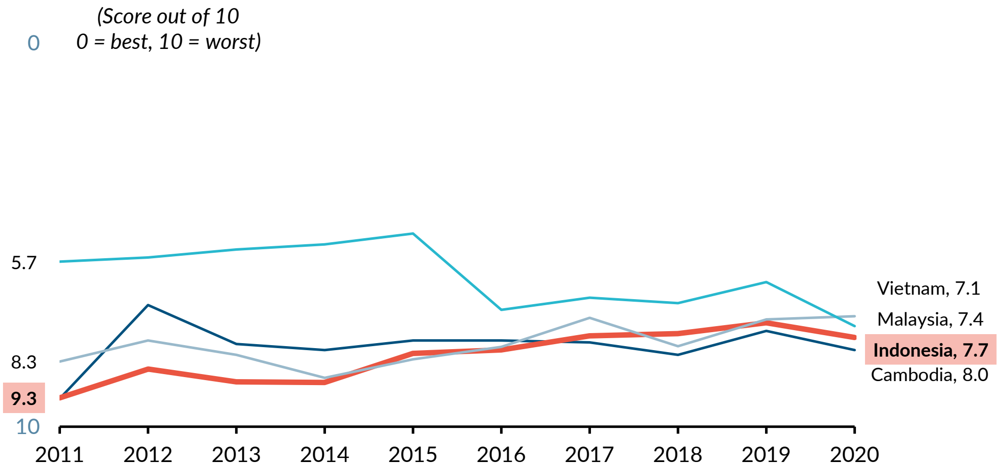
While Indonesia has long had an independent anti-corruption commission, the KPK, its powers, once wide-ranging and impressive, have been curbed of late, largely as a result its own successes. After successfully prosecuting several senior politicians and civil servants, in November 2019, Indonesia's parliament voted to establish a supervisory committee to which the KPK now reports. Parliament also removed the KPK's powers to wiretap and curtailed its powers of investigation and prosecution, particularly against political targets.

Corruption remains bad and is getting worse again . . .

In part due to the KPK's circumscription, government progress in tackling corruption in Indonesia has stalled in the last two years and by common consent, graft remains one of the country's biggest systemic problems. Indonesia has not signed the OECD Anti-Bribery Convention. The Transparency International (TI) Corruption Perceptions Index in 2019 ranked Indonesia in 85th place with a score of 40/100, but its ranking fell to 102nd with a score of 37/100 in the 2020 TI index. Indonesia also fared poorly in the 2020 corruption perceptions survey by the Political & Economic Risk Consultancy, ranking second last in Asia behind Malaysia, with Cambodia at the bottom. This was slightly worse than the 2019 survey, where Indonesia was ahead of Cambodia and India in joint last place. In TI's Global Corruptions Barometer 2019 edition, 65% of people surveyed in Indonesia stated that corruption levels had increased in the previous 12 months. While this figure dropped to 49% in the 2020 barometer, 92% of those polled in 2020 felt government corruption was a big problem.

Figure 3

Second last in Asia: Perceptions of corruption in Indonesia, 2011-2020



Source: Political & Economic Risk Consultancy

Corruption curse

. . . especially in the public sector

Public sector corruption in Indonesia remains a significant problem. The government has not published a public sector code of conduct. The OJK and Bank Indonesia do both publish a code of ethics, but these do not incorporate cooling-off periods for public sector officials accepting commercial appointments and there are no requirements to disclose assets. Indonesia does have an ombudsman, established by statute in 2008, that claims to be independent of government interference or influence. Its commissioners comprise career academics and NGO heads and its key function is to oversee government agency operations and investigate allegations or incidences of maladministration. However, it has no powers of enforcement so is essentially toothless.

No meaningful whistleblowing regulation

Indonesia has a regulation known as Procedures for Implementing Community Participation and Providing Rewards in the Prevention and Eradication of Acts of Corruption, which is the closest thing the country has to whistleblowing legislation. Signed in September 2018, the rule offers no meaningful protection for whistleblowers save provisions already contained in criminal law relating to witness and victim protection, which are designed to address vastly different circumstances.

Judiciary slow, inefficient and corruptible

Indonesia's judiciary remains inefficient and slow. Our research found no evidence that the courts are behaving more adroitly towards securities cases and there is a general consensus among the public at large that the judiciary remains corrupt and pliable. Powerful Indonesians still use the courts to disadvantage outside shareholders, investors and banks for their own ends. The situation surrounding the bankruptcy of internet provider PT Internux by Riady family-controlled companies is an example of this (see box in Listed Companies section titled DIY restructuring).

Insider trading has been illegal since 1995 . . .

The local judicial system has no specialist courts to hear securities cases so complex litigation quickly gets gummed up in the country's archaic and inefficient court system. Insider trading remains illegal under the 1995 Capital Markets Law which provides reasonable powers of investigation, penalties and sanctions, even criminal ones. Yet no one has ever been successfully prosecuted for insider trading in Indonesia.

Insiders remain beyond the law

. . . but no one has ever been convicted

The OJK conducts capital markets investigations (insider dealing and market abuse). However, the public prosecutor decides whether to bring a criminal action, a function known to be corruptible in Indonesia. The OJK has tried to prosecute cases in the past, but without success.

No specialist courts for securities cases, class action limited

Class action and collective lawsuits are permitted in Indonesia and are governed by the Supreme Court's Class Action Procedures. However, there is no provision that deals specifically with securities cases and there is no other legislation covering derivative lawsuits for securities cases. Almost all collective actions that have taken place in Indonesia have been in respect of environmental or social issues. We have not found a single case of a securities class action being brought in Indonesia. So, while in theory, securities derivative litigation is possible, in practice it just does not happen.

SOEs heavily politicised, inefficient and some corrupt

Indonesian SOEs remain heavily influenced by government. Boards of Commissioners of SOEs are dominated by government appointees. Recent scandals at certain SOEs, such as local insurance companies Asuransi Jiwasraya and Asuransi Sosial Angkatan Bersenjata Republik Indonesia, and national carrier, Garuda Indonesia, suggest a clear lack of governance, a high level of corruption and a dearth of accountability (see boxes in Investors and Auditors & Audit Regulators).

Next steps

A CG reset is required at government level

A governmental reset is needed on CG. The damage done to the KPK needs to be addressed while clearly the SOE sector needs a significant overhaul. It is doubtful that the political will exists within the current administration to tackle what are serious and highly politicised issues.

Too much onus on OJK for CG

While the country's economic and developmental priorities lie elsewhere, understandably given the challenges faced, it is probably unrealistic to expect material progress on CG reforms. In the meantime, the country will likely continue to lean heavily on the OJK's work to promote and improve CG practices in the country. It is difficult to escape the conclusion that the OJK is responsible for too much with too little support. It all makes for a somewhat dismal outlook.

Anti-graft watchdog succumbs to politics

KPK powers emasculated in political push

Despite a reputation for endemic graft across the public and private sectors, Indonesia somehow created the Komisi Pemberantasan Korupsi, or KPK: Its anti-corruption commission.

Success leads to contempt

Launched in 2002 as an independent body, and against all odds and expectations, the KPK proved to be highly effective and claimed plenty of political scalps, forging a reputation for integrity and incorruptibility. In fact, it quickly proved to be too successful and soon gained powerful enemies in the police, Attorney General's Office and finally, in political circles.

Political foes crushed anti-corruption body

It was this latter group that ultimately sealed its fate. Putatively as the price of political support from major backers Megawati Sukarnoputri and Surya Paloh during his second term election in 2019, President Joko Widodo's administration passed a new KPK law late that same year to bring the agency to heel. Its independence was crushed with the appointment of a supervisory board led by a police general to control it.

Focus of agency shifts from eradication to education

Investigative powers have been curtailed with prior permission now required from the supervisory board to undertake certain probes as well as surveillance and wiretapping, techniques that had felled some major political figures in the past. The focus of the KPK has been reset to corruption prevention as opposed to overt eradication.

2. Regulators

Indonesia scores 24% and comes last

Indonesia's score under this section actually rose three percentage points to 24% but still left the market last in our rankings, given more positive moves by regulators in the Philippines. The increase in score was principally due to its creation of an effective electronic share voting platform, with barely any progress in other areas. This highlights the stasis in Indonesia's regulatory environment and the apparent lack of political will to do much to change it.

Enforcement is lacking

An erosion of investigatory powers and a clear lack of support from government led to a drop in overall scores for enforcement which remains one of the country's biggest problems. Indonesia lacks the political will to bring about serious regulatory change, but it could make much more effort to enforce the rules it already possesses.

2.1 Funding, capacity building, regulatory reform

Indonesia ranks 11th with a score of 31%

Indonesia gained nine percentage points in this sub-category, increasing its score to 31% and overtaking the Philippines to rank 11th. The OJK, while fully funded via transaction levies (since 2016), still agrees its annual budget with government and remits any surplus to the treasury. This leaves no accumulating surplus, making it difficult to plan for expansion and meet immediate and unanticipated needs for additional resources. Also, with limited publicly disclosed data (particularly in English), it is difficult to assess the adequacy of human and financial resources available to the OJK to carry out its regulatory functions. The OJK's latest Annual Report is 2019 (issued in September 2020) and while it is a glossy production with plenty of coverage of awards and ceremonies, strategic objectives and plans for financial development, it is weak on detailed disclosure of regulatory activity.

OJK lacks a capital markets focus

OJK has placed a significant focus on the banking and NBFI sectors and puts considerable effort and resources into consumer protection and education. Capital markets focus seems to be lacking. It is hard to escape the conclusion that OJK is trying to cover too much ground with too little resources at its disposal. Total staff numbers in 2019 increased by some 20 staff over 2018 although the number of full-time employees actually fell, despite a modest 8% increase in revenues. OJK does not provide a breakdown of staff numbers by regulatory activity.

OJK enforcement activity is low and main focus is banks/NBFIs

No data is provided in the 2019 annual report in respect of investments made by OJK in surveillance, investigation and enforcement capacity so it is not possible to ascertain the extent of progress (if any) made in tackling these key local market problems. In 2019, 22 investigation warrants were issued by OJK, but only four of these were for capital markets matters. Of the 19 cases handed to the Attorney General's Office (AGO), just three were in respect of capital markets matters.

IDX enforcement aims at securities firms vs listed companies

Asleep at the wheel

IDX undertakes its investigation and enforcement activities via the office of the Director of Surveillance and Compliance with two sub-departments - the Member Compliance Division and Market Surveillance Division. However, IDX provides no detailed breakdown of the staff employed in these specific areas, so it is difficult to ascertain the adequacy of resources deployed in these activities. IDX's 2019 annual report refers briefly to enforcement activity in respect of several significant and high-profile scandals involving the national carrier, Garuda Indonesia, as well as a major market manipulation scandal involving Hanson International and Asuransi Jiwasraya, but it provides little information other than to promise that investor protection schemes will be a focus of enforcement in the future.

IDX designates securities firms deemed a financial risk

In 2019, IDX introduced a special notation system which designates certain high-risk securities companies for going concern issues such as bankruptcy, known as *penundaan kewajiban pembayaran utang*, or PKPU proceedings - an Indonesian form of financial restructuring - and negative equity, as well as for adverse audit opinions or disclaimers and/or non-availability (read non-submission) of financial data. As of 31 December 2019, IDX had designated 47 securities firms with special notations. In the same year, IDX also issued 10 sanctions to eight exchange members for non-compliance with its regulations. Sanctions can take the form of a reprimand, warning, fine or even suspension.

IDX delisted companies due to financial issues

IDX forcibly delisted four issuers in 2019, but these were all for going concern issues rather than (or because of) egregious corporate behaviour or flagrant breaches of its regulations. Also in 2019, IDX imposed 648 sanctions on listed companies for non-compliance with its Listing Rules. The corresponding number for 2018 was 649 sanctions. A total of 34 listed companies were suspended: In 2018 the figure was 28.

Limited IDX disclosure of enforcement activities

The IDX 2019 annual report provides limited disclosure on new investment in surveillance, investigation and enforcement capacity and technology. There was some investment in new middleware and document uploading software related to the enforcement division but no major surveillance system upgrades. No breakdown of surveillance staff numbers is provided.

Improving disclosure

OJK's new UBO law is a welcome move . . .

The past two years have seen no material changes to securities legislation aimed at improving CG, but the OJK deserves credit for its initiative in revising some important rules on disclosure, most notably mandating that issuers reveal the ultimate beneficial owner (UBO) behind shareholdings in listed companies. Also welcome was the OJK's tightening of certain rules on related-party transactions, a common area of abuse in Indonesia. The government has loosened foreign ownership limits in certain industries over the last two years, notably in the insurance sector. There is no sign (thankfully) of dual-class shares being introduced into Indonesia, despite a surprisingly strong domestic technology sector.

. . . but IDX's CG rules rollback is not

While the OJK spent the last two years enacting some regulatory reform, IDX has done the opposite, rolling back CG progress via its 2018 rule that abrogated key prerequisites for listed companies, including dispensing with the need for INEDs, reducing listing requirements and scrapping the preliminary listing agreement. IDX has effectively delegated its CG responsibilities to the OJK. It just does not seem to think that it plays a role in promoting and encouraging better CG standards.

Regulators do not consult the public properly, if at all

Another way in which Indonesia's financial regulators lag regional peers is in the lack of public consultation. Neither the OJK nor IDX seems to support public consultation processes when proposing regulations. Our research found no record of prior consultations. The OJK will announce new rules ahead of time, by providing an effective date of, say six months ahead, so arguably this does offer some time for lobbying and theoretically, alterations to requirements. But in practice, OJK procedures are sufficiently slow and cumbersome as to make a proper consulting period impractical. IDX rule changes are few and far between and there is no evidence of prior formal consultation.

The OJK website is woeful

The OJK's website is fiendishly difficult to navigate with many dead ends and several empty pages. The information provided is generally dated, particularly for the English-language site, which always lags the local version sometimes by months. It is difficult to fathom why the OJK has failed for so many years to fix this issue: No other market in Asia is so far behind as Indonesia is with its foreign language news and regulations. The only conclusion we can draw is that the OJK lacks either the will to address the issue, or the budget - or perhaps both.

Upgrade required

IDX site is good but needs better document database

In contrast, the IDX website is good, and the English version is likewise solid and generally up to date. It is more informative in some respects than the OJK site, but in terms of CG, much less so. The IDX site provides announcements in English and Bahasa and is easy to access and to load. However, there is only three years of accumulated data. It may be that the annual data will now start to accumulate; last time we reviewed the site for CG Watch, it only provided two years' data, so hopefully the database will now be incremental.

OJK e-voting system is a welcome initiative

The OJK deserves credit for its initiative in creating an effective electronic share meeting and voting platform. Already in the pipeline when Covid struck, the pandemic accelerated the programme's rollout and the OJK introduced its electronic general meeting shareholders (e-RUPS) system. This allows a shareholder to appoint a proxy by electronic means to vote on their behalf and without the need to file a power of attorney. It also permits shareholders to cast their votes electronically if they wish, although this function has yet to go live (see box in Listed Companies, "AGMs during Covid: eASY").

OJK and IDX aggressively push stock market investment

The OJK and IDX have made no progress, however, in encouraging financial intermediaries to assist in the promotion and development of CG among new listing candidates. Like many other stock markets in the region, the OJK and IDX are aggressively pushing stock market investment and new listings, especially IDX. There are some OJK requirements for sponsors within the existing rules (this is also the case with IDX) but these rules are formulaic and do not focus on CG issues in any way that would help prepare companies for listing.

Next steps

Enforcement can only improve with better funding

While the OJK is self-funding, it is certainly not free of government interference over how its money is spent, with a requirement to return funds to the treasury in excess of agreed budget. This is a recipe for misallocation of resources and this is most obvious in the under-resourced enforcement department at the OJK. If perennially weak enforcement is going to improve, the OJK simply has to invest in human and technical resources appropriate for modern securities markets. Otherwise, it is very difficult to see any improvement in the market's poor enforcement track record.

IDX needs to start to play a role in promoting CG

IDX needs to start playing a proactive role in the promotion of better CG practices among locally listed companies if standards are going to improve measurably. As the frontline regulator, IDX has the duty as well as the resources to police its rules and prosecute. It does a reasonable job at enforcement with its exchange members, the securities companies. The fact that it does not seem to bother much with listed companies suggests that its priorities lie in its commercial endeavours.

Indonesia's response to Covid: sense and e-daptability

The initial response is pragmatic

While Indonesia's response to the pandemic was largely helpful and practical, including bringing forward the implementation of the market's first electronic meeting and voting system, waivers allowed on certain accounting standards were a cause for concern.

Extended deadlines for financial reporting and AGMs

AGMs, financial filings are put on hold

On 18 March 2020, Indonesia's Financial Services Authority, the Otoritas Jasa Keuangan (OJK), granted a two-month extension for preliminary annual financial statements to be published and allowed AGMs to be pushed back by two months to 31 August. On 23 March, two months' grace was also given for 2020 interim financial results. Meanwhile the regulator also encouraged the use of e-voting and allowed the holding of electronic general meetings of shareholders (GMS). (See box on virtual AGMs under Listed Companies.)

Other forms of support

A relaxation of share buyback limits

On 9 March 2020, the OJK allowed issuers to undertake share buybacks without first obtaining approval from a general meeting of shareholders. It also increased the allowable size of these buybacks from 10% to 20% of paid-up capital. The OJK described this as an effort to stimulate the economy and reduce the impact of fluctuating markets.

Accounting waivers

A suspension of standards

More controversially, Indonesia granted waivers from certain accounting rules. In mid-March 2020 it allowed financial institutions to disregard the impact of Covid when applying accounting standards in relation to loan concessions and provisions. The waiver was applicable for reporting periods up to 31 March 2021.

2.2 Enforcement

Indonesia ranks 12th with a score of 16%

Indonesia dropped by three percentage points to score 16% in this sub-category, ranking lowest among the markets and trailing the Philippines by 10 percentage points. Indonesia's track record of enforcement of securities laws and regulation remains the region's weakest with no signs of improvement in the period under review. Enforcement resources at the OJK have not increased materially. There are still no successful insider trading prosecutions. The Hanson/Asuransi Jiwasraya scandal (see box below) demonstrates the scale of the problem that the OJK faces. Enforcement by the OJK against exchange members remains fairly vigorous - but it needs to be - as recent scandals and stock-rigging schemes have shown.

OJK has decent enforcement tools . . .

Arguably, the OJK's powers of surveillance, investigation, sanction, and compensation have deteriorated since our last report, as the KPK's powers of surveillance have been heavily circumscribed by Parliament and the OJK seems further away than ever in getting effective powers of investigation and sanction. In 2019, the OJK referred 19 cases to the AGO, mostly related to banks and

NBFIs: Only three were capital markets cases. Disclosure of enforcement statistics by the OJK remains woefully inadequate, making it impossible to form an accurate picture of genuine enforcement activity and efficacy.

Legal lethargy

. . . but cannot really use them due to an arcane legal system

Indonesia does not have a specific law that deals with corporate fraud: Most offences are covered by the Penal Code. Authorised investigators under the Criminal Procedures Code (which stipulates rules to investigate and prosecute Penal Code offences) are typically police officers. The OJK is provided with some powers to investigate criminal investigations in the financial services sector, but investigators in these cases are police officers seconded to the OJK, or OJK civil servants directly authorised to do so. The OJK can impose certain civil sanctions but all prosecutions must be undertaken by a public prosecutor under the AGO. In large part because of the problems identified above, the OJK has a dismal track record of prosecuting cases of market malpractice. No one has ever been successfully prosecuted for insider trading. Market manipulation is rife, yet sanctions and prosecutions are often slow and inefficiently handled.

IDX takes action against brokers, less so against listed companies

IDX has powers to sanction, fine, suspend and delist companies. It delisted six companies in 2019, two companies due to takeovers and the rest due to liquidation or bankruptcy. There are administrative and criminal sanctions under the Indonesian Capital Markets Law that apply to breaches of IDX listing rules but any criminal sanction is handed over to the AGO. So, IDX has powers, but enforcement remains the key problem.

IDX enforcement by the numbers

Our score for IDX enforcement activity remained the same as our last report. IDX's enforcement track record against breaches of its listing rules is set out in the table below, along with its action against securities companies. While basic data is disclosed, there is no detail provided, no analysis and no discussion of enforcement philosophy or strategy offered.

Market misbehaviour in figures

Figure 4

IDX enforcement statistics, 2019

Listed company enforcement	Number of cases	Exchange member enforcement	Number of cases
Sanctions (warnings, fines)	648	Routine surveillance	76
Unusual Market Activity notices	78	Trading systems checks	24
Suspensions	34	Special inspections	8
Delistings	6	*(with the OJK)*	*(6)*
Total	**766**	**Total**	**108**

Source: IDX

IDX puts commercial interests far ahead of its regulatory role

IDX remains furiously commercial in its strategic outlook. Its December 2018 rule change to defer CG oversight to the OJK by watering down its listing rules is indicative of an approach that puts commercial imperatives far ahead of regulatory ones. IDX seems to continue to believe that regulation is not really its responsibility, especially as it relates to listed companies. Its enforcement approach to securities companies (exchange members) is better and it has tried to sanction and weed out the most egregious cases.

Government support of OJK, IDX enforcement lacking

Meanwhile, neither the OJK or IDX receives committed support from the government or the legal system, including the police and courts. The emasculation of the KPK and increasing politicisation of the legal system suggests that support for capital markets regulation and enforcement has waned under the second Jokowi administration.

Enforcement will not improve until policymakers get serious

Next steps
It is difficult to see enforcement activity and efficacy improving in Indonesia until such time as the government decides to back its regulators, most notably the OJK, with proper funding and political support. While the OJK can and does enforce at times against errant companies, it usually does so only in the most egregious of cases (see box below) and the OJK rarely seems to receive adequate political backing, let alone the resources, for a more consistent enforcement approach.

A rare case of enforcement

The OJK bares its teeth over Hanson
In August 2019, the OJK announced sanctions and significant fines on local property developer, Hanson International, for violations of capital market laws. The OJK said that Hanson had misrepresented its financial statements for 31 December 2016 and used questionable accounting practices to improperly recognise profits from its real estate business by incorrectly recognising revenues from the sale of a piece of land and failing to disclose the exact terms of the sale and purchase agreement related to the sale.

Executives at developer receive censure and fines

The OJK censured and fined Hanson CEO and controlling shareholder, Benny Tjokrosaputro, and his CFO for failing to oversee the company's financial statements. The OJK also sanctioned and fined the audit partner of Purwantono, Sungkoro and Surja, a member firm of Ernst & Young, who conducted the 2016 audit of Hanson International. The OJK said that the partner had violated the professional ethics standards of the Indonesian Institute of Certified Public Accountants (IAPI). Tjokrosaputro's fine was especially heavy: Almost the equivalent of US$350,000, an unusually high sum in Indonesia.

3. CG rules

Indonesia ranks 12th with a score of 35%

We maintained Indonesia's score for our CG Rules category compared with our last survey, leaving it in last place again with a score of 35%. This score, however, hides quite a lot of movement in individual scores. We lowered scores for quality of corporate, financial and CG reporting standards, rules handling price sensitive information, blackout periods, related-party transactions and insider trading deterrents.

Higher scores for some improved rules

Meanwhile, we increased scores for improved rules relating to minority shareholder nomination of directors, barring directors convicted of fraud, and stronger rules on pre-emption and board independence. There were also some changes relating to new scoring methodologies. All told however, Indonesia still lags far behind most of its regional peers in terms of CG rules and there is a lingering sense of drift in terms of progress and reform impetus.

Financial reporting adequate but lags best practice

Corporate and financial reporting standards in Indonesia, while adequate, lag our tests for best practice. Deadlines for issuing quarterly reporting (mandatory) and annual and audited financial statements are generally longer than our recommended deadlines. Management discussion and analysis statements, while required, tend to lack disclosure especially around materiality issues. Risk factor disclosures are generally adequate and while IFRS are generally adopted and applied, local financial reporting standards are still behind best practice. Detailed disclosures around breakdown of operating expenses, share pledges, segment reporting and loans are all behind best practice.

IDX disclosure rules are vague

Lack of detail

An IDX rule states that companies must make "Periodic Disclosures" and "Incidental Disclosures". There is also the concept of a "Public Expose", a public presentation of a company's prospects and plans that must be made on an annual basis. The periodic disclosure requirements for listed companies mean releasing quarterly statements (within three months of period end for audited quarterlies; within two months for a limited review and within one month for unaudited). Audited annual statements must be released within three months of the financial year-end.

Financial statements are solid but detail is lacking

In all cases, companies must include financial statements containing profit and loss, balance sheet, cashflow and changes in equity, all including notes. However, no specific requirements are given with respect to what is contained in the notes, although the financial statements must be drawn up in accordance with an OJK rule, Guidelines for the Preparation of Financial Statements. Interim statements do not have to be audited but if not, must "contain equivalent quality of disclosure to the disclosure that is existed [sic] in the latest Audited Financial Statement".

CG reporting remains rudimentary

CG reporting standards remain rudimentary in Indonesia. Requirements are handed down to listed companies by the OJK, via a regulation passed in 2014, which requires companies to report separately on CG and ESG disclosures on their websites as well as in their annual reports.

How CG stacks up

Figure 5

CG and other disclosures required by the OJK ("comply or explain")

Requirement	Details
List of company shareholders	Requires disclosure of controlling shareholders
Profiles of directors and commissioners	Disclosure of any RPT interests
Details of board committees, name and address of corporate secretary and public auditor	❑ Charters of Boards (directors and commissioners) ❑ Charters of Audit, Nomination and Remuneration Committees ❑ Internal Audit charter
Five years' financial statements	Annual audited and interim statements
General Meeting of Shareholders	Notice; agenda; profiles of board candidates; minutes of previous AGMs
Other	Risk management policy; code of conduct; whistleblowing system; anti-corruption policy

Source: OJK

Most companies explain rather than comply

Companies are required to comply with the disclosure obligations or explain why they do not. Many of course choose the latter option. Much of the disclosure is repeated annually by way of boilerplate wording and there is no explicit ban by regulators on the practice. IDX has no CG-related disclosure requirements.

ESG reporting remains weak

ESG and sustainability reporting standards remain very limited. The OJK regulation referenced above requires companies to include some very basic disclosures relating to CSR policies, types of programme and costs incurred under the following categories: Environment; employment, health and work safety practices; social and community development; and product and/or services responsibility. All these should be accompanied with supporting information. Again, IDX has no such disclosure requirements.

Improving disclosure

Quarterly reporting is generally too brief

As mentioned above, quarterly financial reporting is required under Indonesia's Financial Reporting Standards and these require consolidation, profit and loss, balance sheet and cashflow statements. However, detailed trading and CG statements are generally brief and inadequate.

Substantial ownership rules are better but timing too long

Disclosure requirements for substantial ownership in listed companies is better than it was, largely due to a new OJK regulation passed in 2017, which requires disclosure of the ultimate beneficial owner of any shareholder. "Substantial" in an Indonesian context means 5%, with additional disclosure at each 0.5% integer: Quite respectable. However the timing for disclosure, at 10 days, is far too long.

Director and commissioner ownership rules are better

The same OJK rule cited above requires directors and commissioners of a public company to report to the OJK their direct or indirect ownership and every change (regardless of amount). The rule requires issuers to implement an internal policy for directors and commissioners to report share ownership and/or changes to the company within three working days. This policy must be disclosed in the company's annual report or on its website. Curiously, directors and commissioners are only required to disclose shareholdings and any changes to the OJK within 10 days.

Insiders still protected

No local rules on share pledges

There is no specific regulation in Indonesia with respect to the disclosure of share pledges by controlling shareholders. The only potential rule that catches this eventuality remains the blanket OJK requirement obliging listed companies to disclose material facts or information that may affect the share price to the public within two business days. This provision contains the phrase: "Any other information that is deemed material", which should reasonably cover a share pledge by a controlling shareholder. IDX has a rule stating that an incidental report must be made as soon as possible to the exchange in respect of material events, including, "other matters which appropriately can be deemed potential in influencing the price and or investment decision of an investor".

No blackout period for insiders

While insider trading is forbidden by the Capital Markets Law and OJK regulations mandate additional disclosure of share dealings by directors and commissioners, there is no explicit blackout period during which these individuals may not trade shares. Insiders are simply prohibited from dealing in shares when they are in possession of material non-public information. Some Indonesian companies do disclose policies in their CG reports that incorporate blackout periods, usually one month before any results announcement, and whenever they are in possession of material non-public information. It is difficult to ascertain whether any of these policies or regulations are effectively policed. No one has ever been convicted of insider trading in Indonesia.

No specific rule on PSI

The same OJK regulation requiring the disclosure of material facts and information that may affect the share price covers the disclosure of price-sensitive information (PSI). There is no rule that specifically deals with PSI. There is also no regulation requiring companies to suspend trading in their shares if they have failed to disclose PSI in a timely fashion. Again, the OJK's catch-all rule mandates disclosure within two business days; IDX's rule requires disclosure as soon as possible.

Related-party rules trail best practice . . .

Indonesia's rules relating to disclosure of related-party transactions (RPTs) are also woefully lacking. The current OJK rule is from 2009 and operates on two concepts of RPTs. The first is an affiliated transaction, which can be announced after the event (within two business days) to the market. Basic transaction details are required to be disclosed and an independent appraiser report included to opine on the terms. No circular is required to be sent to shareholders and they do not get to vote on the deal.

. . . with a split definition of RPTs . . .

The second transaction, a conflict of interest transaction, is a little closer to what one would expect to see with respect to RPTs. Directors, commissioners and major shareholders are deemed insiders and excluded from voting. A circular must be sent to shareholders and pre-approved by a majority of independent shareholders. However, the definition of what constitutes an independent shareholder is too vague and is open to abuse (see box below, A material failure in governance).

. . . although a recent rule change has helped

In October 2020 however, the OJK passed a new regulation (No.17/POJK.04/2020 Material Transactions and Change of Business Activities) aimed at reducing the scope for abuse of affiliated transactions by requiring major transactions (essentially any acquisition or disposal representing 20% or more of a company's equity, assets, profits or revenues) that are also affiliated transactions, to be the subject of a specific vote of independent shareholders. While the new rule did not specifically address the RPT rule shortcomings, it would have required the controversial Indofoods RPT to be subject to an independent vote (again, see box below).

Poll voting at GMS is not mandatory . . .

Voting at company general meetings of shareholders (GMS) is not yet required to be carried out by poll and generally takes place on a deliberative consensus basis, which is akin to a show of hands. A formal poll is conducted only if there is no consensus, at which point the voting threshold is typically 50% of those voting in person or by proxy. Abstentions are traditionally counted with the majority. Voting results are required to be disclosed.

Pressure for poll votes pays off

. . . but is beginning to happen in practice

That said, in part due to pressures from external shareholders (principally foreign institutional investors) many local companies exceed regulations and are adopting poll voting as standard practice. In addition, as a response to the pandemic, the OJK introduced its e-RUPS voting system, an electronic voting platform that allows shareholders to vote directly and electronically (see box in Listed Companies, AGMs during Covid: eASY). So Indonesia, both from a regulatory and a practical perspective, has made progress over the last two years or so.

CG Code is dated and needs an overhaul

Indonesia lacks a code of best practice, despite the laudable 2014 CG Roadmap. The latest official CG Code is still the 2006 version although the OJK published CG Guidelines for public companies in 2016, which introduces a "comply or explain" regime for certain additional measures and there was a 2018 CG Manual published (in its second edition), which is not a code and is not mandatory. Indonesia's CG codes and guidelines remain outdated and far behind best practice. A major overhaul is overdue. Unsurprisingly, there is no stewardship code in Indonesia, although the OJK has talked in the past of trying to introduce one, to date without success.

Board independence definition is sound but cooling-off periods are too short

OJK and IDX rules state that independent non-executive commissioners (Indonesia operates a dual board system and there are no independent directors) cannot be affiliated with the controlling shareholder of the company, nor affiliated with any other director or commissioner or any sponsoring bank or broker. The definition of independence is generally sound. However, the cooling-off period to establish independence is just six months which is inadequate and permits former lawyers, accountants and bankers to be appointed easily.

Board remuneration disclosure is weak

Current OJK rules require only the disclosure in the annual report of total remuneration paid to board members and senior executives for the previous financial year. There is no requirement to disclose the remuneration of individual directors or senior management. Companies are also required to disclose how directors' compensation is reviewed and evaluate board remuneration. In practice, disclosure tends to be limited and compliance driven.

Audit committees are mandatory and are generally well run

Audit committees are mandatory in Indonesia, although they are not genuinely independent. OJK rules state that one member of an audit committee must be an independent commissioner and two other members must be appointed outside of the listed company. These appointments are typically external accountants and there are restrictions relating to share ownership and connections with other board members, so there is an element of independence, although the six months cooling-off period restricts that independence significantly. Audit committees report to the board so their ability to access and communicate independently with the external and internal auditors is questionable.

Other board committees are less independent

OJK rules mandate the formation of a nomination and remuneration committee but only require the chair to be an independent commissioner. The other two (or more) members can be outsiders, commissioners, directors or executives, although the latter cannot comprise a majority of committee members. The terms of reference for the nomination committee set out in the OJK regulations are adequate but not extensive.

Minority shareholder director nomination is possible, but rare

It is possible for minority shareholders to nominate independent directors, but it is not easy and rarely happens in Indonesia. For listed companies, a shareholder (or group of shareholders) must hold 10% or more of an issuer to call a GMS or 5% or more to propose a resolution. The voting requirement to pass any such resolution is 50%, however. In practice, very few INEDs get nominated by minority shareholders.

Fraudsters thrown off boards

Rules on exclusion of errant directors are strong

Curiously for a country with some egregious board room misdemeanours, Indonesia has strong rules against permitting persons convicted of fraud or other corporate crimes from serving on the boards of listed companies. Anyone sentenced for a crime relating to the financial sector or one that caused losses to the state, is forbidden from acting as a director. Likewise, directors held responsible for the bankruptcy of a company on whose board they served are also barred. Stringent though these rules seem to be, however, it is not clear whether they are enforced in practice.

Pre-emption rules have improved but still weak

Pre-emption rights for minority shareholders remains a problem in the Indonesian market. While a 2014 OJK regulation tightened rules a bit, requiring any non-pre-emptive issues to be pre-approved by shareholders and limited to 10% or less of the issued share capital, there are no limitations on discounted issue prices. And financially stressed and distressed companies may issue shares without pre-emption.

AGM notice at 21 days is behind best practice

The minimum notice period for an AGM (known as General Meetings of Shareholders or GMS, in Indonesia) is only 21 days, compared with our benchmark of 28 clear days. Also, information requirements in notices are alarmingly general. To quote the relevant OJK rule: "Shareholders have the right to receive information on the meeting agenda and corresponding material related to the agenda as long as it is not against the interest of the Public Limited Company." Potential board appointees must have their CVs posted on the company website ahead of the GMS.

Basic minority protections in takeovers and delistings

Minority shareholder protections during takeovers, voluntary delistings and major transactions remain basic, although an OJK 2018 regulation did introduce some positive changes. The threshold at which a mandatory takeover is required in certain circumstances was lowered to below 50% and there are certain restrictions on the prices at which these transactions can be done. Major corporate transactions (between 20% and 50%) simply require post facto notification and an independent appraisal. An independent shareholder vote is required for a transaction of more than 50% and, following the rule change mentioned earlier, since October 2020, an independent shareholder vote is required for a major transaction that is also an affiliated transaction.

Collective engagement is possible but rare

Under Indonesian company law, any shareholder is free to call a GMS (there is a 10% shareholding threshold), nominate directors (at 5%) and litigate against the company. So in theory, institutional investors are free to undertake collective engagement. However, the law does not specifically recognise institutional investors as distinct from other investors and concert party rules in Indonesia are weak. So in practice, institutional collective engagement and activism is both difficult and rare.

Next steps

CG guidelines need to become rules

Indonesia is overdue a CG code overhaul. Like the Philippines, Indonesia would benefit from codifying more of the guidelines into regulations to forcibly push standards higher. Without direct intervention from the regulators (which for all practical purposes, means the OJK) it seems unlikely that CG standards are going to improve materially. The same goes for environmental and sustainability reporting which remains far behind best practice.

Upgrades are overdue

Specific areas of CG that the OJK should take a long hard look at include:

- Close the "affiliated transaction" loophole in the existing RPT rules;
- Mandate disclosure of share pledges;
- Tighten rules on price discounts for pre-emption issues;
- Improve board committee independence;
- Introduce a formal takeovers code; and
- Enforce insider trading rules.

Controlling shareholder exploits weak RPT rules

A material failure in governance

A May 2020 deal involving Indonesian tycoon Anthoni Salim and his listed Indonesian group, Indofood CBP Sukses Makmur (ICBP), demonstrates how weak the market's related-party transaction (RPT) rules are compared with international best practice. The deal saw ICBP agree to acquire food distribution businesses based in Africa and the Middle East, owned by Salim. In addition to some questionable valuation metrics, institutional investors were outraged when ICBP announced that Salim's Indofood Sukses Makmur, ICBP's controlling shareholder, would vote on the deal, reversing an earlier statement that it would recuse itself.

Quirk in rules draws ire

The about-turn was made possible by a quirk of Indonesia's RPT rules that permits certain connected transactions to be categorised as "affiliated transactions" as opposed to "conflict of interest transactions". The latter require an independent shareholder vote to proceed; the former do not: They merely require an announcement and an opinion from a financial advisor that the transaction is affiliated and not conflicted. As ICBP shareholder, BlackRock stated in a voting bulletin: "There is a material failure in governance at the ICBP board level resulting in a failure to protect minority shareholders' rights in what is an acknowledged related party transaction." BlackRock voted against the transaction, but it proceeded anyhow.

Deal is pushed through ahead of new rule

To rub salt in the wound, the deal was approved ahead of an October 2020 OJK rule tightening rules around major transactions that are also affiliated, and which now require independent shareholders' approval. The new rule would have caught the ICBP deal.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

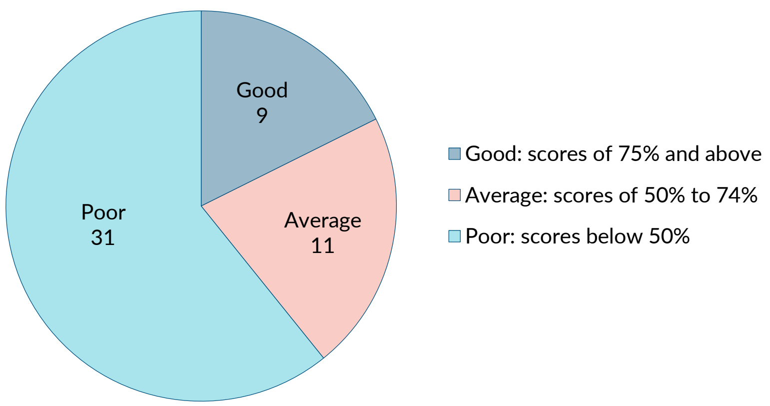
Indonesia ranks 12th with a score of 38%

Our score for the listed companies' section for Indonesia fell by five percentage points, to 38%, placing it 12th overall. The drop was in the main due to a tightening of our assessments from our new scoring methodology, with seven high-level questions where scores fell and just two where scores rose. Our aggregate results showed that large caps performed well in nine of 51 sub-questions, averagely in 11, and poorly in 31 (see figure below).

Indonesian companies rated "poor" in most questions

Figure 6

Indonesia: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Indonesian companies are good at certain aspects of IR

Where Indonesia does well

Indonesian companies provide investors with some detailed disclosures, including beneficial and substantial ownership, and some key financial metrics such as company loans, trade receivables and payables. Large caps are generally better at financial disclosure but mid-cap companies also have decent investor relations departments that provide regular financial disclosure. However, corporate announcements are still lacking: Six of the 15 Indonesian large caps we analysed did not have sufficient historical records (dating back five years or more), none of the 15 disclosed AGM investor discussions, and the four AGMs that suggested amendments to their articles of associations did not provide new articles with highlighted changes. Furthermore, some poor performers dragged Indonesia's score down when it came to the disclosure of operating costs and rationale behind corporate actions.

Indonesia doesn't permit INEDs to receive share-based remuneration

Along with a few other markets, Indonesia performed particularly well on whether independent directors were not paid with stock options or restricted share awards. With a dual tier board structure - board of directors and board of commissioners, Indonesia's equivalent of independent directors - commissioners are appointed in proportion to the shareholding profile and thus expected to look after these specific interests. As such, INEDs do not receive share-based remuneration, so Indonesia scored full marks by default.

CG reports are formulaic with plenty of boilerplate

Where Indonesia performs averagely

Indonesian companies produce CG reports that are average by our assessment criteria, but they are still far from best practice. Both large and mid-cap companies are required to produce these under OJK rules and so tend to follow form and strict requirements, rendering reporting formulaic and of dubious utility. From our assessment, all 15 large caps disclosed director attendance statistics and how they implement the CG code. However, when it came to committee reporting, the majority of large caps at most disclosed lists of their committee members and only discussed general responsibilities of committees. On board evaluation, most companies disclosed that they performed the evaluation; however, only three of the 15 mentioned the use of third-party assessors, and none shared conclusions or lists of areas for improvement.

Board remuneration disclosure is weak and audit independence could be stronger

Audit committees (AC) among Indonesian companies scored averagely in terms of competence in finance or accounting, and AC chairmen's independence from management or external auditor. Auditor independence is offered to some extent by audit partner rotation, although audit firm rotation is not required given the shortage of suitable auditor alternatives. The majority of the 15 large caps showed sensitivity to the issue through maintaining non-audit fees to be less than half of audit fees, though a handful dragged Indonesia's score down. Furthermore, for many of the large caps, there is no clear disclosure on internal audit departments reporting directly to the ACs.

Anti-corruption policies are generally okay, but their enforcement is suspect

Anti-corruption policies among Indonesian companies are also far from best practice. Eight of the 15 large caps provided whistleblowing policies with methodology and confidential contact details, but 10 of the 15 did not have public codes of conduct. The efficacy of such policies is also suspect given the lack of material enforcement effort and disclosure.

Sustainability reporting is poor

Where Indonesia does poorly

ESG and sustainability reporting among Indonesian companies is generally poor, particularly among mid-cap companies, which scored a zero in our survey, while our score for large-cap companies was just a single point. Of the 15 large caps, 12 disclosed a materiality matrix, but only one provided a clear link to its business with discussion of how materiality is determined. Only a handful of companies discussed some of their SASB-identified material issues in detail. In particular, when it came to discussing physical risks of climate change, SASB identified the issue as material for five of the 15 large caps, but only one acknowledged the risk without disclosing steps to addressing it, while the others did not discuss the issue at all.

Weak disclosure of board and executive remuneration

Remuneration disclosure continues to be an area where local companies follow strict rules and benefit from "comply or explain" loopholes. Within our analysis, Indonesia only scored well in the question on whether INED remuneration excludes share-based awards, and otherwise scored poorly in other remuneration-related questions, with no disclosure of remuneration by director or executive, or INED policies. Most companies only provided board remuneration in aggregate, for either the board of commissioners or board of directors.

Disclosure of board policies is also weak and chairpersons are seldom independent

Board policies and disclosure matters are also weak among local companies. Our analysis of chair independence among listed companies revealed that 11 of the 15 large caps had chairmen that were not designated independent and none appointed a lead independent director: Controlling shareholders tend to control the boards of companies, especially the board of commissioners. Disclosure of board diversity polices is also rare: Most of the large caps mentioned board diversity in their reporting but did not disclose any plans or target for improvement. In addition, only one of the 15 provided a board skills matrix, while the others only provided director biographies.

Indonesia's corporate scorecard

Figure 7

Helicopter view: Rating Indonesia's CG disclosure and governance, 2020

Good	Average	Poor
❑ Disclosure of substantial and beneficial ownership ❑ Detailed outline of loans ❑ Disclosure of trade receivables and payables with ageing analysis ❑ No restricted stock/option remuneration for INEDs ❑ Director attendance statistics	❑ Some corporate announcements don't go beyond 5 years ❑ AGM circulars lack details and results do not include investor discussion ❑ Breakdown of operating costs, but limited explanation of "other expenses" ❑ Formulaic CG reports explaining how companies implement the CG Code, with limited committee activities disclosed ❑ AC chairmen generally independent from companies and external auditors but some ACs lack evidence of competence ❑ Auditor independence generally recognised ❑ Many internal audit departments do not report directly to AC ❑ Policies for mitigating corruption: some provide whistleblowing policies but many do not have public codes of conduct	❑ Limited discussion of rationale behind corporate actions – mergers, acquisitions and divestments ❑ Limited details from board evaluations ❑ ESG reporting still lacks discussion of materiality process with limited discussion of material issues ❑ Aggregated, not individual, board and executive remuneration disclosure ❑ Lack of board chairman independence ❑ Board skills matrices not linked to business and no disclosure of plans for improving board diversity

Source: ACGA, ARE

How Indonesia can do better

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- Longer corporate announcements history (at least five years)
- Disclose investor discussion with AGM results
- Better disclosure on operating costs, with minimal aggregation of "other expenses". If the latter are aggregated, they should be explained
- Disclose rationales for corporate actions acquisitions/mergers/divestments
- Higher quality CG reports, with specific references to activities undertaken by board committees during the year
- Introduce formal board evaluations, and better disclosure of details
- Better transparency on board remuneration and top-five executive remuneration by individual name
- Discussion of board diversity and board skill matrices to ensure an appropriate mix of skills

Medium to long-term challenges

- Improve AC competence and independence from management or external auditor
- Better disclosure of policies for mitigating corruption: codes of conduct should be available to public and extend to suppliers
- Improve the quality of ESG/sustainability reports to include substantive discussion of the materiality selection process, and how they set meaningful targets
- Improve independence (especially for chair) via stricter definitions and longer cooling-off periods

Electronic rollout is accelerated

AGMs during Covid: eASY

Indonesia was fast to move on electronic shareholder meetings and accelerated the rollout of a platform it had in the pipeline since 2016 for proxy and e-voting. On 18 March 2020, companies were informed by Indonesia's Financial Services Authority, the Otoritas Jasa Keuangan (OJK), that issuers could hold their general meeting of shareholders (GMS) using an "electronic authorization mechanism". Under the Electronic-General Meeting Shareholders System (e-RUPS), companies could convene meetings electronically, or arrange a proxy.

Virtual proxies and votes . . .

The first phase of e-GMS implementation duly came into effect on 20 April. In conjunction with e-GMS meetings, Indonesia's Indonesia Central Securities Depositary implemented the KSEI Electronic General Meeting System (PT KSEI). This served as an electronic authorisation mechanism for general meetings held by listed companies. KSEI also provided a system, the KSEI Electronic General Meeting System (eASY.KSEI), comprised of an e-proxy framework allowing investors to grant voting authority to a third-party electronically, and e-voting which allows shareholders to participate using live streaming technology. The e-proxy system went live on 20 April and the e-voting was scheduled to be implemented in the first quarter of 2021.

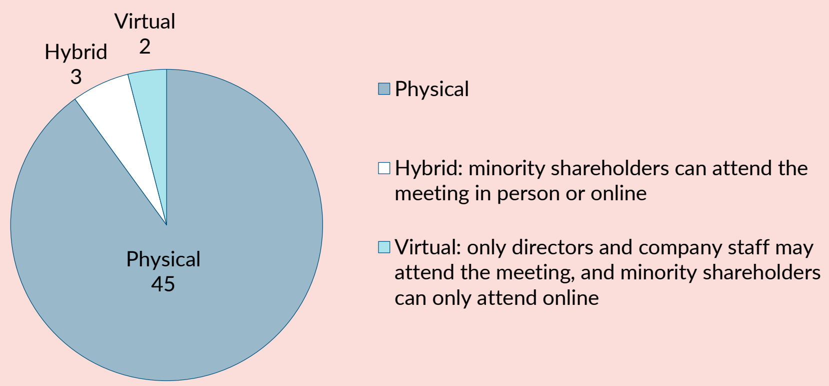
. . . but limited physical meetings are still required

Unless the regulator stated otherwise, issuers are still required to hold a limited physical meeting as well as an electronic GMS with three categories of person in attendance: The chairman, one board director (or commissioner) and any supporting professionals whose attendance is deemed necessary for the organisation of the meeting. Shareholders have the opportunity to be physically present as long as the issuer sets a certain quota.

AGMs in figures

Figure 8

AGM modes in Indonesia: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

Issuers opt for in-person meetings

Out of the top 50 public companies by market value in Indonesia, only three held hybrid meetings, and two held virtual AGMs. Of the 45 physical meetings, most were held in August 2020, with a sizeable number also held in April through to July. While the eASY.KSEI system is forward-looking, it has not been greatly embraced by the market, particularly large caps.

DIY restructuring

Indonesia's self-dealing specialty

Indonesian companies have long displayed a strong appetite for debt, especially US dollar-denominated and sourced from foreign banks and bondholders. Painstakingly constructed, using offshore structures in an attempt to protect creditors in the event of financial distress, the assets backing the loans and bonds are very much onshore and effectively far from the clutches of foreign creditors.

Riady-controlled entity files for bankruptcy

When financial distress hits an Indonesian company, despite the elaborate offshore structuring, promoters often prove to be resourceful in protecting assets and interests from creditor claims. A case in point is the 2018 PT Internux restructuring, a defunct mobile broadband business controlled by the Riady family, better known as the controlling shareholders of real estate group, Lippo.

Two companies linked to Lippo emerge as creditors

The Riadys managed to avoid ceding control of Internux to its creditors and retained command of the outcome of the financial restructuring. In August 2018, two creditors of Internux emerged to sue the company for non-payment of debt owed to them and to file a debt postponement petition. While the courts declared the two creditors independent of Internux, it later emerged that the two companies were in fact previously linked to the Lippo group: One was even directly associated with the Internux CEO. The two companies had purchased the debt of two genuine trade creditors some months earlier, helping to give effect to the scheme and thus potentially influencing the outcome.

5. Investors

Indonesia ranks 11th with a score of 19%

Our category score for Investors in Indonesia remained unchanged at 19%, a percentage point ahead of China and two behind the Philippines, leaving it in 11th place. The unchanged total, however, hides a number of important changes in scores. In our institutional section, we marked scores down for domestic institutions promoting good CG and for voting their shares including against management sponsored resolutions (all for reasons that will become apparent). Scores rose, however, due to more discernible and positive activity among foreign institutional investors and focus funds. The scores for our retail investor section remained almost unchanged.

Domestic institutions are weak

The domestic institutional investor sector is in some turmoil. There is still no stewardship code, despite efforts over the last two years to promote one. Government-controlled investors have had a very bad two years with appalling scandals at Asuransi Jiwasraya and Asuransi Sosial Angkatan Bersenjata Republik Indonesia (ASABRI), both of which racked up enormous losses via corrupt and incompetent management. Both had to be bailed out by the government.

Indonesia has a new sovereign wealth fund, but will it work?

After years of prevarication, 2021 finally saw the establishment of Indonesia's first sovereign wealth fund, the Indonesia Investment Authority. With growing international backing, the fund aims to invest in major internal infrastructure projects. Given the mismanagement and corruption at many state-owned entities, it might seem rash to place significant funds with a new sovereign wealth fund, but governance details remain largely unclear so perhaps we should give the Jokowi administration the benefit of the doubt for now.

Existing state pension funds have very limited CG frameworks

Meanwhile, existing state pension funds are basic (see figure below): None has anything but the most generic of inward-looking policies on internal governance, stakeholder engagement and in some cases, environmental responsibility statements. None has a detailed CG policy or statement, let alone a stewardship strategy or proxy voting guidelines.

The key state pension schemes

Figure 9

Indonesia's pension system and key state pension schemes

Institution/system	English name/description	Comments
Dana Pensiun Pemberi Kerja (DPKK)	Employer Pension Fund	Pension funds established by non-financial private sector companies
Dana Pensiun Lembaga Keuangan (DPLK)	Financial Institution Pension Fund	Pension funds established by bank or life insurance companies
Badan Penyelenggara Jaminan Sosial (BPJS) Ketenagakerjaan	The Employment Social Security Administration	Public legal entity whose duty is to protect all workers through four labour social security programmes
Dana Tabungan dan Asuransi Pegawai Negeri (Taspen)	Civil Servant Savings and Insurance Fund	State pension fund mildly affected by Jiwasraya and ASABRI scandals
Asuransi Sosial Angkatan Bersenjata Republik Indonesia (ASABRI)	Armed forces pension fund	Victim of a huge internal corruption scandal

Source: ACGA

Fund manager groups have codes of ethics but no CG or stewardship policies

Indonesia has two local asset management associations. The Investment Managers Association of Indonesia (AMII) has a six-page code of ethics (last updated in 2017) that covers a lot of areas in terms of risk, compliance, marketing and advertising, conflicts of interest, engagement with asset owners, but says nothing about stewardship or engagement with companies or voting policies. The Indonesian Association of Mutual Fund Managers (APRDI) undertakes some training and professional education for members and acts as a representative body. It has not published any CG, proxy voting or stewardship policies.

Foreigners fearful

Foreign investors tend to sell when major CG issues arise

Foreign institutional investors make limited efforts to promote better CG standards among listed companies in Indonesia. While there is engagement from some foreign investors, if a difficult CG issue occurs, foreigners tend to sell rather than engage and fight. Most of the major foreign players in Indonesia are AMII members but there are no obvious signs that these members are especially focussed on improving CG proactively in Indonesia as a specific strategy.

Local investors attend and vote but rarely rebel . . .

Voting and meeting attendance practices diverge between foreign and local institutional investors in Indonesia. While domestic shareholders do attend and vote at GMS, there is little evidence that they are actively voting against resolutions they disagree with. None of the major domestic investors disclose any voting activities or behaviour on their websites. A survey by a local law firm of the influence of local institutional investors on monitoring and encouraging local corporate governance behaviour noted that since Indonesian company law does not distinguish between institutional and other shareholders, the type of shareholder has no effect on a company's behaviour or compliance with CG practices. Rather, companies tend to see their responsibility as having to comply with OJK governance regulations rather than investors' concerns.

. . . as foreign investors attend and vote and sometimes rebel

In contrast to local institutions, foreign investors tend to attend and vote at GMS, including, at times, voting against or abstaining from resolutions with which they disagree (see box in CG Rules section). Many foreign institutions routinely attend and vote at the GMS with a small but prominent group providing a company-by-company breakdown of proxy voting actions in Indonesia and/or engagement and voting summaries.

Some foreign investors are voting against but activism is nascent

There is a small foreign contingent of institutional investors that are beginning to show a more proactive, even activist bent towards their investments in Indonesian companies and there are one or two local funds that also engage more directly with local companies. However, the trend is no more than nascent.

No domestic leadership in RI or stewardship

There are no indications that domestic asset owners are playing a leadership role in promoting responsible investment or investor stewardship. In fact, given the recent pension fund scandals, if anything, the opposite is the case. Indonesia's state-owned pension funds are civil service-like in their mindsets and processes and are prone to mismanagement and malfeasance. While some of these funds include broad statements about CG and CSR on their websites or promotional materials, there is no indication that any of these firms are taking a proactive stance in favour of responsible investment. Any stewardship code is still some way off. Local institutional investors do not even have CG/ESG teams internally to manage the necessary screening, engagement and reporting. We have not found any examples of collective engagement with listed companies by domestic investors in Indonesia.

Some foreign investors engaging collaboratively over major CG problems

Foreign institutions are better equipped and better positioned to undertake such activities and we do see a small number of these investors working together on engagement processes. This tends to be especially obvious when confronted with a CG issue or problem.

Basic codes of ethics help manage conflicts of interest among local asset managers

Voting policies kept private

Domestic institutional investors do not publish codes or policies that demonstrate that they are able to manage conflicts of interest. However, AMII, the local asset management association, publishes a code of ethics that commits its members to manage conflicts of interest in respect of investing, which is quite detailed. Also incorporated into this code are the relevant OJK laws relating to asset management, including the OJK Investment Management code of conduct.

Local managers do not disclose voting policies or activities

Domestic institutional investors' voting policies and activities are a mystery: None of them publish any information as to how they vote at company level. There are also no local proxy advisor firms in Indonesia.

Retail investors are a lively but tiny community . . .

The local retail investor market, while quite lively, is tiny compared with the size of Indonesia's population and its economy. Less than 1% of the population invests in companies through the local securities market. While both the OJK and IDX are expending considerable efforts to widen share ownership, with such a low representation in the market, it begs the question as to whether retail investors are even relevant.

. . . but love to attend shareholder meetings

That said, those retail shareholders who do exist are generally quite good at attending GMS, asking questions of management and actively voting their shares. Yet there are no retail investor associations in Indonesia that promote better CG standards or engage with companies on a collective basis. The nearest thing may well be the Indonesia Investor Protection Fund, although this was established by the OJK so is not an independent retail investor body.

Class action is legally possible but does not happen

Action against errant directors and companies is something that investors expect the OJK or IDX to do. Indonesian law does not expressly permit class action, but it does not prohibit it, so such action is possible. It is just that most investors in Indonesia expect OJK to initiate class action on their behalf.

ACGA undertook a survey in Q3 2020 of member voting and engagement

The foreign dimension

As part of our research for CG Watch 2020, ACGA also conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As the responses showed, most respondents invest in Indonesia but as expected for a smaller capital market, the number of investments held is considerably fewer than in larger markets:

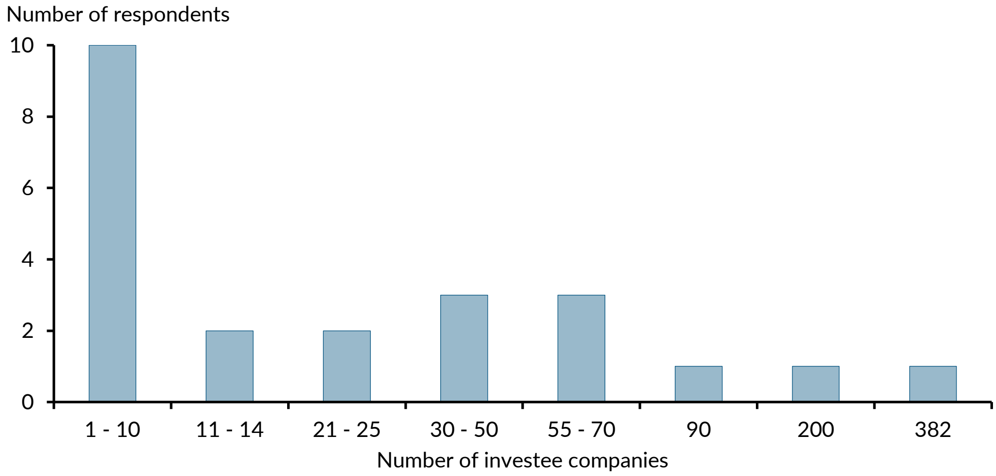
- ❑ 38 or 86% of foreign investor respondents indicated that they invest in Indonesia
- ❑ Only 23 respondents answered the question on the exact size of portfolios. The average number of investee companies per respondent was 48, with a range from one to 382. The average figure is notably higher than the Philippines, broadly in line with Malaysia, Singapore and Thailand, and well below the 100 to 130 in most North Asian markets (with the exception of China and Japan that are significantly higher).

Another way to show the extent of investment in Indonesia is to group portfolios by size. As the following figure shows, while a few ACGA members invest in close to 100 or more companies each, most have portfolios of 50 companies or less, and a large number hold no more than 10 stocks.

Here is a breakdown by portfolios

Figure 10

Foreign investors in Indonesia: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Although Indonesia is a relatively small market from the perspective of global institutional investors, respondents still take voting seriously:

- Nearly all respondents with holdings in Indonesia vote in 100% of their investee-company AGMs. One votes in 24%.
- On average, they voted against at least one management resolution in 19 meetings in 2020. The median figure, which is arguably more representative, was 16.
- As a proportion of their holdings, respondents voted against at least one management resolution in a mean average of 40% of meetings and a median of 100% - a much higher proportion than in other markets (although this result is clearly affected by the small number of holdings in most portfolios).

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

There is some individual engagement by foreign forces

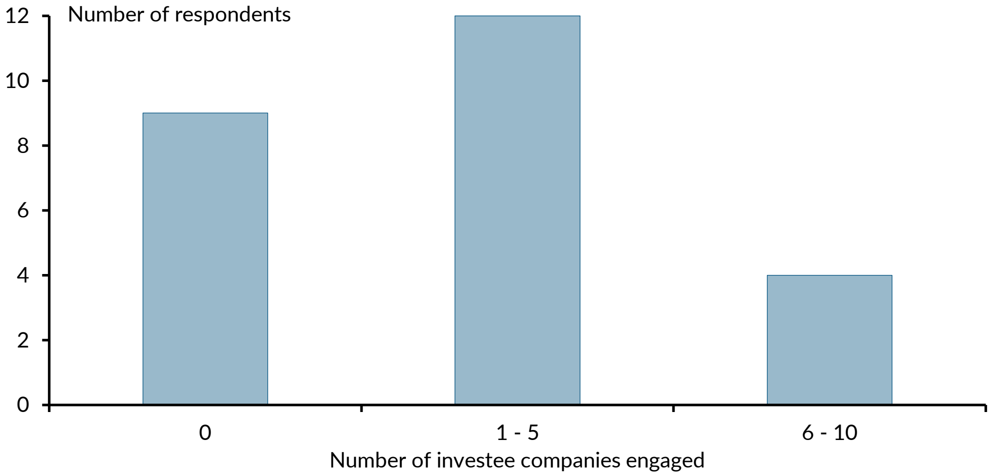
Company engagement

Many of our foreign investor members do engage individually in Indonesia. Of the 38 respondents who indicated that they invest in Indonesia, 25 answered our question on company engagement. Of these, nine said they undertook no engagement at all over 2019 and 2020. Of the remaining 16, two engaged with 10 listed companies and most of the rest with five issuers or less, as the following figure shows.

Most investors engage with five firms or fewer

Figure 11

Foreign investor engagement prevalence in Indonesia, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Most respondents engage with 10% or less of their investee companies

In terms of the relative level of engagement in Indonesia (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who do some level of engagement is 10% or less but rises to 20% to 30% for three firms and 60% for another. The problem with these higher ratios, however, is that they mostly represent firms with small holdings. It is also important to emphasise that these results do not include foreign-owned asset managers in Indonesia that are locally managed and, in some ways, operate more like domestic investors, such as Aberdeen Standard. Other respondents are predominantly foreign institutions based outside Indonesia.

Next steps

State-owned investors need a recap before any CG role

Given the parlous financial condition of several of Indonesia's state-owned investment institutions (see box below) it is difficult to see how these domestic entities can credibly be expected to play any kind of stewardship role in the immediate future.

Can the new sovereign wealth fund play a CG role?

There may be a role for the newly-minted Indonesia Investment Authority, the country's new sovereign wealth fund - it is desperate to prove that it can avoid the equivalent of Malaysia's 1MDB fiasco - but expectations should be kept realistic.

Private sector investors, especially foreign-controlled, have a role to play

More likely, there is a role for private sector institutional investors, including the foreign investors already operating in Indonesia, to improve company engagement and lobby for better CG standards. Certainly, the two local asset management associations could and should step into that role, perhaps forming a voluntary code that would see local and foreign institutional investors publishing company engagement, voting details and perhaps eventually, producing a stewardship code. Currently, however, these appear to be little more than pipe dreams.

Pensions plunder at state insurers

State investors lose billions

Recent scandals at two state-controlled insurance and pensions investment firms illustrate just how far behind international best practice domestic institutions are in Indonesia.

State-owned insurance firm goes bust and prompts probe

In November 2019, Minister for State-owned Enterprises, Erick Thohir, asked the Attorney General's Office to investigate the collapse of state-owned insurance firm PT Asuransi Jiwasraya amid suspicions that significant accumulated losses may have been incurred by serious mismanagement at the company.

Insurance premiums used to binge on small caps

Jiwasraya, 100% state-owned, provides insurance products and services to state employees and others. In October 2018, it failed to meet US$58.8m of commitments to policy holders. It has since emerged that Jiwasraya invested the overwhelming majority of its insurance premiums into small-cap companies in the local stock market, both directly and via a number of third-party fund managers. A March 2020 report by the Badan Pemeriksa Keuangan, the Audit Board of Indonesia, found that losses to the state caused by management totalled at least Rp16.81 trillion (US$1.2 billion).

Another insurer faces huge losses

In January 2020, Thohir fired two directors of state-owned insurer, Asuransi Sosial Angkatan Bersenjata Republik Indonesia (ASABRI) which provides social insurance and pensions to Indonesia's police and army personnel. The sackings came after it emerged that ASABRI was facing losses of as much as US$840m from disastrous investments made in the companies owned by the same local businessmen believed to be responsible for the losses at Jiwasraya.

6. Auditors & audit regulators

Indonesia ranks 10th with a reduced score of 59%

Indonesia's overall score in this section dropped two percentage points from our last survey, to 59%, placing it third last, ahead of China and India and just behind the Philippines. The drop was principally due to scoring methodology changes from previous surveys. Overall, Indonesia's financial reporting standards are good relative to its economic development status.

IFRS convergence but no adoption yet

Indonesia has not adopted International Financial Reporting Standards (IFRS). All listed companies are required to use the Indonesian Financial Accounting Standards (Standar Akuntansi Keuangan - SAK) which track IFRS closely, however. Indonesia's approach to IFRS adoption is to maintain its national GAAP (SAK) and converge them gradually with IFRS as much as possible. Currently there is no plan (and consequently no timetable) for a full adoption of IFRS so local standards are not fully converged and IFRS remain partially adopted.

Local auditing standards lag ISAs

Under the Public Accountants Act of 2011, the Institut Akuntan Publik Indonesia (the Indonesian Institute of Certified Public Accountants, or IAPI), has direct responsibility for setting auditing standards and has adopted the Indonesian Public Accountant Professional Standards, known as SPAPs. The International Federation of Accountants (IFAC) Statement of Members' Obligations Action Plan for Indonesia states that, if necessary, IAPI can modify International Standards of Auditing (ISAs) to tailor them to local professional and regulatory requirements following the "IFAC Modifying Policy". In 2012, ISAs (2010) were adopted as SPAPs effective for periods commencing on 1 January 2013 for application in audits of financial statements of companies that trade on IDX. Clearly, however, local auditing standards in Indonesia, while on a path to convergence, lag current ISAs by some distance.

Audit independence moves are only partially adopted

Independence not established
Indonesia still faces challenges with respect to establishing independence of the audit profession. The IFAC Global status notes that Indonesia has only partially adopted the International Ethics Standards Board for Accountants (IESBA) Code of Ethics and not the latest 2019 version. Ikatan Akuntan Indonesia (The Institute of Indonesia Chartered Accountants, or IAI) has adopted the 2014 IESBA Code; while IAPI has adopted the 2008 Code. The May 2018 World Bank Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing standards dated May 2018 notes that, "ISAs and IESBA Code of Ethics are not fully adopted and are based on outdated versions of international equivalents".

Non-audit work disclosure is weak

Audit and non-audit work undertaken by external auditors is required to be disclosed but a detailed narrative is voluntary. OJK Audit Committee regulations require that the audit committee must at least perform an evaluation of consistency between the external auditor's work and prevailing auditing standards. Extended auditor reports focussing on key audit matters (KAMs) are not required in Indonesia: ISA 700 has not yet been adopted.

Large caps produce detailed audit accounts

Generally large listed companies produce detailed audited accounts and in a timely fashion. Smaller listed companies tend to face more challenges from the auditor and some lack resources to complete all tasks required for an issuer. This can lead to a blurring of roles between internal accounting staff and auditors. Certainly, our review of audited accounts of mid-cap companies identified a clear difference in quality, as they are not as detailed or sophisticated.

Big Four affiliates dominate the large-cap audit market

Local auditing standards are converged with IAS (but not fully). Large listed companies almost all engage the local arms of Big Four auditing firms. Again, mid-cap companies are less likely to pay the fees for a Big Four local affiliate and will opt for less expensive auditor options.

Asset valuations, non-standard accounting treatments are a concern

While our research did not find instances of audit firms assisting large listed companies with their accounts, we note that the World Bank's May 2018 ROSC review of 51 companies identified problems in financial reporting relating to certain accounting treatments and valuations of assets. These issues also apply to mid-cap companies, where audit firms are more likely to assist their clients with preparation of the accounts.

Audit standards are generally good, but some areas need improvement

Standard audit deviations
Audits of large cap and mid-cap companies in Indonesia are generally of a good standard and in line with local auditing standards, although, again based on the ROSC survey, there are areas that need improvement:

- Distinguishing between significant judgments and assumptions;
- Lack of detail in disclosure of assumptions and judgments for asset depreciation;
- Incomplete disclosure of unquoted equity instruments;
- Fair value measurement practices; and
- Poor disclosure on litigation and tax issues.

Audit oversight is messy and confused

Audit oversight in Indonesia paints a confused picture. Rather than having no independent regulator Indonesia has too many, causing duplication, overlap and confusion.

IAPI is the main audit regulator . . .

Both the audit and accountancy professions are regulated with practitioners required to be members of the IAI for chartered accountants, or IAPI for public accountants. Auditors are regulated by IAPI under the Public Accountants Act 2011.

. . . but there are two others

Pusat Pembinaan Profesi Keuangan, or the Centre for Supervision of the Financial Service Professions (PPPK), is the authorised body to regulate and supervise the accountancy profession in Indonesia, including monitoring the professional activity of statutory auditors. The PPPK is a member of IFIAR and is recognised as a competent authority by the EU but is under-resourced. In addition to the PPPK, the OJK also registers and oversees auditors for entities under its supervision, which includes banks, securities firms, insurance companies as well as listed companies. Confused? So are we.

Statutory audit oversight does come with consequences, but finding experienced inspectors is a challenge

The PPPK has powers to sanction and does, including fines, reprimands, licence revocation and even mandatory training. It is severely resource constrained however and oversight is patchy. According to the World Bank ROSC, finding staff with substantial practical audit experience is very challenging, so the PPPK uses inspectors from within the audit profession. To achieve some inspector independence from the auditors being reviewed, the PPPK imposes a three-year cooling-off period and makes inspectors sign a conflict of interest statement. The situation, however, is far from ideal.

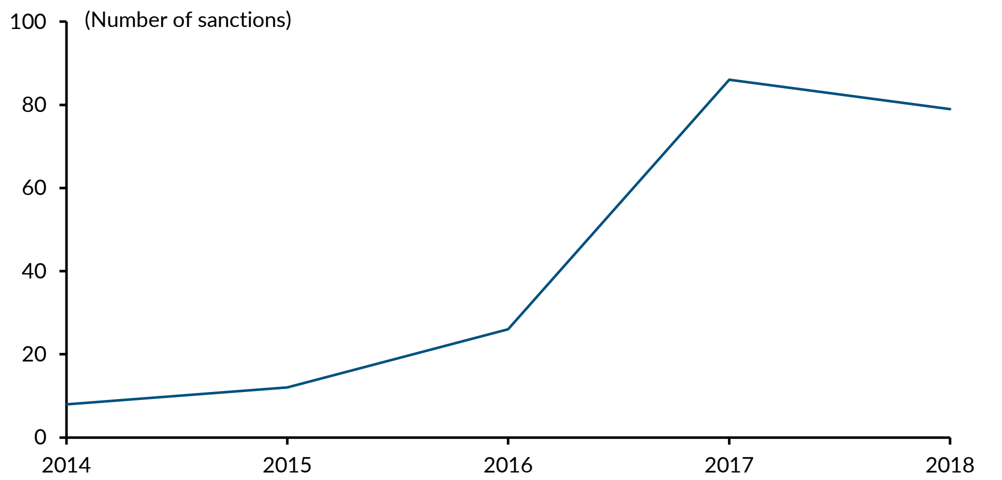
Enforcement data is not as current as it should be

PPPK enforcement data is available, although not as up to date as it might be (see figure below). The PPPK also publishes an annual report which discusses its activities, including internal and external training, policy formulation and continuing professional development. In addition to inspections of public accountants and auditors, the PPPK also audits valuers and actuaries.

Enforcement activity in figures

Figure 12

PPPK enforcement activity, 2014-2018



Source: PPPK

Audit capacity is tiny compared to size of economy

The PPPK conducted customer satisfaction surveys and a survey of quality with the profession, details of which were included in its 2018 annual report. Overall, 61% of the sample of service users considered that the quality of public accountants in Indonesia was good while 36% considered that the quality was very good. Just 3% considered public accountant quality to be poor. Quality or not, audit and accounting capacity remains a serious problem in Indonesia, relative to the size of the economy and the speed with which it is growing. According to the PPPK, the number of public accountants increased to 1,412 in 2018 from 1,328 in 2017. Meanwhile the number of auditing firms increased from 395 to 468 over the same period.

Next steps

Addressing capacity constraints is critical, but difficult

Indonesia's biggest problem is a chronic shortage of qualified audit personnel and a lack of audit firms other than the local affiliates of the Big Four. Addressing that problem will take some time and will need government programmes to encourage students to study accountancy.

Audit oversight needs to be rationalised and adequately resourced

The confusing and overlapping audit oversight responsibilities of the OJK, the PPPK and IAPI should be rationalised, probably with the consolidation of all audit responsibilities into one adequately funded and resourced entity, ideally separate from government interference. Significant political will would be needed to make that happen, so it seems to be an unlikely outcome.

Disclosure of inspection and enforcement should improve

That said, the PPPK in particular seems to be playing an active audit oversight role, albeit limited, given the resources relative to the scale of the industry. One easy way for the regulators to improve quickly would be to increase the level of disclosure of its inspection and enforcement activities.

Accounting shenanigans land Garuda in trouble

Financial stress forces Garuda to break accounting rules

In May 2019, state-owned airline Garuda Indonesia became the target of a special investigation by the Audit Board of Indonesia (BPK), which monitors accounting and auditing at state-controlled entities.

Probe eyes advance payments

The investigation followed fines and orders by OJK and IDX to restate its financials as a result of significant accounting irregularities in the airline's 2018 accounts. A BPK Commissioner told reporters in Jakarta that the BPK was focussed on advance payments made by Garuda in connection with aircraft maintenance reserve funds, totalling more than US$1.5 billion, which were booked on 31 December 2018, the last date of Garuda's financial year. A BPK report issued in June 2019 also accused Garuda of financial engineering and violating accounting standards by recognising receivables associated with a joint venture as income. Garuda denied the claim.

Equity boosted amid loan risk

In addition to allegedly inflating its revenues, US$130m of security deposits for operating leases and the advance payments from the maintenance reserve funds were recorded as financial assets, effectively boosting Garuda's equity and reserves at a time when the firm was at risk of breaching certain loan covenants. Garuda had more than US$1 billion of short-term loans and just US$250m of cash at end December 2018.

7. Civil society & media

Indonesia ranks 9th with a score of 38%

Indonesia's score for this section dropped by six percentage points to 38%, placing it 9th in our rankings, ahead of China and the Philippines. The score suffered as a result of a lack of diversity in director training, a lack of ESG promotion by other stakeholders and weaker CG coverage by local media. We increased one score, for better corporate secretarial training. Civil society and media support for better CG standards remains weak in Indonesia, perhaps understandably given prevailing economic issues.

IICD provides some cause for optimism . . .

Indonesia's directors' institute, the Indonesian Institute for Corporate Directorship (IICD), is a proactive and well-run organisation founded as a non-profit by educational institutions. IICD provides good quality training for company directors, including a Corporate Governance Leadership Programme, delivered by professional trainers. IICD was also the appointed agency to manage Indonesia's ASEAN Annual Corporate Governance Scorecard and did a decent job when the programme was still running. IICD has also been instrumental in assisting the OJK with its CG Roadmap and has participated in the World Bank's ROSC process.

. . . along with ICSA . . .

As with IICD, the Indonesia Corporate Secretary Association (ICSA) is a well-run and focussed organisation that offers regular training to its members via its ICSA Academy. ICSA also reacted to Covid-related regulatory changes by offering specific training issues to assist company secretaries to adjust to new requirements brought in as a result of the pandemic.

Governance wasteland

Not much to write about on CG otherwise

So much for the positives. Aside from IICD and ICSA there is little else going on of note with respect to CG or ESG promotion by other professional associations, such as accountants, financial analysts or banking institutes. The two main accounting institutes, Ikatan Akuntan Indonesia (IAI) and Institut Akuntan Publik Indonesia (IAPI) are well run organisations that focus primarily on training for accounting and auditing qualifications and socialising new accounting and auditing standards. IAI has run courses on whistleblowing but we could find no evidence of any CG training, research or promotion. Institut Akuntan Manajemen Indonesia, Indonesia's management accountant institute, offers similar activities to IAPI and IAI, but is less active and with no focus on CG training. There is also a good deal of overlapping activities between these three institutes, which is not helpful. The local CFA branch provides no CG training, events or courses while the Indonesian Investment Manager Association is little more than a members' club for local asset managers. It has published a very basic code of ethics but nothing else on CG: no training, research or publications. The same goes for the Association of Indonesian Publicly Listed Companies.

Business chambers playing no role in promoting CG

KADIN (Kamar Dagang dan Industri Indonesia) is the principal Indonesian Chamber of Commerce and Industry. It is chiefly a members' association designed to promote business matching and advance Indonesian businesses. It offers no training in terms of public courses and no CG training at all. The International Chamber of Commerce Indonesia offers public training courses but these are focussed on trade promotion and trade-related training only. The National Committee on Corporate Governance (Komite Nasional Kebijakan Governance) is a government-sponsored entity set up in 1998 after the Asian financial crisis. It provides some socialisation of CG matters, especially relating to SOEs, but offers no CG training. The National Center for Sustainability Reporting is active in training - providing GRI and Certified Sustainability Reporting Assurer (CSRA) certification as well as undertaking the Asia Sustainability Reporting awards.

Plenty of CG research but of questionable utility

Indonesian academic institutions publish a surprising amount of academic research on CG and ESG matters, although most of it is highly theoretical. Indonesian academic institutions research gets published quite widely, especially in the Islamic world. Much of it is of questionable practical value or utility, however.

Media reporting on CG issues remains weak

Mediocre media
Indonesian media reporting on companies generally is poor and lacks depth and analysis of CG scandals and issues. Headline-grabbing issues around SOE problems and scandals are covered but private sector coverage is limited and reporting in mainstream publications is somewhat amateurish. Freedom House's report, Freedom in the World 2020, notes that a 2008 law that extended libel to online media, criminalising the distribution of information, "contrary to the moral norms of Indonesia", has subjected journalists to harassment and threats when covering controversial subjects. It has also led to some self-censorship.

Libel laws act as deterrent to journalists

Perhaps in part because of the libel law tightening, CG coverage seems to have weakened since our last survey. Stories get spiked easily and those that do appear lack depth and meaningful analysis. Indonesia's media lack sophistication and sufficient quality to report in depth on CG and ESG issues.

Civil society remains apathetic towards CG . . .

Next steps
Indonesia's civil society could do with a shot of enthusiasm if it is going to start to play a more active role in CG awareness and promotion. While the IICD and ICSA play an important role in promoting CG practices, supporting CG research and offering board room training, these two associations cannot be expected to operate in a vacuum.

. . . while many professions are hostile . . .

The banking, accounting and business associations all need to step up to play a role in promoting better CG standards for Indonesian companies. However, political self-interest and in some cases a lack of resources makes it unlikely that this will happen.

. . . and the media are focussed on politics

The media remains generally focused on covering Indonesia's lively political scene, with corporate coverage, in the main, remaining perfunctory reportage with little or no analysis. There are signs that perhaps a few titles are beginning to tackle some of the more egregious company scandals in more detail (see box below). But the outlook for CG among civil society generally in Indonesia is not a very bright one.

Mainstream press lack CG savvy . . .

Old media, new hope
Indonesian mainstream media coverage of CG issues is weak. Fact-checking is often overlooked and company press releases copied and pasted straight into publications. Perhaps understandably given endemic state corruption, any political or state-owned company scandals always get plenty of coverage, albeit basic. Private company problems are less well (and accurately) covered. Company owners are known to bribe or even threaten journalists to suppress bad news and spike articles. One of the two main English-language dailies, the Jakarta Globe, is controlled by the Riady family, which controls major business group Lippo. So editorial independence is perhaps suspect.

. . . but two titles offer glimmer of hope

Encouragingly, two historically important titles offer some hope that coverage may improve. Indonesian weekly news magazine, Tempo, also available in English in an online daily known as Koran Tempo, occasionally covers corporate misdeeds, and while lacking in detail, the publication has a reputation for being fearless and getting behind stories and fiercely protecting its independence. It famously exposed massive police corruption in a 2010 article that earned it a firebomb attack. It was even banned for a short while in 1994 after upsetting former President Suharto.

Autonomy and political neutrality at title

Another critical political newspaper, DeTik, shut down by Suharto along with Tempo, later re-emerged as an online news portal, Detikcom. Now a major Indonesian news site, Detikcom maintains its reputation for independence and political neutrality. Corporate misdeeds still play second fiddle to political scandals, but perhaps with the reinvigoration of two old titles, there is some hope for improved coverage.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- Further degradation in data disclosure by regulators - already woeful
- No meaningful overhaul of RPT rules - long overdue
- No blackout rule introduction for insiders
- Continued absence of IDX involvement in CG reforms

What to fix

Quick fix list

Issues to address as soon as possible

- Data disclosure by regulators - in English and on a timely basis
- Website revamp - especially the English-language sites
- Revised CG Code to refocus Indonesia on a pathway to best practice
- Better enforcement and increased resources for regulators
- Overhaul RPT rules to eradicate “affiliated” transactions

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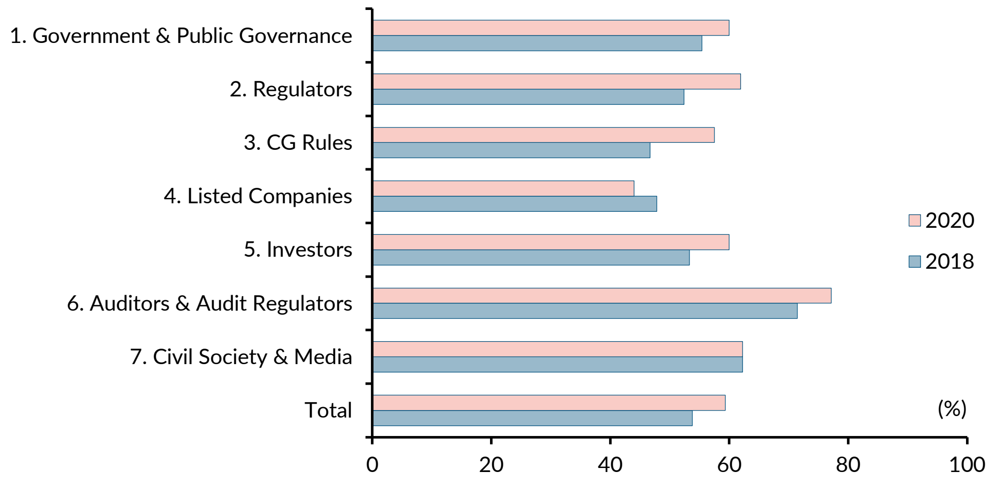
Japan – Fragmented reformer

- Regulators signalled some firming of hard-law rules and regulations
- Soft-law codes on stewardship and CG underwent further change
- Fragmented nature of reform effort seen at all levels: Government, regulators, investors, civil society
- Higher scores for regulatory policy and enforcement work, yet still room for improvement
- Listed company CG disclosure considerably less informative than in most markets, while Covid did not spur the growth of electronic AGMs
- Investor stewardship developed rapidly, but collective engagement still scarce
- A higher number of shareholder proposals put forward over 2019 and 2020
- Consolidation among civil society groups could help to drive reform

Figure 1

Japan CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Japan rises to equal 5th with a score of 59.3%

Japan's scores firmed in most areas of our CG Watch 2020 survey, as the figure above shows, stayed steady in one and only fell in Listed Companies. Its overall score improved by a respectable 5.3 percentage points to 59.3% and its ranking rose from equal 7th with India to equal 5th with Malaysia. It is worth pointing out, however, that the makeup of Japan's score is quite different to Malaysia's. It is still well ahead of the Southeast Asian nation in Government & Public Governance, Investors, and Civil Society & Media. It has effectively swapped scores on Regulators, and it remains notably behind on CG Rules, Listed Companies, and Auditors & Audit Regulators.

Putting the comparative Malaysia score in context

One word of caution about Malaysia in this comparison: While its political turmoil of the past 12 to 15 months has battered its scores in Government & Public Governance and Regulators, and to a lesser extent Civil Society & Media, in other categories of our survey Malaysia has fared as well if not better than in 2018. Political strife does not immediately translate into lower scores for CG rules, for example.

Some progress being made in hard law

Recapping CG Watch 2018

In our previous report we argued that CG reform in Japan seemed to be reaching a plateau, with regulatory efforts more heavily focussed on soft than hard law - that is, updating codes of best practice rather than addressing fundamental problems in company and securities law. While many of the issues raised in 2018 have not been resolved, financial regulators have indicated that some might be put on the agenda of future policy discussions and the Japan Exchange (JPX) formed a study group to review minority shareholder rights in 2020. Moreover, at the beginning of 2019, the Financial Services Agency (FSA) introduced amendments to the Financial Instruments and Exchange Act requiring stronger disclosure of non-financial narrative reporting. On other specific issues:

Still much to do on the regulatory front

Figure 2

Japan: Recap of 2018

	Recommendations	Outcomes
1.	Regulator to produce a new "safe-harbour" document on collective engagement	No progress. But FSA noted in the revised Stewardship Code (2020) that legal guidance from 2014 needed to be reviewed
2.	Remove prohibition on investors "making important suggestions" to issuers about governance, strategy, business restructuring, and so on	No progress. While investors can ask for more disclosure from companies, and many have learned to live with this rule, we still consider it adds a layer of unnecessary complexity
3.	Set quotas for AGMs to reduce clustering	No progress
4.	Mandate disclosure of *Sodanyaku/Komon* (ie, senior counsellors and advisors)	Still not mandatory, but JPX voluntary rule is having an effect
5.	Tighten definition of "independent director" on issue of business relationships	No change in definition on this point, however we re-rated our score for the overall definition of independent director (see CG Rules).

Source: ACGA

Japan ranks equal 4th again on an improved score of 60%

1. Government & public governance

Japan's score improved five percentage points in this category to 60%, while its ranking remained the same at equal 4th, a position it now shares with Korea as well as Singapore. Overall, the factors driving the higher score had more to do with various methodological changes in our survey that led to a rerating of some questions, rather than a significant change or improvement in the Japanese government's approach to public governance or corporate governance policy. Indeed, there were times during our survey period when it felt like government policy was going backwards - notably in late 2019 when amendments to the Foreign Exchange and Foreign Trade Act (FEFTA) were proposed to control outside investment in sensitive industries.

Does the government have a consistent policy on CG?

The question of whether the government has a coherent and consistent policy on CG reform is an interesting one. Many observers would argue that it does, otherwise how would the country have made such strides in corporate governance under former Prime Minister Shinzo Abe? The evidence in favour is not a single roadmap, such as one sees most clearly in Taiwan today, but a collection of policies that include: The high-level Action Plan of the Growth Strategy approved by Cabinet on 21 June 2019 and which called for a further strengthening of corporate governance, including around listed subsidiaries; revisions to the two codes on CG and stewardship; new guidelines from the Ministry of the Economy, Trade and Industry (METI) on fair M&A; and certain changes from the Ministry of Justice (MOJ) to the company law in early 2019. Supporting this narrative is the fact that the FSA released new rules requiring annual securities reports to contain improved narrative (non-financial) information and a statement in April 2019 on Recommended Directions for Further Promotion of Corporate Governance Reform from the Council of Experts on the two codes.

The government is at its best on certain big CG issues

Yet the Japanese government is clearly not a single entity devoid of competing views on how to move forward on governance. It is at its best when it puts political capital behind high-level issues that the domestic market feels are timely and relevant, such as the conflicts inherent in the listing of subsidiaries or the need to address cross-shareholdings. The solutions proposed may not fully resolve the problems, but the attention it gives to these issues is welcomed by investors and governance advocates.

It tends to avoid some of the more complex challenges

Conversely, it has a tendency to avoid areas where market consensus is much weaker, inertia favours the status quo and governance issues are more complex. These include certain minority shareholder rights on takeovers and capital raising, the timing of AGMs (a simple enough issue yet seemingly impossible to resolve), and the structure of annual corporate reporting (the so-called double audit issue created by the timing of business and annual securities reports). The government can be notably tentative on reforms in company law and was slow to act during the pandemic in encouraging virtual AGMs - companies wanted legal flexibility, but the government could not change the law quickly enough. Contrast this to other markets such as Australia, India, Malaysia, the Philippines and Singapore that swiftly changed regulations or policies to allow virtual meetings. And then there was the FEFTA issue, which was initially communicated poorly and appeared to be hijacked by special interests and anti-foreign elements in government and business. The end result was more positive than originally expected, in part because the government genuinely listened to investor feedback, yet the final amendments still contained a few CG-unfriendly sections. The whole episode could surely have been handled better.

Japan did better on six of 13 questions, and worse on two

In terms of the 13 questions in this section, Japan did better on six, worse on two, and stayed steady on the remaining five. Higher scores were given for the government's support for financial regulators, the structure of the capital market regulatory system, the funding for the FSA, the existence and work of anti-corruption agencies, and judicial skill. The two lower scores were for policies on bank governance and the independence of the judiciary. Highlights of certain issues follow.

Capital market regulatory structure

Japan's score for regulatory structure improved . . .

Like most markets in Asia-Pacific, Japan has a separate securities commission, the FSA, and a securities exchange, JPX, and both face pressure from competing interest groups within the financial system. Despite this, we increased our score from 3/5 to 4/5 for a question (Q1.4) on the coherence of the regulatory system and the extent of conflicts of interest within it to take into account the existence of JPX Regulation, a separate regulatory arm of the stock exchange. This brought Japan's score into line with our assessments for Australia and Singapore, which have also created quasi-independent entities to enforce the listing rules.

. . . but not for the independence of the FSA

There was no change in our score of 2/5 for a question on the independence of the FSA from government. The agency is headed by a commissioner and overseen by the Minister for Financial Services. It has no separate board or commission comprising a portion of outside directors or commissioners to provide oversight of its operations. Indeed, few securities commissions in the region have such a governance structure, hence most markets score the same or even less than Japan. The two markets that score a point higher are Australia and Hong Kong.

Gaps in bank governance and green finance policy

Japan lacks detailed bank CG guidelines

While we have not changed our view on the FSA's generally strict approach to regulating banks, we have reduced our score on its efforts to improve bank governance in light of developments in other markets. Whereas Australia, Hong Kong and Singapore have detailed sets of guidelines on bank governance and have been updating these over the past decade or more (see their respective chapters in this report), the FSA has no dedicated guidance document on CG or ESG per se. Instead it addresses governance, albeit briefly, in its Comprehensive Guidelines for Supervision of Major Banks. Topics include the quality and ability of board candidates, disclosure on risk, and CSR reporting. In the mid-2010s the FSA introduced specific rules for banks and insurance companies on reducing cross-shareholdings and, more recently, a statement on the management and governance of regional banks in 2020. However, none of these documents are as extensive as those found in other markets.

The FSA seeks an exploratory dialogue with regional banks

The statement on regional banks is intended to create a framework for an exploratory dialogue with the management of these banks, many of which have been losing money in recent years. The aim is to allow the FSA to understand their management philosophy, business strategies, and governance systems more deeply. It poses a series of eight questions, which include among others:

- How do regional banks engage with stakeholders in their local communities?
- What role is expected of the board of directors? How do they evaluate the effectiveness of the board and its independent directors?
- How do they think about rationalisation of business processes and collaboration with other institutions in light of changes in the business environment?

This appears to be a constructive initiative and over time may well lead to governance improvements in regional banks. For the present, however, the FSA is at pains to point out that the questions are not intended as a checklist nor a set of "comply or explain" provisions. It is still early days then.

Japan also lacks a comprehensive policy on green finance

Perhaps the most noticeable gap is the lack of an overarching policy statement in Japan on green and sustainable finance - an area where other jurisdictions are surging ahead. This is slightly odd since the government is an avid supporter of the Task Force on Climate-related Financial Disclosures (TCFD) and the United Nation's Sustainable Development Goals (SDGs). As a 19 October 2020 briefing paper from the Principles of Responsible Investment (PRI) stated, "There is no comprehensive government-level policy strategy on sustainable finance and investment, but issues such as corporate governance and green finance are included in the Government's Growth Strategy and Long-term Strategy under the Paris Agreement."

Policy development on sustainability is fragmented

The paper was written by Natsuho Torii, an official from JPX on secondment to the PRI, and went on to note that different government ministries, agencies, the stock exchange, investors and other organisations had formed working groups and created guidance in their respective jurisdictions. For example, the FSA has a chief sustainable finance officer and formed an Impact Investing Study Group in 2020. METI formed study groups on TCFD in 2018, SDG Management/ESG Investment in 2019, and then Environmental Innovation Finance in 2020. While there is a degree of coordination between these government bodies, especially on activities related to TCFD, these activities further reflect how policy initiatives in Japan can tend towards fragmentation rather than consolidation.

The status of corruption: What lies beneath?

Japanese people are less than impressed with the official track record on corruption

Graft is by no means a way of life in Japan. Its citizens do not report having to grease palms to get their children into school, access public services or deal with police. In fact, Transparency International (TI) reported in November 2020 that just 2% of Japanese people surveyed as part of its Global Corruption Barometer had experienced paying a bribe. Yet the same people perceive their government to be highly corrupt (85% think corruption in government is a big problem) and slightly less than half (48%) feel law enforcement is doing a good job in policing it. Further, citizens are reticent to speak up: 56% of respondents said they would fear reprisals if they reported corruption.

Blockbuster graft cases dominate headlines

In attempting to research the level of corruption in Japan, a similar theme emerges. There are no national statistics publicly available on graft-related prosecutions or convictions. What gets reported instead in the news are senior officials that from time to time take payoffs on a large scale. Former Prime Minister Shinzo Abe was among the luminaries implicated in a political funding scandal in 2020 (as of March 2021 Abe was facing a fine over his role in the violation of political spending rules). It was hardly reassuring to see the country's former justice minister among those accused in 2020 of illicitly lining their pockets: In July 2020 Katsuyuki Kawai was charged for allegedly paying politicians and supporters to help get his wife elected to the Upper House in 2019. As of March 2021, Kawai was out on ¥50m bail. And the Kansai Electric Power (KEPCO) scandal was shocking for its crudity (see box below, The curious case of the small town official and the big power company).

The true extent of graft is an enigma

The other familiar scenario that emerges is that of Japanese executives bribing foreign officials overseas, but not facing repercussions at home (see box below, Foreign bribery: Easy does it). But beyond the political nobility and foreign business set, there is no discernible narrative on the extent of corruption in the middling public sector and its prevalence in the private sector. This opaque state of affairs reflects the fragmented nature of corruption law enforcement in Japan where there is no central agency coordinating policing efforts and no unity in legislation. Anti-bribery provisions are scattered across different statutes, from the Penal Code to competition and public service ethics laws. Responsibility for investigating most corruption lies with the Public Prosecutor's Office and the national and local police, while METI also administers certain laws. Private-sector corruption effectively gets a free pass: there is no specific law or regulation to restrict it. Only within very narrow circumstances is private graft prohibited (no bribing of directors and auditors under the Companies Act; no giving benefits to clients to make up for losses on transactions if you are a securities company or bank, according to the Financial Instruments and Exchange Act).

Poor record-keeping on private-sector graft

Ministry of Justice statistics on crime make no mention of bribery or corruption. The closest we get is a figure on violations of the Companies Act which are reported in aggregate: In 2018 there were 31 prosecutions, while under the Financial Instruments and Exchange Act there were 51 prosecutions. There is no breakdown of individual offences.

Japan's ranking in the annual TI survey has slipped . . .

Given Japan's blurred disclosure of graft at home and abroad it is not surprising that it barely scrapes into the top 20 countries in terms of the perceived extent of corruption. In 2020, Japan ranked as the 19th least corrupt country globally with a score of 74/100, according to TI. Of note is TI's reminder of Japan's decline since 2012: back in the day, it ranked joint 17th with the United Kingdom. Britain conversely was in joint 11th place with Canada in 2020.

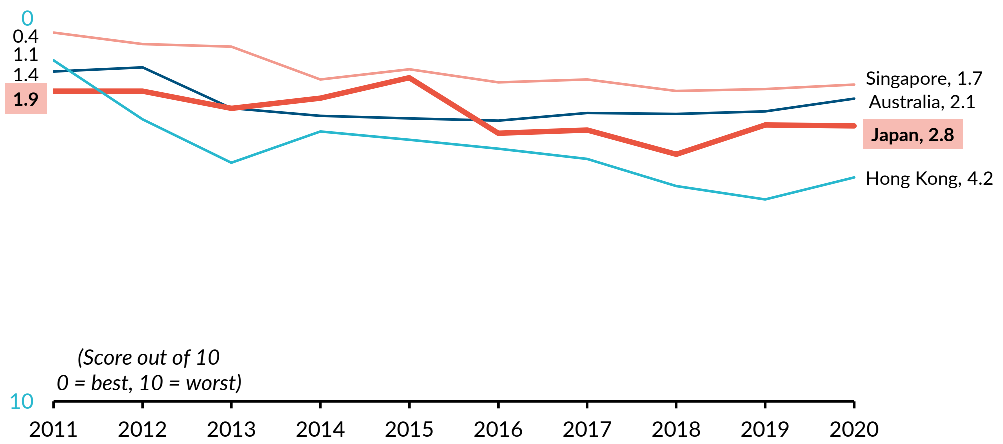
. . . as has its score in the annual PERC survey

In another closely followed regional survey, published by the Political & Economic Risk Consultancy (PERC), where the lower the score the cleaner the market is, the picture is also mixed: While Japan consistently ranks third in the region after Singapore and Australia for having a corruption-free system of government and economy, its score has been slipping since 2011, as the following figure shows.

Japan's score in PERC falls from 1.9 in 2011 to 2.8 in 2020

Figure 3

Not as clean as it used to be: Changes in perception of corruption in Japan, 2011-2020



Source: Political & Economic Risk Consultancy

The curious case of the small town official and the big power company

A bribery scandal at KEPCO dating back 30 years

There are so many troubling aspects to the corruption scandal involving Kansai Electric Power (KEPCO) which played out over 2019 and 2020 that it is difficult to know where to start. For the population of Takahama, which numbers just 48,736, it may have been unnerving to learn that for 30 years a former public official was bribing executives and employees at the operator of the town's four nuclear reactors. The now-deceased former deputy mayor, Eiji Moriyama, lined the pockets of KEPCO staff and in turn is said to have received kickbacks from local businesses and lucrative deals from the power firm for construction firms he was involved with.

The case was initially prompted by a tax inspection

Shareholders of KEPCO learned that a September 2018 internal investigation into the matter (prompted by a tax inspection) initially found the giving of ¥360m in cash, gifts and even gold coins, to be perfectly legal. But still there was no mention of the incident to the board - that is, until a whistleblower went to the press and KEPCO appointed an independent investigator to look into the matter a year later.

75 executives and employees received cash and gifts over three decades

In March 2020, KEPCO released a report into the scandal that revealed 75 executives and employees had received cash and gifts for three decades starting from 1987, when Moriyama retired from public service. The report recounted tales of a bad-tempered bully who drove fear into the hearts of staff and reproached them when they attempted to return gifts. It was a far cry from the initial internal review conducted by KEPCO in 2018 (kept from the public eye) which concluded that Moriyama was bent on showing his authority, craving the limelight while merely being polite, expecting nothing in return. The 2020 report concluded that the scandal involved "grave and serious" problems from a CG perspective. It cited a lack of decisiveness by management to tackle the problem and an "introverted corporate culture" throughout KEPCO.

Sanctions seem limited

Perhaps what is the most striking aspect of the whole affair, however, is how little seemed to come of it. There were apologies and resignations: KEPCO chairman Makoto Yagi resigned in 2019 and president Shigeki Iwane followed him out the door in 2020. Meanwhile, METI in March 2020 issued a business improvement order to KEPCO, seeking a clarification of responsibilities and better legal compliance. But the only people likely to see a day in court are a handful of former executives being sued by the company for their alleged part in the scandal.

Next steps

A single CG/ESG roadmap from government would help

A clearer, overarching policy or roadmap from government on ways forward in CG and ESG would be welcome. This could pull together various disparate policy strands and explain how different government agencies intend to work together.

Time for standalone guidance on bank governance?

More explicit guidance documents on bank governance would facilitate improvements, especially among regional banks, and lay down clear policies on the need to reduce unnecessary equity holdings.

Aggregate data on corruption cases would be nice

An integrated set of statistics published annually on progress against corruption, with narrative explanations of the figures, would greatly help to clarify what the Japanese government is doing in this area.

Foreign bribery: Easy does it

Overseas bribery is a familiar theme

Over the past 20 years there has been no shortage of Japanese companies embroiled in foreign bribery scandals, from the US$19m penalty Hitachi paid in 1995 to US law enforcement to settle charges over illicit payments in South Africa, to the US$143m that Panasonic paid in criminal penalties to the US in 2018 to resolve bribery offences relating to its in-flight entertainment systems. In fact, the OECD Working Group on Bribery has counted 46 foreign bribery allegations since 1999 involving Japanese nationals and companies. That year Japan joined the OECD Convention on Bribery.

Cases are not pursued at home

But while these corrupt payments attract censure by overseas law enforcement, on the home turf the legal fallout is negligible. Of the 46 cases identified, Japan has investigated only 30. This has resulted in just five cases being prosecuted domestically, leading to the sanction of 12 individuals and two companies. One of the five cases was that of Mitsubishi Hitachi Power Systems. In 2015, executives at the power plant construction company bribed Thai public officials to secure permits for a gas-fired plant. Two of the executives admitted the charges in Japan's first plea bargain deal and in March 2019 and they were sentenced by the Tokyo District Court to 18 months and 16 months, respectively, in prison. Both of their sentences were suspended for three years.

A global anti-graft body chides Japan

The OECD Working Group released an evaluation of Japan's track record on implementing the Bribery Convention in July 2019. Efforts to date did not quite hit the mark. "Japan's enforcement rate is not commensurate with the size and export-oriented nature of its economy or the high-risk regions and sectors in which its companies operate," it concluded. Of the 30 cases investigated, 13 were discontinued without sanction, 12 were still ongoing and there was one outstanding prosecution. Japan itself appears to have difficulty identifying foreign bribery cases: Half of the 30 cases were brought to Japan's attention by the OECD Working Group itself. Within these, nine investigations were initiated during the working group's trip to Japan in 2019.

2. Regulators

Japan ranks 5th on a much-improved score of 62%

Japan saw a significant 10-percentage point boost in score in this category, from 52% in 2018 to 62% in 2020. Changes in survey methodology contributed to these higher scores, as did some substantive factors - as implied by Japan's move from 9th place two years ago to 5th today. With scores for both sub-categories in Regulators improving by an equal amount - nine to 10 percentage points - the overall gain was not driven by just one part of the system. We have also corrected certain errors made in our previous report and highlight these below.

We emphasised an imbalance between hard and soft law in CG Watch 2018

Thematically speaking, one of our main concerns in CG Watch 2018 related to an imbalance in reform efforts between soft and hard law. These are colloquial terms that relate to non-mandatory codes and guidelines for listed companies and institutional investors (hence the word soft) as opposed to amendments in laws, regulations and listing rules that must be complied with (the hard part). For the record, ACGA has always considered both approaches necessary in the drive to improve corporate governance. Our argument was essentially that most of the regulatory energy and political capital behind CG reform in Japan was being focussed on revising and promoting the Stewardship and CG Codes, leaving improvements to hard law, in particular shareholder rights and corporate disclosure rules, largely unattended. While we did award points in our previous survey for various upgrades to soft law, we also deducted points around hard law.

Despite improvements to hard law, we still believe it deserves more attention

As this section shows, regulators should be commended for driving certain improvements in hard law over 2019 and 2020. It should also be noted that some of these efforts began before the completion of CG Watch 2018 and only came to fruition after - hence were not included in the scoring for our previous survey. Some initiatives remain ongoing. We continue to believe that hard law deserves more sustained attention in Japan.

2.1 Funding, capacity building, regulatory reform

Japan moved up to 4th with a score of 58%

The score for this sub-category jumped 10 percentage points from 48% to 58% and its ranking moved up from 8th to 4th. This boost came from higher ratings for five of the 11 questions in this sub-category, namely: Regulatory funding of the FSA and JPX; investment by both entities in new technology; and efforts by JPX to modernise its listing rules.

The regulatory consultation process could be better . . .

One area where Japan did less well was a new question on public consultations. In ACGA's experience, the consultation process in Japan is less accessible and transparent than in Australia and Hong Kong, which set the benchmark for the region. Another long-standing issue is the relatively limited archive of corporate reports and announcements available to the public on the JPX website (see "A deeper company archive please!" on page 246).

. . . but Japan stands out for its e-voting system

Conversely, Japan has always stood out for having a well-established electronic voting system, which was created in 2004 through a 50/50 joint venture between the Tokyo Stock Exchange and Broadridge, the global vote tabulator. Although India and Taiwan have now caught up, and Korea is not far behind, Japan has been far in the lead in Asia.

Amending FEFTA caused huge pain to foreign investors

As for specific areas of regulatory reform, the past two years have seen multiple efforts by the FSA, METI, JPX and, to a lesser extent, the Ministry of Justice (MOJ) to raise standards of CG and ESG. Unfortunately, market participants also had to face the pain of a series of amendments to the Foreign Exchange and Foreign

Trade Act (FEFTA), which governs foreign investment in sectors that are considered sensitive from a national security point of view. The consultation process on FEFTA began in late 2019 and, at least initially, was poorly communicated, leaving foreign investors deeply concerned as to the government's intention. While dialogue improved thanks to the outreach efforts of the Ministry of Finance (MOF), the episode could have been much better managed.

FSA funding

IOSCO - 'Proper funding is key for effective regulation'

A new avenue of investigation for ACGA in recent years has been the level of funding and human resources utilised by securities commissions and stock exchanges. There is broad agreement that financial regulators need to be properly funded if they are to do their jobs properly, including hiring experienced staff, investing in new regulatory technology (RegTech) and initiating sustained enforcement action. The International Organization of Securities Commissions (IOSCO) states in its Objectives and Principles of Securities Regulation (2017) that: "The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers." Interestingly, neither IOSCO nor any of its members appear to have developed any way of assessing how much funding is enough relative to the scope of a regulator's responsibilities and the size and complexity of the securities market. The issue is further complicated by the fact that funding mechanisms are not independent in many markets (ie, budgets allocated by government rather than a form of user pays).

ACGA assesses volume of funding, how it is changing

As a preliminary line of inquiry, ACGA assesses the volume of regulatory funding, how it is derived, whether it is increasing over time, total staff numbers (as well as any breakdowns provided between administrative and professional staff), and what salaries are based on (ie, a rigid civil service pay structure or a more flexible commercial system). We accept that this provides only a limited answer to the question of funding adequacy, but believe it offers some useful insights. We intend to develop this analysis further in coming years.

Understanding regulatory spending in Japan is difficult, at least initially

Gaining an understanding of the FSA's funding is not entirely straightforward: The information is only in Japanese, it needs to be extracted from budget requests to the National Cabinet Office, and the figures come with general headings and only brief supporting explanations. To gain the full picture, one also needs to look at the resources allocated to Local Finance Bureaus - a separate set of figures. We are grateful to the FSA for helping us navigate this thicket of data.

FSA budget requests have been gradually increasing

The trends over the first three years of the current era, called Reiwa in the official calendar to mark Emperor Naruhito's ascendency to the Japanese throne on 1 May 2019, show a gradual increase in funding requests from the FSA. Highlights include:

- The budget request in Reiwa 2, which started on 1 May 2020, was for an increase from ¥25.58 billion in Reiwa 1 to ¥26.54 billion - a 3.75% rise.
- The budget request in Reiwa 3 is for an increase from ¥25.68 billion in Reiwa 2 to ¥26.97 billion - a 5% increase. (Note that the full amount requested in Reiwa 2 does not seem to have been spent and the baseline was adjusted down.)
- Labour costs account for around 70% of the FSA's total budget. They increased in Reiwa 2 by only 0.76%, but this looks set to improve to 1.56% in Reiwa 3.
- As for key policy issues, the original plan for Reiwa 2 was to focus on the promotion of "financial digitalisation", financial services to "meet diverse needs" (eg, improving financial literacy), and the quality of financial

monitoring (eg, strengthening financial intermediary functions and dialogue with financial institutions). Note that this plan was released in August 2019, hence pre-Covid.

- The plan for Reiwa 3, released in September 2020, not surprisingly had a heavy focus on the pandemic. Key policies included supporting a strong economic recovery, "building a new society after Corona" (eg, promoting Sustainable Development Goals), and "building an attractive capital market" (eg, creating an international financial city, improve the quality of audits).

In addition to these developments, we gave an uptick in Japan's score for the funding of its securities commission for one more important reason - the work of Local Finance Bureaus - as the following box highlights.

Our 2018 score for funding was on the low side

Correction: Local Finance Bureau budgets
Our score for the FSA's funding in 2018 of 3/5 was lower than it should have been due to an error in our survey: We failed to account for the budgets of 11 Local Finance Bureaus which undertake regulatory functions delegated by the FSA.

Allocations to the 11 Local Finance Bureaus increases the regulatory budget by 70%

Teasing out the funding figures for the Bureaus is a challenge - once again it is only available in Japanese and one has to focus just on their FSA-related work, ignoring the many other tasks they do for the MOF. Nevertheless, expenditure on their securities work adds about another 70% to the FSA budget figures.

Japan spends about the same as Australia on securities regulation and enforcement

This means that the Japanese government spends approximately ¥46 billion (US$420m) on securities regulation annually. This is considerably more than the US$252m that the Securities and Futures Commission in Hong Kong spends - although the FSA's role is much broader - and close to the US$430m that the Australian Securities and Investments Commission (ASIC) spent in 2019-20. Like the FSA, ASIC also has a wide remit. While such direct comparisons need to be treated with caution, they do indicate that the Japanese system is better funded than we suggested in 2018. We increased our score accordingly to 4/5 in CG Watch 2020. Our apologies for the previous error.

New technology - FSA

The FSA is exploring the use of new regulator technology

In terms of investment in new regulatory technology, the FSA's budget requests include references to increased spending on IT systems, market monitoring and surveillance technology. For example, its financial digitalisation strategy envisages developing the next version of EDINET, the "Electronic Disclosure for Investors' Network" database that distributes securities reports. This would be very much welcomed. Plans are also afoot to upgrade the agency's "integrated operation support system, which was initiated in 2013 for monitoring, analysing, inspecting and supervising financial institutions and market transactions.

A 2019 experiment on the use of AI to understand narrative reporting produced some interesting results

The FSA also told ACGA that it was working on "various initiatives to respond to technological innovations", in particular the use of artificial intelligence to analyse information disclosure. In late 2019, its Open Policy Lab announced the results from a proof-of-concept test into the use of AI to examine company annual reports, in particular the quality of non-financial information. The basic goal was to assess if AI could judge if narrative descriptions in reports were good or bad. The test concluded that narrative information was much harder for a computer to read than financial information, yet AI clearly has advantages in analysing large volumes of data and can learn if humans work closely with it.

JPX funding

Stock exchange regulatory funding disclosure generally limited in Asia

Publicly available information on the funding of stock exchange regulatory work is scarce in most of the markets we cover. Japan is no exception, as the Japan Exchange Group (JPX) annual reports provide a full set of financial accounts but little direct information on the budget allocated to its regulatory work. Nevertheless, JPX Regulation (JPX-R), the standalone self-regulatory arm of the Group, helped to fill some of the gaps.

20% of JPX staff work in JPX-R

According to information provided to ACGA, JPX-R has around 200 staff out of the 1,000-plus that work for JPX. These people are spread across key functions such as listing examination, listed company compliance, trading participant examination, market surveillance, and general administration. To this total one needs to add a further 150 people working in regulatory departments under the Tokyo Stock Exchange (TSE) and Osaka Securities Exchange (OSE), which runs the derivatives market. These sections play more of a preventative regulatory role, such as real-time monitoring of the market and, in the case of TSE, assisting with surveillance of listed-company disclosure. The inclusion of TSE and OSE staff helped to provide an uptick to our JPX regulatory funding score.

The JPX-R budget has been stable in recent years

While JPX-R is reluctant to provide hard numbers on its budget, it does note that the budget has "not changed significantly" in recent years. It also emphasises that the budget is independent according to law (FIEA, Article 85-3) and "sufficiently covers the necessary cost of Self-Regulatory Services". Moreover, staff recruited by JPX-R are expected to have "sufficient experience" in the stock market and it hires outside professionals such as lawyers, CPAs, CMAs and private investigators when necessary. It also accepts secondments from law firms, accounting practices and the police.

JPX is a for-profit entity that still runs a tight financial ship

To put this picture into more context, it is worth emphasising that JPX remains a for-profit entity listed in the TSE 1st Section and runs a tight ship financially. Looking at data for the past five years from the JPX annual report for FY2019 (1 April 2019 to 31 March 2020), one sees that total operating expenses remained fairly stable at slightly below ¥51 billion over FY2015-2017, the n rose 6% in FY2018 to around ¥54 billion and another 8% in FY2019 to ¥58.5 billion. While 21% of the additional expenditure in FY2019 went on personnel, the rest was mainly due to depreciation and amortization, system maintenance/operation, real estate expenses, and "other". In other words, the report appears to confirm that additional investment in regulatory services has not been all that material in recent years.

Like other exchanges, JPX does not disclose exactly what it spends on regulation

Over the same time period net income increased from just under ¥45 billion in FY2015 to just over ¥50 billion in FY2017, then slid to ¥47.6 billion in FY2019. At the same time, dividends per share increased from ¥50 to ¥70 during these years before dropping to ¥54 in FY2019 (while remaining in line with the firm's 60% payout ratio). The numbers show that JPX faces the same tensions as other stock exchanges between its commercial and regulatory roles and is clearly under pressure to perform well financially. What is lacking from JPX disclosure is any detailed explanation of how it allocates resources to regulation. To be fair, it is no different in this respect to its counterparts around the region. Yet this is part of the problem with frontline regulatory work being delegated to exchanges - the financial inputs remain hidden in a black box.

JPX also using AI to enhance surveillance of the market

New technology - JPX

JPX is also investing in new technology and has a focus on the use of AI in market surveillance. As the JPX 2019 annual report said regarding its introduction of artificial intelligence in 2018: "The AI we use is taught the knowledge of surveillance personnel for preliminary evaluations of unnatural trading execution patterns. By utilizing this AI in market surveillance and compliance operations, surveillance personnel can expedite the preliminary investigation process, and this allows them to focus on detailed, fullscale investigations. In this way, AI has enabled more detailed and in-depth market surveillance."

JPX IT Master Plan covers JPX-R as well

More broadly, JPX has an IT Master Plan that links to its mid-term business plan and covers JPX-Regulation. Specific parts of the plan focus on digital transformation, strengthening cyber security, and constructing additional back-up facilities to manage risk in the event of any future natural disaster. It also talks about making market surveillance more sophisticated.

JPX company report archive is comparatively thin

A deeper company archive please!

One digital service that we would dearly like to see improved is the company reports and announcements archive on the JPX website. This is an issue we have written about in successive CG Watch reports and accounts for one of Japan's lowest scores in this section of our survey. At the risk of repeating ourselves, statutory annual and quarterly reports, timely disclosure (TD) notices on financial information and CG reports are archived for only about five to six years, while other TD notices for much shorter periods. The search engine is not very effective. Regional best practice is to maintain a fully transparent archive of all company reports, announcements, notices, prospectuses and other public documents for 20 years - and to facilitate access with a powerful search engine.

A multiplicity of reform efforts, tarnished by FEFTA

Regulatory reform

The past two years have brought a number of improvements in new regulation and guidelines, including enhanced narrative (ie, non-financial) reporting, a second revision to the Stewardship Code, a plan to revise the CG Code in 2021, some revisions to the Companies Act, and new METI guidelines on fair M&A, group governance, virtual AGMs, and independent directors. Unfortunately, this good work was tarnished to some extent by the way in which the 2020 FEFTA amendments were handled and, in our view, unnecessarily linked disclosure obligations for investment in sensitive sectors to the exercise of certain shareholder rights.

JPX has been active on the regulatory front

JPX also had an active couple of years. It introduced some important rule changes on the governance of listed subsidiaries, formed a study group on minority shareholder protection, published a substantial Practical Handbook for ESG Disclosure, and began consulting on a new market structure.

We highlight some of these reforms and policy proposals below:

- **Narrative non-financial reporting**: In late 2018, the FSA announced changes to securities reports to improve disclosure on MD&As, executive remuneration, top-60 cross-shareholdings, activities of the Kansayaku board, tenure of external auditors, and audit/non-audit fees. The CG disclosure elements started from 2019, while the other measures were scheduled for 2020.

- **Recommended Directions for Further Promotion of Corporate Governance Reform**: In April 2019, the FSA's Council of Experts published a brief document highlighting a number of issues that could be discussed in the next revision of the CG Code, which the council started deliberating in October 2020. The issues ranged from the role of nomination and remuneration committees to cross-shareholdings in corporate pension funds and poor explanation of the activities and performance of the board of directors. It also emphasised the formalistic nature of much investor-company dialogue, the variable quality of investor stewardship reports, and questioned whether proxy advisors have sufficient resources to do their job properly. One particularly important recommendation related to the internal auditing process and the need to ensure it was more independent of management.
- **Second revision to Stewardship Code**: Following a consultation in late 2019/early 2020, the FSA released the second revision of its Stewardship Code for institutional investors in late March 2020. Key additions included an emphasis on taking ESG and sustainability issues into account in the investment and stewardship process, a new emphasis on the role of proxy advisors, and the application of the code to asset classes other than listed equities. The document also contains somewhat firmer language around the disclosure of the reasons for voting for or against an individual agenda item, especially where there may be a perceived conflict of interest.
- **Practical Guidelines for Group Governance Systems**: In late June 2019, METI published new guidance on group governance that covered issues such as business portfolio management, internal control systems in groups, and the governance of listed subsidiaries including nomination and remuneration decisions. As METI said at the time: "While conventional governance discussions have been based on corporate units, actual management is carried out on a group basis, so effective governance in group management has become an issue for Japanese companies." It further noted that recent scandals in listed subsidiaries gave this issue an added impetus.

It is likely to take time for recent reforms to be implemented

While these reforms are to be applauded, it will take time for them to be adopted in both word and spirit. For example, when reviewing disclosure on executive remuneration we found many instances where the depth and breadth of reporting fell well below regional best practices, despite the new non-financial disclosure regulations from the FSA in early 2019. For the record, we assessed annual securities reports and other company reports for the fiscal year 1 April 2019 to 31 March 2020. In other words, the first full year after the new rules were introduced. It is to be hoped that disclosure improves more substantially in FY2021 and FY2022.

New Stewardship Code principle on proxy advisors raises concerns

We also welcomed the revisions to the Stewardship Code and felt they marked a constructive step forward. The one area where we have concerns relates to proxy advisors. The introduction of a brand-new Principle 8 on service providers makes some reasonable requests around such entities ensuring they have policies on conflicts of interest and invest sufficiently in HR and IT capacity. However, the wide-ranging Principle 8.3 that requires proxy firms to actively exchange views with listed companies, check the accuracy of company information with companies (upon request) and then "provide the submitted opinion of the company to its clients together with the (voting) recommendation" raises a host of logistical and fairness issues in our view, especially with regard to the last item in this list. Proxy advisors should engage with issuers where necessary and ensure the accuracy of their recommendations. But it does not seem reasonable, given the intensity of the AGM season and clustering of meetings in Japan, that they must also convey the ad hoc opinion of a company on a specific voting recommendation - beyond what is already in the standard AGM meeting materials. This responsibility should fall to companies. Indeed, many already do so.

Public consultations

Public consultation standards in Japan are below regional best practice

Like most markets in our survey, Japan underperformed on a new question (Q2.7) about the process for undertaking public consultations prior to major rule changes. The government and regulatory agencies do undertake such consultations, but their timing and length is often problematic in our view. Some consultations are timed for the end of the year, which is holiday season for many foreign investors - meaning a six-week consultation, such as for the last revision to the Stewardship Code in December 2019, becomes effectively only a three- to four-week process. We appreciate that this timing is linked to the normal March year-end/June-AGM cycle of most listed companies. Even so, an earlier start in Q4 would be welcome.

Timeframes for submissions are usually shorter . . .

In terms of timeframes given for submissions, regional best practice is at least two months - or three months plus if an issue is complex. While the JPX now tends to allow six weeks for most consultations, the average FSA consultation has historically been four weeks. We hope that the Stewardship Code period of six weeks is followed in future consultations.

. . . as are consultation documents

In terms of content, regional best practice involves the publication of a detailed consultation paper, often of 50 to 100 pages, although this depends on the complexity of the issues being discussed. Most consultation papers in Japan are relatively brief, although the CG Code and Stewardship Code versions were quite long (albeit with the bulk of each paper comprising the previous code with revisions marked).

The FEFTA consultation process was deeply painful

The most challenging consultation of the past two years was undoubtedly FEFTA in late 2019. Information first reached the market through the media, which was highly unsatisfactory. The government then released a brief summary of proposed amendments, but not the full documents, with a more limited English translation. Additional documents were released in Japanese and English, but the latter continued to be skimpy and did not state the case for the amendments at all clearly or give a proper rationale for specific rule changes. Indeed, the documents raised more questions than they answered. Although the end result was more reasonable than initially expected, the whole process was an extremely painful one for ACGA and other interested market participants.

Links not provided to individual submissions

Lastly, while a conclusions document is usually produced that summarises major feedback received, links are not provided to individual submissions (unlike in Australia and Hong Kong, and to a lesser extent Singapore.)

Next steps

A combined document on FSA and Local Finance Bureau budgets would be welcome

A combined document outlining the FSA budget and Local Finance Bureau expenditure on securities supervision, with explicit reference to investment in new technology, staffing numbers and how expenditure has changed over the previous several years, would be welcome.

A similar document on JPX's overall regulatory budget would also be welcome

A similar document from JPX on the JPX-Regulation budget as well as TSE and OSE spending on other supervisory activities, including investment in new regulatory technology, would also be welcome. As a for-profit listed company, we believe that the exchange should be more transparent as to how it makes budgetary decisions on its regulatory work - a highly material part of its operations. Indeed, it is surprising that other regulators must disclose their budgets, but not JPX.

More time is needed for public consultations

Regulators could benchmark their public consultations processes against regional and international best practice. As our ACGA Investor Survey indicates (see Chapter 3 at the beginning of this report), Japan is the single largest investment destination for foreign investors in Asia. Consultations, including regulatory study and working groups, do not sufficiently cater to this important stakeholder group.

The JPX company reports archive needs to be deeper

Much could be done to improve and expand the company reports archive on the JPX website. This information belongs to issuers - and by extension their shareholders - and not the exchange. Providing it free of charge is a public service and market development mechanism.

An active regulatory response to the pandemic

Japan's response to Covid: Giving options

The regulatory response to the pandemic in Japan comprised a mixture of reasonable extensions for full audited annual accounts, a surprisingly long extension for quarterly reports, sound advice on continuous disclosure and hybrid AGMs, and a somewhat complicated structure for a "double AGM".

In early 2020 issuers invited to apply for extensions to financial reporting . . .

Financial reporting extensions

On 10 February 2020, the FSA published guidance informing issuers that they could postpone publication of their periodic securities reports and internal control reports, as required by the Financial Instruments and Exchange Act (FIEA), where they were unable to file them by the usual due date because of the pandemic. Approval to delay publication was to be provided on a case-by-case basis by the relevant Local Finance Bureau.

. . . then a general extension allowed in April 2020

Then on 14 April 2020 the FSA announced that firms with a 31 March year-end (ie, most listed companies) could have an additional three months to the end of September to file their annual securities reports - and there was no need to apply for this extension. Somewhat surprisingly, the FSA also gave firms with a calendar financial year until September 2020 to file their first and second quarterly reports for 2020. Firms that took advantage of this waiver would, therefore, leave their shareholders without any updated financial report for up to nine months. The same extension to end-September was applied to any financial filing due for release between 20 April and 29 September. Hence, firms with a 31 March 2020 year-end could delay the publication of their first quarter reports.

MOJ did not give extensions for pre-AGM business reports

In contrast to the three-month extension allowed by the FSA for the annual securities report, companies were given no extension by the MOJ for their pre-AGM audited financials and business report. Instead, the MOJ merely allowed companies to distribute these documents electronically through their websites rather than in printed form. Before Covid, web disclosure of business reports and accompanying financial statements was only partially allowed. The "Progress and results" and "Issues to address" sections in the business report, as well as the non-consolidated financial statements, had to be sent in printed form to

METI issues guidelines on hybrid meetings

METI guide defined difference between attendees and observers in hybrid meetings

Issuers allowed to postpone their AGMs . . .

. . . or hold a double meeting on two dates

MOJ reminded issuers they could hold AGMs after June

There were few takers

Virtual meetings not permitted in the past

shareholders with the notice and agenda of the AGM. But the MOJ revised the "Regulation for the Enforcement of the Companies Act" on 15 May to temporarily allow these items to be disclosed on websites as well. The revision was only valid for six months.

AGMs: Hybrid meetings encouraged

On 26 February 2020, the Ministry of Economy, Trade and Industry (METI) fortuitously issued its new "Guidelines on Approaches to Hybrid Virtual Shareholder Meetings" (in Japanese only). This document had been in the works for some time and was not a response per se to the pandemic.

The guide sought to address the legal and practical issues arising when companies conduct hybrid meetings. For example, it clarified the distinction between "attendees" and "observers" at hybrid meetings. To recognise shareholders as "attendees", there needs to be a two-way, instantaneous connection between the physical meeting and online participants; and this should be ensured for the duration of the meeting.

The double AGM idea

Other authorities - namely MOJ, FSA and TSE - later issued guidance saying that firms could postpone their AGMs and the disclosure of annual financial statements where the epidemic had rendered it impossible to conclude the audit of the financial statements. For example, a company that had subsidiaries in China where the audit fieldwork could not be completed.

Listed companies had two new options: Postpone their meeting beyond June; or hold two meetings, one before the end of June and the second later. In a memo on 15 April, the FSA noted that certain meeting resolutions, such as the election of directors, could be conducted at the first meeting, while the second would be for the presentation of the audited accounts and approval of any other business. (Note, however, that in Japan shareholders are not given the right to approve the audited accounts unless the audit opinion is qualified.)

On 15 May, the MOJ reminded companies that the Companies Act did not require them to hold AGMs within three months of their financial year-end - the normal practice in Japan. Instead, they could delay their AGMs outright by setting a new record date. All they needed to do was to give the market two weeks' notice and then hold the meeting within three months of the new date.

Few companies opted for either the double-AGM idea or postponing their meeting. Even the pandemic could not shift the inertia around annual meetings in Japan.

Virtual is coming

Interestingly, while hybrid meetings are allowed in Japan, companies have not been permitted under the Companies Act to conduct a fully virtual AGM. But this may be changing. In early 2021, the government indicated it wanted to address the legal issues surrounding them. On 5 February, METI released details of amendments to the Industrial Competitiveness Enhancement Act, one of which was to allow for virtual-only meetings in exceptional circumstances. As of late April 2021 the bill was still under discussion in the Diet, but was expected to be passed in the near future.

Guidance on material disclosure was robust

Continuous disclosure

Robust guidance was given to companies on the need to keep investors informed of any material impacts on their business arising from the pandemic. As early as 10 February 2020, the TSE reminded issuers of the importance of such information and requested that they "consider promptly and actively disclosing information on the impact of the novel coronavirus outbreak, etc, where possible, provided that the first priority is ensuring the health and safety of listed companies' officers and employees, business partners and other related parties".

Investors need meaningful information, says TSE

It reinforced this the following week by noting that, while "many companies have recognized it [the epidemic] as a significant risk in their business operations", domestic and foreign shareholders were "closely watching" its impact on business performance and operations, and "expect listed companies to provide meaningful and substantial information proactively".

Japan ranks 5th with an improved score of 66%

2.2 Enforcement

Japan's score in this sub-category increase nine percentage points to 66%, taking it to 5th place from 8th in 2018. We observed in 2018 that enforcement outcomes in Japan were not among the most robust in the region and their frequency appeared low compared to the number of listed companies and, indeed, the number of regulatory investigations launched. In terms of sanctions, regulators tended to apply monetary penalties rather than file criminal charges - and few people go to jail for insider trading. While many of these patterns continue to exist, we marked up the scores this time on four out of the 10 questions in the sub-category:

❑ Have the efforts of regulators improved and evolved?

❑ Is there a stronger track record on enforcement against market misconduct?

❑ Does the stock exchange have an effective range of regulatory powers?

❑ Have authorities sought to manage the conflicts of interest inherent between the commercial and regulatory roles of the stock exchange?

Scores improved for both substantive and methodological reasons

Scores on the first two of these questions increased for substantive reasons, while those on the second two were adjusted in line with our more granular scoring methodology and to take account of certain positive developments in Japan. Scores on all remaining six questions remained the same and, to put Japan's performance in context, it is worth noting that Hong Kong, Singapore and Taiwan are still several points ahead at 76%, 70% and 70%, respectively.

SESC provides good disclosure on enforcement activity

Enhanced communication

One of the strengths of the Japanese regulatory regime has long been the detailed disclosure provided by the Securities and Exchange Surveillance Commission (SESC), the enforcement arm of the FSA. The commission produces an annual report, usually around 100 pages in length, that contains a detailed overview of its activities for the fiscal year (April to March), a focus on certain key topics, and multiyear statistics for the previous five years. The report also provides interesting case studies on different aspects of supervision and dubious market behaviour, such as reporting suspicious transactions, the finer details of insider trading rules, and preparing for cyber-attacks. Meanwhile, the SESC's ad hoc announcements on individual enforcement actions are quite detailed and informative - though not surprisingly the news provided on its Japanese website far outweighs that offered on its English site.

SESC puts more emphasis on dialogue with the market . . .

In 2019 the SESC said it would put more emphasis on dialogue with companies and auditors to better understand the reasons for disclosure violations, improve its whistleblowing system (called the Contact Point for Information Reporting), and publish a casebook on administrative monetary penalty payment orders to both "provide information on trends and overviews of the recommendations" and "identify issues regarding internal control systems that can be improved to prevent insider trading at listed companies," according to its FY2018/19 annual report. The effort was "aimed at preventing both occurrences and recurrences of market misconduct".

. . . and starts tweeting

The SESC is also using social media to communicate. It opened a Twitter account in March 2019 and posts several times a month (in Japanese). The tweets cover everything from enforcement announcements, statements to the market and job ads. These developments in improved communication were a factor in the higher score in our survey for regulatory effort and innovation.

Enforcement patterns and outcomes - SESC

The number of market misconduct examinations remains stable

The number of SESC examinations of market misconduct has been broadly stable and consistent over the past five years (ie, the five most recent full fiscal years) as the table below shows. Some highlights:

- Total cases examined amount to more than 1,000 per year.
- The vast majority of these relate to suspected insider trading: 976 in FY2019 alone and more in previous years.
- Most of the remainder focussed on market manipulation: 78 in FY2019.
- A small number are classified as "other cases", which refer to such things as fraud and spreading rumours.

Most cases of misconduct relate to insider trading

Figure 4

Market misconduct cases examined in Japan, 2015-2019

Fiscal year	2015	2016	2017	2018	2019
Insider Trading	992	1,031	1,002	977	976
Market Manipulation	95	98	83	70	78
Other cases	10	13	14	5	7
Total	**1,097**	**1,142**	**1,099**	**1,052**	**1,061**

Note: The years relate to fiscal years. Hence, "2019" is the year from April 2019 to March 2020.
Source: Securities and Exchange Surveillance Commission, Annual Report, 2019/20

The nature of misconduct is evolving due to IT and the external environment

While the numbers remain largely the same, the SESC notes in its 2019/20 annual report that the nature of market misconduct is evolving due to changes in "the external environment, including macro-economic trends and advances in information technology". The former relates for example to increased uncertainty in the global economy and the latter to such things as the rise of high-frequency trading. The SESC accordingly has been trying to expand its sources of information, including from market participants and whistleblowers. In FY2019, it modified its website to allow the public to contact it through their smartphones to "improve convenience".

The SESC relies heavily on the use of monetary penalties

In terms of the sanctioning process, the SESC relies largely on making recommendations for what are termed "administrative monetary penalty payment orders" (ie, fines) rather than the filing of criminal charges. After reaching a combined high of 63 cases in FY2016, the total number of sanctions dropped sharply to 32 the following year before rising again to 51 in FY2018 and falling to 38 in FY2019 (see table below). Some patterns:

- Most of the monetary penalty orders each year relate to market misconduct, while the remainder are for disclosure violations.
- What the figure does not show is that most of the market misconduct fines in FY2019 comprised insider trading cases: 24 of the 29 cases; the other five were for market manipulation.
- The number of criminal charges is less than 10 a year. There were only four in FY2017, rising to eight in FY2018 and then only three in FY2019.

Administrative fines far outweigh criminal charges

Figure 5

Recommendations for fines and filing of criminal charges, 2015-2019

Fiscal year	2015	2016	2017	2018	2019
Recommendations for fines	**41**	**56**	**28**	**43**	**35**
Market misconduct	35	51	26	33	29
Violation of disclosure regulations	6	5	2	10	6
Filings of criminal charges	**8**	**7**	**4**	**8**	**3**
Market misconduct	5	7	4	5	1
Violation of disclosure regulations	3	0	0	3	1
Others	0	0	0	0	1
Total	**49**	**63**	**32**	**51**	**38**

Source: Securities and Exchange Surveillance Commission, Annual Report, 2019/20

The SESC explains the apparently low number of enforcement actions

ACGA asked the SESC for its comment on the relatively small number of monetary penalties and criminal charges. It does not necessarily see the numbers as being low and noted that it worked closely with JPX-Regulation to prevent violations of the FIEA. Moreover, the regulators have a good working relationship with brokers who report suspicious transactions to the SESC and JPX-R. "We are doing a very good job to prevent (rule breaking), so the number of recommendations is not so small (in that sense)," the SESC said.

The rising trend in sanctions led to a small uptick in our score

Indeed, despite the fall in the number of recommended sanctions in FY2019, the rising trend since FY2017 contributed to a slight uptick in our score for enforcement outcomes by the securities regulator. Despite the ever-present time lag in the issuing of sanctions in any market, on balance we concluded an improved rating was warranted. Accordingly, our score increased from a low 2/5 in our previous survey to a moderate 3/5 in this one.

Insider traders divide equally into corporate insiders and connected outsiders

The SESC reports also contain interesting information on the source and nature of insider trading in Japan. In FY2019, exactly half the violators were corporate insiders - mostly employees but a few contract counterparties as well. The other half were people who received tips from an insider - mostly friends and colleagues, as well as customers, family members and others. Historically, insider-trading sanctions have mostly been imposed in connection with takeover bids, earnings revisions, the issuance of new shares, or business alliances. In recent years, the SESC has recommended penalties in relation to business transfers and demergers as well.

Many companies are unprepared to control insider trading

Meanwhile, in its 2018/29 annual report, it made a telling observation about the lack of preparedness to control insider trading among multiple issuers: "The SESC's investigation of insider trading revealed many listed companies that had never revised rules for preventing insider trading since they had established such rules, and quite a few listed companies whose rules did not contain any statements about prohibition of trade recommendations. There were also listed companies where individuals who had become aware of material facts were permitted to buy and sell the company's stock. Even though a system for preventing insider trading had been established, it was not functioning effectively in practice."

A correction on our CG Watch 2018 survey

Correction: Insider trading statistics
In CG Watch 2018 we also made a mistake with regard to the number of market misconduct examinations that related to insider trading. Due to an unfortunate misreading of a chart, we stated that only a small proportion of the 1,000-plus cases annually (12-14) related to insider trading. In fact, the vast majority of them did so, as we have reported above. Our sincere apologies for this error.

JPX has a wide range of powers and sanctions

JPX powers
We raised the score for JPX's range of enforcement powers since they stand up well in comparison with other exchanges around the region. The exchange can publicly criticise and censure issuers, impose fines, force companies to undertake remedial measures, and suspend or delist. Two of its more potentially powerful measures are the use of targeted "improvement reports" for companies with material governance deficiencies and its ability to designate companies as "securities on alert", meaning they face probable delisting unless they take certain remedial measures. Meanwhile, its delisting mechanism is not as cumbersome as those found in some other markets.

JPX enforcement outcomes show little change in recent years

Enforcement patterns and outcomes - JPX
Overall, we saw no discernible change in the low level of enforcement outcomes at JPX during our survey period. An ACGA analysis of the enforcement announcements on the exchange's website for the past five years, 2016 to 2020, found the following (with the data accurate as of early November 2020):

- The number of "securities on alert" was just two or three in recent years.
- The number of "public announcement measures" fell from nine in 2019 to five in 2020.
- Listing violation penalty agreements remained constant at three.
- "Securities under supervision" and those to be delisted rising somewhat over the four years from 54 in 2017 to 74 in 2020.
- Other securities under supervision/delisted falling somewhat. (Note: The figures here aggregate the TOPIX-17 Series ETF as one.)

The detailed figures are as follows:

Figure 6

JPX enforcement action, 2016-2020

	2016	2017	2018	2019	2020
Designation of Securities on Alert	1	0	2	3	2
Public Announcement Measure	4	9	9	9	5
Listing Agreement Violation Penalty	1	1	3	3	3
Stocks either under supervision or to be delisted	66	54	64	70	74
Other securities either under supervision or to be delisted (ETF, CF, CB, ETN)[1]	26	29	11	10	4

[1] This category classifies the TOPIX-17 Series ETF as 1. Source: JPX website, ACGA analysis

JPX gives its side of the story: "We are not only a policeman"

We also engaged in a useful dialogue with JPX about its enforcement figures, as well as other items. It made the following observations:

- As an exchange, JPX's mission is not to police listed companies on the violation of every law but rather to maintain a fair, orderly and transparent financial market.
- JPX is authorised to ensure accurate and timely disclosure, hence false statements and inappropriate disclosure are the main purview of its penalties. Violation of other laws, including for example product liability and other things, are the purview of other government agencies.
- While the exchange enforces the listing rules against listed companies, the ultimate goal is not to punish these companies (which in turn could bring unintended damages to shareholders), but the improvement of corporate disclosure.
- In recent years, JPX has been proactive in publishing principles-based guidance to help issuers avoid problems. Topics covered include equity financing (2014), responding to corporate scandals (2016), and preventing corporate scandals (2018).

Firm enforcement of the listing rules helps to counter charges of conflict of interest

We appreciate that the enforcement powers of stock exchanges do not have the full weight of the law behind them - unlike the main securities regulator in each market. Nevertheless, firm enforcement of the listing rules sends a clear message to the market that these rules are intended to be followed and helps to answer the standard criticism that for-profit exchanges are conflicted and inherently soft on enforcement. As we mentioned in CG Watch 2018, more narrative explanation of JPX-R aggregate enforcement statistics would also help the market understand underlying trends and the meaning of changes from year to year. Meanwhile, we increased the score for the management of conflicts of interest at JPX because of the existence of JPX-R, which we view as a positive.

Next steps

More narrative please

More narrative explanation by the SESC and JPX on their enforcement outcomes, specifically what the low numbers mean, would be welcome.

More reporting please

JPX-R could take a leaf out of the SESC's book and produce an annual report on its market supervision and regulatory action.

Japan remains 9th despite an 11-percentage point rise in score to 58%

3. CG rules

This continues to be one of Japan's weakest categories and it remains 9th despite an 11-percentage point improvement in score to 58% - an indication that all markets enjoyed a boost to their scores here. This was in large part due to our more objective and granular scoring methodology, which broke each question into a detailed set of sub-components and assigned a weighting to each. Eight of the 24 questions in this section benefited positively from scoring adjustments, while our ratings on three questions fell. This left the scores of 13 questions unchanged.

Japan does best in CG Rules on financial reporting and soft-law codes of best practice

Japan does best in this section in areas such as basic financial reporting standards, quarterly reporting, and the existence of both a CG and stewardship code. The CG Code is undergoing a process of revision, with a new draft released for public consultation in early April 2021. (See "Stop Press: The Draft CG Code 2021" on page 261). The Stewardship Code, the first in the region in early 2014, was revised in 2017 and then again in 2020. One interesting fact about the CG Code and a reason for the one-percentage point increase in score on this question (Q3.13) is that it remains one of the few codes in Asia that actually addresses local governance issues, as opposed to being a wholly generic document that could apply to any market. The Stewardship Code, meanwhile, has consistently raised the bar on disclosure by investors, especially around voting practices and reasons for voting against resolutions.

It underperforms on takeover rules, private placements, remuneration disclosure, among other things

Japan continues to underperform however in areas such as takeover rules, third-party allotments (private placements), executive and director remuneration disclosure, rules on collective engagement, the functioning of audit committees, and the legal basis for and functioning of nomination and remuneration committees. It is also not keeping pace with developments around the region in the counting and publication of AGM voting results and meeting minutes (including shareholder Q&A).

Where scores rose

Scores increased on ESG reporting, disclosure of director trading, blackout periods and other areas

Scores increased in our survey on questions relating to ESG reporting standards, the disclosure of director trading and share pledging, blackout periods for director trading, related-party transactions (RPTs), the CG Code, the definition of independent director, and the nomination of independent directors. A summary of the reasoning behind the score increase on each question follows. We also highlight where our 2018 scoring was incomplete in certain respects and would like to acknowledge the assistance of the FSA in clarifying a number of matters.

JPX released guidance on ESG reporting in March 2020

- **Q3.3: Do ESG/sustainability reporting standards compare favourably against international standards?** The score increased from 1/5 to 3/5 with the publication by JPX in March 2020 of its Practical Handbook for ESG Disclosure. The handbook covers key subjects such as the need for board oversight of the disclosure process, linking ESG to strategy, identifying material risks and opportunities, engaging with stakeholders, and setting metrics and targets. It also encourages issuers to utilise international standards of sustainability reporting, including the Global Reporting Initiative (GRI), Integrated Reporting, the Sustainability Accounting Standards Board (SASB) and TCFD, if they wish. At this stage, the handbook is intended only as a guidance document to help issuers think through their approach to ESG reporting and describes four steps for doing so. It is not mandatory or subject to "comply or explain". Nor does it lay down a list of numeric KPIs to follow.

Our more graduated scoring on disclosure of director trades benefited Japan

- **Q3.6: Must directors disclose on-market share transactions within three working days?** Reports must be made by officers and "major shareholders" (ie, those holding more than 10% of the voting rights), but not until the 15th day of the following month. (FIEA, Article 163) The same applies for directors with stakes of less than 5%. However, directors who own 5% or more must follow the large-shareholding reporting rules and disclose within five business days. We think it unlikely that many directors would own more than 5% of a listed company, hence used the first rule as the main benchmark for our scoring. Whereas in previous years we applied a more binary approach to scoring this question and gave zero points for disclosure longer than five days, this time we applied a more graduated scoring system. This resulted in Japan's score increasing from zero to 2/5.

We corrected our scoring on disclosure of share pledges

- **Q3.7: Must controlling shareholders disclose share pledges in a timely manner?** We previously scored this question 0/5 based on the rather limited share pledging rules in the Companies Act. However, the FIEA requires a shareholder who owns more than 5% of outstanding shares and who has pledged 1% or more of these shares as collateral must file an amendment to their large-shareholding report within five business days. (FIEA, Article 27-35(1) and Q10 of the Large Shareholding Report Q&A). Related rules are also found in Form No.1 of the Cabinet Office Order on Disclosure of the Status of Large-Volume Holdings in Share Certificates. However, given that disclosure is longer than three business days and there is no English translation of Form No.1 or the Large Shareholding Report Q&A, we scored this 3/5.

We adjusted our scoring on blackout periods to take more account of informal norms

- **Q3.8: Is there a closed period (a blackout) of at least 60 days before the release of annual results and at least 30 days before interim/quarterly results during which directors cannot trade their shares?** While there are no formal rules on blackout periods in Japan, each listed company is expected to develop an internal rule requiring directors and insiders to seek permission to trade. Since other markets set clear and mandatory rules, we previously scored Japan 1/5 here. We increased the score to 2/5 this time because, as the FSA said to ACGA, "insiders tend not to trade their shares during such periods because of insider trading laws. Also, there are fair disclosure rules. Directors and insiders are more cautious." Although somewhat dated, a survey conducted by JPX and other exchanges in 2016 found that 93.1% of 1,990 listed companies had insider trading rules in place. Of these, 71.9% required their directors to obtain prior approval by the company to trade its listed shares, while 6.4% prohibited trading of the shares.

The FSA thinks few companies allow trading before the release of results

The regulator also noted that it believed prior approval would only be given by companies if there was no undisclosed material information - in other words, no approval would be given during the blackout period before the release of results. Moreover, if directors or employees violate insider trading rules in their company's shares, the company is also subject to criminal proceedings (fines of up to ¥500m), which can in turn lead to shareholder derivative lawsuits.

Blackout rules could be greatly simplified in Japan - though the demand for change is not strong

While these arguments support a slightly higher score, the system still appears to be more complicated than it needs to be. A simpler approach would be to enact a listing rule that applied to all issuers and provided either clear windows for director trading after results were released or firm closed periods before results. As one investor said: "The policy (of most listed companies) is that as long as you occupy a board seat you cannot trade." Such an approach hampers liquidity and is too blunt an instrument in his view. But putting the issue into a wider context, he also noted: "There has not been a domestic need for change. Most directors do not buy their own stock!"

We adjusted our scoring on RPT rules to put more weight on disclosure elements

- **Q3.10: Are there clear rules on the timely and meaningful disclosure of related-party transactions, calibrated for the size/materiality of transactions, and that allow minority shareholders to approve major RPTs?** We increased the score on this question from 1/5 to 3/5 after applying a greater weighting to the disclosure components of related-party transaction (RPT) rules. Whereas rules in Japan are weak on the issue of minority shareholder approval for RPTs, current regulation under the Companies Act and FIEA requires issuers, firstly, to disclose transactions with related parties, including controlling shareholders, in their annual financial statements. Secondly, the FIEA requires companies to explain how they manage conflicts of interest in transactions with a parent company (eg, setting up an independent committee to review transactions). Thirdly, the TSE listing rules require disclosure of any material transactions with a parent and for issuers to get an independent fairness opinion on such transactions. Some further progress came in February 2020 when the TSE updated its guidelines on CG Reports to require listed companies with a listed subsidiary to disclose the reasons for doing so, how they will ensure effective governance, and any RPTs.

Japan's CG Code may be lacking in certain respects, but has a solid focus on local CG issues and challenges

- **Q3.13: Is there an up-to-date national code of best practice - and accompanying guidance documents - that takes note of evolving international CG standards and is fit for purpose locally (ie, addresses fundamental CG problems in the domestic market)?** We deducted two points from five here because Japan's CG Code remains weak in certain respects (eg, on board diversity, takeovers, capital management) and treads carefully around other sensitive issues (eg, the Kansayaku board), but added a point back in recognition that the code is one of the few in Asia that actually tries to address local governance challenges (see box below, "A window on Japan). This resulted in the score rising from 3/5 to 4/5. (Note: We did not incorporate the new CG Code of 2021 in our scoring since it was not published when we undertook our survey.)

We took a more balanced view of Japan's definition of "independent director"

- **Q3.15: Is there a clear and robust definition of "independent director" in the code or listing rules? (ie, one stating independent directors should be independent of both management <u>and</u> the controlling shareholder; that does not allow former executives or former professional advisors/auditors to become independent directors after short "cooling-off" periods, nor people with business relationships)?** We increased the score on this question from 1/5 to 3/5 to more fairly reflect the strengths of the INED definition in Japan, namely that it largely requires independence from both management and controlling shareholders; former executives cannot become independent directors if they have worked for the company or a subsidiary in the last 10 years; and there are equally long cooling-off periods for other former employees. Weaknesses, however, include: Short or no cooling-off periods for business partners/advisors, with companies allowed to define their own rules here; and only general mention of the positive skills that independent directors are expected to have.

We reassessed our view of the director nomination process in Japan

- **Q3.19: Can minority shareholders easily nominate independent directors?** We reassessed our view of this question, raising the score from 0/5 to 3/5. Our previous score was zero largely because the chances of any person nominated by a minority shareholder being elected to a board is rare in Japan. However, our latest survey put greater weight on the legal rights of shareholders and the nomination process itself. This shows that it is not too difficult to nominate a candidate in Japan. There are three thresholds: More than 1% of a company's shares (a high bar for most shareholders) or 300 voting rights (a very low bar) and the shares must be held for at least six months (not a long period). Indeed, according to data provided by the FSA, 34 listed companies received such proposals in 2020 and minority shareholders were successful in two of them. However, we did not accord full points here because the CG Code provides little guidance to companies on how to constructively engage with minority shareholders on such nominations, many companies continue to resist the whole concept, and nomination committees that could help to develop internal policies are not mandatory.

A window on Japan

Japan's CG Code speaks to local issues and challenges

For an outsider, one of the most interesting features of Japan's CG Code, first published in 2015, is its focus on locally important governance issues. Whereas most Asian codes of best practice date from the early to mid-2000s and remain largely generic - in part because they were so heavily influenced by imported models - the Japanese version speaks more directly to domestic governance challenges. In some ways its later start was an advantage.

Most CG codes in Asia say little about the local problems they are trying to solve

A handy litmus test for relevance when reading any CG code is to ask: "Have I learned anything about (name of market) from it?" The answer for Hong Kong, for example, is a deafening "No". Its code fails to mention even once fundamental governance issues such as the family business, state-owned enterprises or concentrated ownership. Any new family business issuer listing on Hong Kong Exchanges (HKEX), therefore, gets no guidance from the code on how to manage the inherent governance tensions within and between family shareholders and its listed entity.

One can learn much about Japan from reading the code

While the Japanese code is not perfect, it does at least give the reader a sense of some of the issues considered critical in Japan. These include: Cross-shareholdings; CEO succession; capital management; CG as a value-creation mechanism for corporates; encouraging corporate pension funds to play a stewardship role as asset owners; and the need to proactively facilitate the participation of institutional investors in AGMs where their shares are held in street names (ie, their own name is not on the shareholder register). Although much of the discussion on these points is tantalisingly brief, the code makes clear there is a challenge to overcome.

But there are areas where it fears to tread

At the same time, the code approaches a range of other sensitive issues with extreme caution. These include: The function of the Kansayaku board, the traditional governance oversight system in Japan, and its generally inferior relationship with the board of directors; the function and culture of the board of directors itself and how this needs to change (eg, fewer board meetings per year, greater diversity, proper director training); the adoption of anti-takeover measures; and policies on related-party transactions. But even here, the window is left slightly ajar and a perceptive passerby will see something of interest inside.

Where scores fell

Scores fell in two areas of disclosure and voting by poll

Following our more objective and granular scoring methodology, scores fell in three questions relating to disclosure of substantial ownership, disclosure of price-sensitive information, and voting by poll. The reasons were as follows:

Disclosure of 5% stakes is slower than regional best practice

- **Q3.5: Is timely disclosure of "substantial ownership" required?** We shaved a point off the score here - from 5/5 to 4/5 - following a slight tightening of our scoring criteria. Reports must be made within five days after a 5% stake is reached (FIEA, Article 27-23(1) and there is a "creeper rule" regulating disclosure of each additional 1% increase or decrease, which is also subject to the five-day rule, (FIEA Article 27-25(1). Since disclosure is longer than three working days, we deducted a point.

Issuers do not need to request trading halts re price-sensitive information

- **Q3.9: Are there clear rules on the prompt disclosure of price-sensitive information?** We shaved a point off the score here - from 5/5 to 4/5 - following a slight tightening of our scoring criteria. While Japan's rules are fairly robust, they do not require issuers to request a trading halt if they are in possession of material price-sensitive information and cannot disclose it without delay. Since other markets do mandate this, we marked down Japan accordingly.

Japan falling behind on post-AGM disclosure

- **Q3.12: Is voting by poll mandatory for all resolutions at general meetings, followed by disclosure of results within 1 day?** We shaved a further point off the score here - from 4/5 to 3/5 - following a broadening of our scoring criteria. Few listed companies in Japan publish meeting minutes with a summary of the shareholder Q&A, something that is becoming increasingly common in certain markets. Japan also loses a point here because it still does not mandate the full counting of votes of retail shareholders who attend AGMs in person.

Finding answers to regulatory questions should surely be easier in Japan

A regulatory treasure hunt

A major drawback in getting to grips with Japan's securities regulatory regime is the fragmented nature of the rules and regulations. Like other parts of North Asia, and in contrast to markets with a common law legal regime (eg, Australia, Hong Kong, India, Malaysia, Singapore), finding the answer to a regulatory question can be time-consuming and complicated. The rules are invariably not in one place, but scattered across primary legislation, subsidiary legislation/enforcement orders, Cabinet Office Orders, and other documents. It would be extremely helpful if the FSA could develop a guide on where key laws and regulations are located.

Next steps

Consult investors on what reforms they would like

A greater focus on minority shareholder rights is urgently needed. Regulators could undertake an open-ended consultation of investors to ascertain what reforms they would like to see.

Benchmark regional and global practices more closely

Regulators could more closely benchmark Japan's CG regime and company practices with regional and international best practices. To an extent this process has already started in areas such as non-financial reporting.

Produce a handy guide on where to find rules

A handy guide on where to find the precise details of securities laws and regulations would be extremely helpful. This could be organised by topic, such as takeover bids, third-party allotments or RPTs, then the specific sources for relevant laws, regulations and other rules or guidelines provided (with html links).

To an extent, such a document exists: A 2015 FAQ on the FIEA. However, in our experience, this document does not answer all the questions we had and, in any case, is becoming out of date. It would also be helpful if such a guide highlighted regulations that are not translated into English.

The new CG Code draft released in late March 2021

Stop Press: The draft CG Code 2021

As ACGA was close to concluding its work on this chapter, the FSA released for public comment a revised draft of the new CG Code. Many of the revisions to the 2018 had been well-flagged, as highlighted earlier. Some of the more interesting changes include provisions for:

- A minimum of one-third independent directors for companies listed on the TSE's Prime market, a new premium segment starting operation in April 2022 that aims to include companies with a higher quality of CG.
- Companies with controlling shareholders (typically listed subsidiaries) should opt for either one-third independence (unless they are listed on the Prime market in which case a majority of their board should be independent) or they should form a special and independent committee to review material related-party transactions.
- A new reference to the use of TCFD in sustainability reporting and more explicit mention of boards taking account of climate change, human rights and fair treatment of their workforce in managing sustainability risks and opportunities. Companies on the Prime market in particular should assess the impact of climate risk on their business and report in line with TCFD.
- Companies should disclose voluntary and measurable goals for enhancing diversity in management, including the "promotion of women, foreign nationals and midcareer hires to middle managerial positions".
- Companies listed on the Prime market should disclose all their company documents in English.
- The language around voluntary nomination and remuneration committees has been firmed by removing the adjectives "advisory" and "optional", and deleting a footnote explaining they are not legally required for Kansayaku board and Audit/Supervisory Committee companies. Moreover, a majority of members of each committee should be independent directors if a company is listed on the Prime market.
- Boards should make use of a "skills matrix" when selecting new directors to ensure the right balance of skills and expertise, including independent directors with "management experience in other companies".

Standards for Prime market issuers could be more ambitious

While these are all significant measures that could have a positive impact over the longer term, it is disappointing that the standards for Prime market issuers and listed subsidiaries are not a little more ambitious - for example, a minimum of one-half independence rather than one-third. Since the quality of directors is key, the new nomination guidance could have included a recommendation that companies reach out to their shareholders and invite them to nominate candidates. Moreover, the revised CG Code could have refreshed the sparse section on board evaluation. And we note that it does not add to the sections on shareholder rights, the management of shareholder meetings, capital policy, or cross-shareholdings, among other things.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

Japan performed poorly in this year's company survey

Japan's score in this category fell from 48% to 44% and its ranking from 8th to 11th. While this may seem a surprising outcome given the many structural changes in Japanese boards in recent years and requirements for more disclosure in CG reports and the annual securities report, the fact remains that compared to their regional counterparts and global best practices, Japanese companies are considerably less transparent in many areas of governance. (See our Markets Overview chapter at the beginning of this report for an explanation as to how we selected the 25 companies examined in depth in each market.)

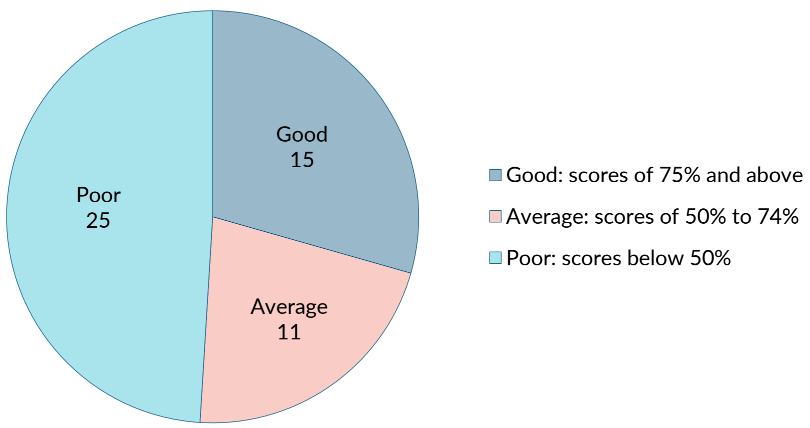
Scores on only 15 of 51 questions were rated "good"

Our aggregate results showed that large caps performed well in only 15 of 51 questions, averagely in 11, and poorly in 25 (see figure below). If large caps wish to meet global standards of disclosure, following local statutory requirements will not be sufficient.

Almost half of the scores were rated "poor"

Figure 7

Japan: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where Japan does well

Basic corporate reporting is of a reasonably high standard

Corporate reporting in Japan covers the basics of financial, CG and ESG disclosure quite well. Management discussion and analysis narratives in securities reports are relatively rich. Information as to how companies implement the principles of the CG Code can be found in standalone CG reports, with further governance details in securities reports and voluntary integrated or sustainability reports. Most companies state that they provide both induction and ongoing training to directors. Very few provide stock options to independent directors.

IR sections on websites are usually informative

Investor relations sections of websites are informative, with most large caps supplementing statutory financial reports with analyst briefing presentations and webcast recordings and providing English translations. Company announcements on corporate actions are typically archived for more than five years. And pre/post-AGM notices, business reports, voting results and other material are detailed.

Issuers are ahead of the region on climate disclosure

In sustainability reporting, one area where Japanese companies are broadly ahead of the region is in describing the physical risks of climate change. This was addressed by most of the Japanese companies we surveyed and reflects the fact that Japan has many more TCFD supporters than most developed markets.

Where Japan performs averagely

Shareholder-engagement disclosure is sparse

There were certain areas where a lack of substantive detail in disclosure brought scores down. One was in shareholder engagement - although normally mentioned in CG reports, companies tend only to describe the types of activities undertaken, such as quarterly briefings and foreign investor roadshows; they say little about the content of the discussions.

Risk disclosure is generic

Risk identification and management is covered in annual securities reports, but much of these explanations were generic, not company specific, and policies for how to address these risks were not fully explained.

Issuers say as little as possible about board evaluations

Discussions of board evaluations follow a similar pattern: most CG reports explain the fact that companies undertook an annual board evaluation, but further details including processes and outcomes of the evaluation are limited.

Most issuers do not extend codes of conduct to suppliers

Corporate codes of conduct are publicly disclosed by most large caps and their contents are quite comprehensive. But 10 of the 15 large-cap issuers we surveyed did not extend the code to their suppliers, which brought down the score.

Where Japan does poorly

Board committee reporting is still boilerplate

According to Tokyo Stock Exchange (TSE) data as of September 2020, more than 50% of companies listed on the 1st Section of the TSE have either statutory or optional nomination and remuneration committees. However, there is little disclosure on the activities of these committees in corporate reports. A list of committee members with independence status is insufficient. CG reports should provide specific critical points of discussion or actions taken by these committees during the year. It would also be nice to see attendance statistics for all directors for both board and committee meetings - companies tend to give one but not the other.

Most audit committee reporting is unhelpful

A further concern relates to the financial and accounting knowledge of audit committee (AC) members - it is hard to tell - and whether the AC chairman is genuinely independent. Disclosure of AC activities, including Kansayaku board activities, is so formulaic that investors have no real way to understand how effective the committee has been during the year. There is also a lack of clarity as to whether internal audit departments report to the board and specifically the AC, or just to the CEO.

Details on operating costs and payables/receivables is poor

As mentioned in CG Watch 2018, basic information on financial reporting is robust in Japan but there are areas where disclosure is surprisingly poor compared to international, and even regional, standards. For example, the provision of details on operating costs, ageing analysis of trade payables and receivables, and loans. We have not seen any improvement here since our last survey.

Few issuers have solid plans to improve board diversity

Board diversity policies remain unclear. It is common to see statements saying that directors have been nominated based on their skills and experience regardless of gender or nationality (which often reads like an excuse for not appointing women or foreigners to the board). However, only three out of the 15 large caps articulated a skills matrix. Nor did we find any company that explained a plan to improve board diversity.

Lead independent directors remain extremely rare

In 13 of the 15 large caps, the chairman of the board of directors was an executive director, such as the CEO or president, and there was no evidence of any lead independent director being appointed. Although this is not a requirement in Japan, it is becoming increasingly common elsewhere and is recommended by Japan's CG Code. Hence, there is clearly room for improvement in board independence.

Companies do not need to name a chair for their Kansayaku board

We also noted that companies with a traditional Kansayaku (statutory auditor) board never identify the chairman of this board, even though a majority of its members may be outside Kansayaku. Strictly speaking, companies are not required to appoint a Kansayaku board chairman, nor is there any mention in company law regarding this person's authority or obligations; and any individual Kansayaku may call a meeting of this board. Nevertheless, this does not engender confidence in the authority and effectiveness of this traditional supervisory mechanism.

Remuneration disclosure is well behind even regional best practice

The issuers we surveyed provided little granular information on either their executive or director, including independent director, remuneration policies. Apart from executives earning more than ¥100m, whose pay must be disclosed by law, disclosure in this area was disappointing. Unlike leading markets in the region the compensation structure of each director is not provided by name (ie, in a simple table), nor is further detail given on senior executive pay (ie, top five executives). Meanwhile, the fees for independent directors are usually only given in aggregate for the group, creating uncertainty as to what each is paid.

Few companies discuss ESG materiality in any detail

Lastly, in sustainability or integrated reports, only three large caps had a clear illustration of a materiality matrix with a detailed discussion as to how materiality was determined and is relevant to their business. Other large caps either did not articulate materiality issues or articulated them but failed to discuss their business relevance. We checked if materiality indicators suggested by SASB's industry specific standards were disclosed and found only four companies disclosed them comprehensively, of which two did so with targets. Generally, material issues were listed at the beginning of reports, but related factors such as stakeholder communication, metrics and targets were not discussed in any or much depth.

Overview of Japan's CG performance

Figure 8

Helicopter view: Rating Japan's CG disclosure and governance, 2020

Good	Average	Poor
❑ IR pages on websites provide all the basics ❑ MD&A discussions are thorough ❑ History and details of any share issuance ❑ Basic narrative on CG Code implementation ❑ Stock options and restricted share awards are not granted to independent directors ❑ Audit fees and non-audit fees disclosed ❑ Physical risks of climate change are addressed ❑ ESG materiality issues are listed	❑ Shareholder engagement activities are disclosed in CG reports, but the nature of discussion is not fully explained ❑ Annual board evaluation is conducted, but little explanation of evaluation process or results ❑ Risk information is provided, but not always company-specific and lacks discussion of risk responses ❑ Most companies have a public code of conduct, but one-third do not extend it to suppliers	❑ Lack of details on operating costs, trade payables and receivables, and loans ❑ No director attendance statistics ❑ Board committee reports lack specific narrative ❑ Audit committee (AC) expertise, effectiveness unclear. ❑ Internal audit: who does it report to? ❑ Director remuneration policies, fee disclosure remains limited ❑ Board diversity policies unclear or non-existent ❑ Board chairmen not independent ❑ ESG targets not clearly discussed

Source: ACGA

Ways Japan could improve

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Provide detailed notes on expenses to minimise the unexplained other costs; ageing analysis of trade receivables and payables; loan details
- ❑ More disclosure of director attendance statistics (not just independent directors) on board and committee meetings
- ❑ Provide activity records on:
  - ■ Shareholder engagement, including number, type, and nature of discussion
  - ■ Director training (not just a policy but actual training provided)
  - ■ Stakeholder engagement, including groups engaged, frequency, key themes
- ❑ More board evaluation disclosure, including: use of independent consultants; factors on which board is assessed; list of areas for improvement
- ❑ Disclosure of audit and non-audit fees in English, ideally in pre-AGM report
- ❑ Making reporting channels (contact details) for whistleblowing publicly available

Medium to long-term challenges

- ❑ Disclosure of beneficial ownership in company shareholder lists
- ❑ Meaningful reporting on the activities of nomination and remuneration committees
- ❑ Remuneration disclosure for each director and top five most highly paid executives
- ❑ Articulation of a clear policy on board diversity, with a skills matrix forming the basis for board composition decisions
- ❑ Improve the independence of board chairmen
- ❑ Disclose who chairs or leads the Kansayaku board
- ❑ Improve accounting and financial competencies among audit committee and Kansayaku board members, and disclose this information
- ❑ Internal audit department to have a direct reporting line to the board
- ❑ Sustainability reporting:
  - ■ Material issues to be explained in more detail, not just complying with GRI standards
  - ■ Metrics to be used to monitor progress on material sustainability issues

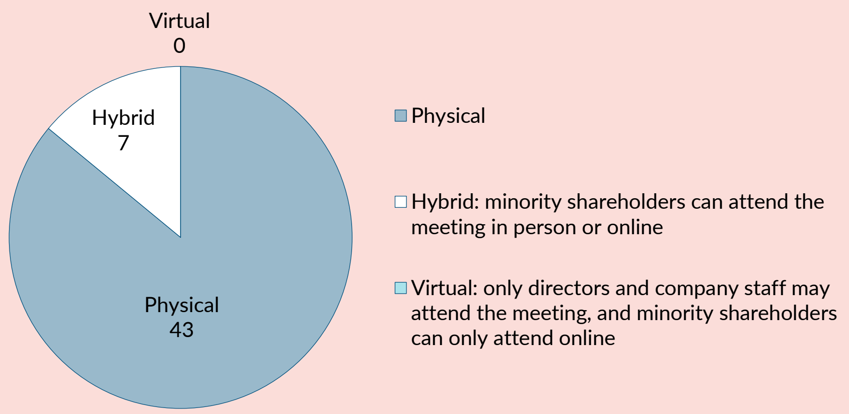
Only seven of the top 50 issuers held hybrid AGMs in 2020

Electronic AGMs: Minority report

ACGA conducted a survey on the top 50 companies by market cap in each of the 12 jurisdictions covered in this report to see how many AGMs were physical, hybrid, or virtual in 2020. We found only seven were hybrid, all of which were held in June, and the rest were all physical. Of the 43 physical meetings, most (33) were held in June, seven in March, one in May, one in July, and one in November. Since Covid had not escalated that much by end of June in Japan, it seems these hybrid meetings may have been held mostly for reputational purposes.

Figure 9

AGM modes in Japan: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

Japan ranks 2nd with a score of 60%

Japan ranked 2nd in this category with a score of 60%, increasing seven percentage points from 53% in 2018, but still behind 1st-placed Australia at 66% in 2020, and ahead of India and Korea at 44% each. Hong Kong and Singapore do poorly in this section and were much further back at 34% and 39%, respectively.

The Stewardship Code has done wonders for Japan's strong performance here

One of the factors behind Japan's more robust performance here is its Stewardship Code, first published in 2014 and revised twice - in 2017 and 2020. These revisions have steadily raised the bar on domestic institutions through such measures as higher expectations on conflict-of-interest management (including the disclosure of voting decisions on individual AGM resolutions), the integration of ESG into the investment process, and the quality of investor-company dialogue and stewardship reporting. The guiding principle, as with the CG Code, is to move from "form to substance". The signatory list to the Stewardship Code stood at 293 at the end of 2020 and has expanded in recent years to include corporate pension funds as well as other asset owners, asset managers, and a selection of intermediaries.

There are also historic and economic reasons for Japan's high relative score

There are also historic and economic reasons for Japan's strong relative performance: It not only has one of the broadest and deepest institutional investor bases in the region, but the involvement of investors in CG reform dates back the best part of two decades. In early 2003 the Pension Fund Association (PFA), a federation of employee/corporate pension funds and one of the largest pension investors in its own right, produced a set of in-house voting guidelines that was highly influential among domestic investors. One of the earliest efforts at collaborative engagement arrived in 2004 with the creation of Governance for Owners Japan (GOJ), an ACGA member. Through its Japan Engagement Consortium, GOJ undertook outreach to companies to discuss governance improvements on behalf of its clients. More recently, other collective initiatives and discussion fora have been created, industry bodies such as the Life Insurance Association of Japan have given impetus to ESG, and leading asset owners have played a high-profile role in promoting stewardship. The result is one of the more diverse investor ecosystems in the region.

Japan does not (yet) have a national entity formed by investors and dedicated primarily to CG reform

To add further context, it is worth noting that Japan does not (yet) have a national association formed by investors to represent their views and drive reform on CG or ESG, such as one finds in the US, Canada, the UK and Australia. There is an industry body, the Japan Investment Advisers Association (JIAA), created under government statute in 1987, that plays a trade-association and self-regulatory role. It sets rules on a range of business, investment and disclosure matters relevant to the investment industry, including on proxy voting, insider trading and implementation of the 5% large-shareholding report, among other things. JIAA also makes submissions on regulatory consultations and undertakes an annual survey of its members on their implementation of the Stewardship Code. It is fair to say that while the association is not a campaigning organisation per se, it does encourage its members to take CG and ESG issues seriously. Moreover, its focus on these areas is comparatively more wide-ranging than most of its trade-association counterparts in Asia ex-Australia. Nevertheless, a dedicated body funded by investors, fully focussed on raising CG and ESG standards in Japan, and free of the need to promote the commercial interests of its members, would be a positive development in our view.

ACGA surveyed disclosure by top asset owners and managers in Japan

The domestic dimension

To understand the domestic investor approach to stewardship more broadly, ACGA undertook a review during the second half of 2020 of publicly available policies, voting records and company engagement practices among the top five asset owners and top 10 asset managers in Japan. Our main findings on policies were as follows:

All 15 institutions have formal policies on CG/ESG and make them public

- All the asset owners and managers have formal policies on stewardship and make them public. This is not the case in all the markets we cover. One other difference of note in Japan is that the country's largest asset owner, the Government Pension Investment Fund (GPIF), is not permitted by law to invest directly in companies, hence it cannot vote or engage. Rather it must outsource this work to its external asset managers, as it says in its Stewardship Principles: "In order to fulfill its own stewardship responsibilities, GPIF continuously monitors the stewardship activities of its asset managers, including their exercise of any voting rights, and proactively conducts dialogue (engagement) with them." The Principles were first adopted in June 2017 and amended in February 2020.

Dedicated voting policies are common and pre-date the Stewardship Code

- Dedicated voting policies are also widespread and often predate the first Stewardship Code of 2014. For example, the Pension Fund Association for Local Government Officials formulated its "Corporate Governance Principles" and "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)" in 2004 and has revised them four times since. It did not develop voting guidelines for its foreign equity holdings until 2016.

Disclosure of voting records is widespread and detailed

The disclosure of voting records is both widespread and detailed - indicating that the Stewardship Code is having the desired effect:

- Four of the five asset owners disclosed their voting records, three by providing links to external asset-manager voting data and one with its own data. While all gave votes to the level of individual resolutions, two also provided aggregate summaries.
- All 10 asset managers provided voting records to the individual resolution level, with nine showing all votes "for" and "against", and one just the votes against.

But reasons given for voting against tend to be formulaic

- Several investors gave standard reasons for voting against management resolutions, with the most frequent being concerns about the independence of director candidates and the configuration of external directors. The use of formulaic phrases, such as "did not meet our standards", was common. Quite a few investors also cited "general corporate governance" concerns.

Stewardship reports are quite informative

As expected, reporting on stewardship is common, with most institutions publishing standalone responsible investment reports (some of which are in English). Regarding engagement with companies, just over half of the investors reviewed provided case studies and aggregate figures on individual engagement efforts, though few divulged company names. There was meanwhile little mention of collective engagement and we found little evidence that the investors surveyed attended AGMs on a regular basis.

Collective discussion on stewardship is flourishing

Collective advocacy deepens

While single-company collective engagement by domestic investors remains limited in Japan, there is a broad array of discussion and/or advocacy groups formed after 2014 that focus on systemic policy and corporate issues. As reported in previous issues of CG Watch, these include (in rough chronological order): the Japan Stewardship Forum; the Forum of Investors Japan; the Institutional Investors Collective Engagement Forum (IICEF); and a collective engagement consortium formed by the Life Insurance Association of Japan (LIAJ). Some highlights on the newer initiatives follow.

IICEF is a legal entity representing seven major institutional investors

Formed in 2017, IICEF has seven major long-term institutions as members and writes letters to companies seeking collective engagement meetings on systemic obstacles to good governance and ESG. Recent letters have focussed on cross-shareholdings, parent-child listings and companies that receive a large number of negative votes at AGMs. It also makes comments on major policy developments, notably the revised Stewardship Code and CG Code.

Life insurers formed a working group in 2018

Formed in 2018, the Stewardship Activity Working Group of LIAJ comprises 11 life insurance companies that write collectively to almost 180 companies annually on key issues. According to its latest report in December 2020, the group will continue to focus on seeking improvements in three main areas: Shareholder returns; ESG information disclosure; and climate change disclosure. On climate change, for example, the working group will write to 50 companies with the highest greenhouse gas emissions - a material increase on the 17 companies it wrote to in the previous year. It will also seek a dialogue with these companies.

The newest group is the Japan Stewardship Initiative. It is promoting a standardised reporting framework

The newest project in this space is the Japan Stewardship Initiative (JSI), formed in November 2019 and dedicated to enhancing communication between asset owners and investment managers through the creation of smart format reporting. It describes this as a "new reporting model for stewardship activity reports from asset managers to asset owners". This format covers the core stewardship activities of managers, allows asset owners to collect information more consistently through standard questions, and helps owners monitor their managers more effectively. Organisationally, JSI has 49 members including Japanese and foreign financial institutions, and three leading intellectuals. Its secretariat is provided by JPX, and the FSA and Keidanren have observer status.

Stewardship is firmly aimed at raising corporate value

The purpose of stewardship

The consensus objective of all these efforts is to raise corporate value in Japan over the long term, derived from a view that many companies have been poorly managed over the past two decades when judged on standard financial metrics like ROE and ROIC, returns to shareholders have been low by global standards, capital has been managed either too conservatively (cash hoarding) or too aggressively (over-priced M&A), and boards of directors are full of yes-men. With a large pension system and an ageing demographic, Japan needs a corporate sector making better decisions and producing higher returns. Indeed, Japan remains somewhat unique in the region in promoting corporate governance as a way to encourage more calculated risk-taking by management as opposed to a framework for limiting excessive risk, which has tended to be the founding spirit of CG in most other places.

A Japanese pension fund that wants to see better returns

In the context of improved shareholder returns, one refreshingly direct statement of objectives comes from the Pension Fund Association for Local Government Officials. Its Corporate Governance Principles (2019) state the following:

> "The Association holds equity for no other purpose than to increase the value of its assets over the long term to contribute to the interests of the Association members. Therefore, the Association, like many other shareholders, invests in shares of companies whose values are expected to increase over the long term, expecting those companies to be managed in a way that contributes to long-term shareholder's value. If shareholder's value is not likely to increase, the Association will call for management needed for enhancing shareholder's value, in order to fulfill its fiduciary responsibility.
>
> "To this end, if shareholder's value of an investee company is not expected to increase sufficiently over the long term, the Association will take actions so that its opinions as a shareholder will be fully reflected in management of the company."

Shareholder value and social responsibility are not opposites

The statement concludes by explaining that the Association "needs to actively work on the enhancement of corporate governance" as one way to "fulfill its social responsibility as a public pension fund". Thus it nicely squares the circle between the need for a decent shareholder return and its social mandate.

GPIF drives the same message, through an ESG lens

Other asset owners, notably GPIF, make a similar point but more through the lens of ESG. Its Stewardship Principles state that asset managers should integrate ESG into the investment process in order to "increase corporate value and promote the sustainable growth of investee companies and the capital market as a whole, thereby contributing to long-term investment returns".

GPIF's annual survey of listed companies provides insights into the quality of investor stewardship

Is stewardship working?

What impact are investors having on CG and ESG in Japan through their stewardship efforts? While this is hard to ascertain, not least because much company engagement is behind the scenes and investors naturally prefer to talk more about their successes than failures, some objective information is available. One broad measure is the GPIF's annual survey of how companies view the stewardship efforts of its external asset managers. The fifth survey was undertaken over January to March 2020 and sent to 2,160 companies listed on the 1st Section of the TSE (as of 30 December 2019). A total of 662 replied. Key conclusions, some of which relate to corporates themselves, were:

Companies have a longer term view of the long term

- Companies are taking a longer-term view of what "long term" means. Whereas three to four years had been the most common choice in the previous survey (38.9% of respondents), this changed to 10 to 14 years (40.4%).

Companies say investors are better prepared today

- Companies credit investors with being more prepared for meetings, in particular making good use of company Integrated Reports (rising from 39.4% to 50% of respondents).

TCFD on the rise

- The number of companies expected to endorse TCFD is likely to increase. While 22% of respondents did so, a further 60% expect to do so soon.

"G" the biggest factor in ESG

- Governance continues to be the major theme in corporate ESG activities (selected by 70.8% of respondents), followed by climate change (53.9%) and diversity (44%).

Investors learning to love IR

- More than 40% of companies have observed "desirable changes" in the attitudes of some, all or a majority of investors towards IR meetings.

Activists mostly want to discuss finance and strategy

Interestingly, 43% of respondents said they had received requests for a dialogue from activist investors, with almost 85% of this group proceeding with meetings. More than two-thirds of such discussions focussed on financial performance and business strategy, with the remaining third addressing governance and capital policy (16.9%), followed by "comprehensive themes" covering strategy, capital policy, ESG (7.9%), pure ESG (2.2%), and other issues taking up the rest. As for whether companies found these meetings useful, only 30% responded. But of these, most of them felt the dialogue was helpful.

A study of GOJ's engagement impact found positive results

At the micro end of the spectrum, an academic study in 2019 of the engagement efforts of Governance for Owners Japan (GOJ) found that the "probability for success for GOJ improvement requests across proposals related to board structure, shareholder payout, and corporate strategy is very high, at more than 70%". Moreover, when a company announced changes in board structure and shareholder returns in line with GOJ requests, it was able to earn a "cumulative abnormal return" of 6%, which is roughly the same as activist funds. The study was undertaken by the Research Institute of Economy, Trade and Industry, an entity under METI, and Waseda University, with the results made public in the Nihon Keizai Shimbun newspaper in January 2020.

The foreign dimension

Regionally, Japan is by far the largest market for foreign investment and investor stewardship

Foreign investors have been participating directly and indirectly in CG reform in Japan for more than two decades and, in absolute terms, the country remains by far the largest focus of their voting and engagement efforts in the region. They take voting seriously, typically voting all or the vast majority of their shares. Although sometimes criticised for not voting against more aggressively, the evidence suggests this is changing. Collective engagement with companies remains limited, as in other markets, but there have been initiatives around climate change (notably the Climate Action 100+ campaign) and on systemic issues such as board independence and diversity. Foreign investors have also strongly supported ACGA's regulatory and policy advocacy work in Japan since our inaugural White Paper in 2008. More recently, several investors have upped the ante by saying they will vote against any company that fails to improve its governance or meet certain ESG targets.

ACGA surveyed its members in Q3 2020 on voting and engagement in Asia-Pacific

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of our investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As the responses showed, foreign pension funds and investment managers invest in far more listed companies in Japan than any other market, including China:

- 36 or 86% of foreign-investor respondents indicated that they invest in Japan
- Only 22 respondents answered the question on the exact size of portfolios. The average number of investee companies per member was 768, with a median of 400, while the range was the largest in our survey—from just five to 3,000 issuers. The next biggest market is China, with an average of 282, a median of 85, and a range from five to 1,953.

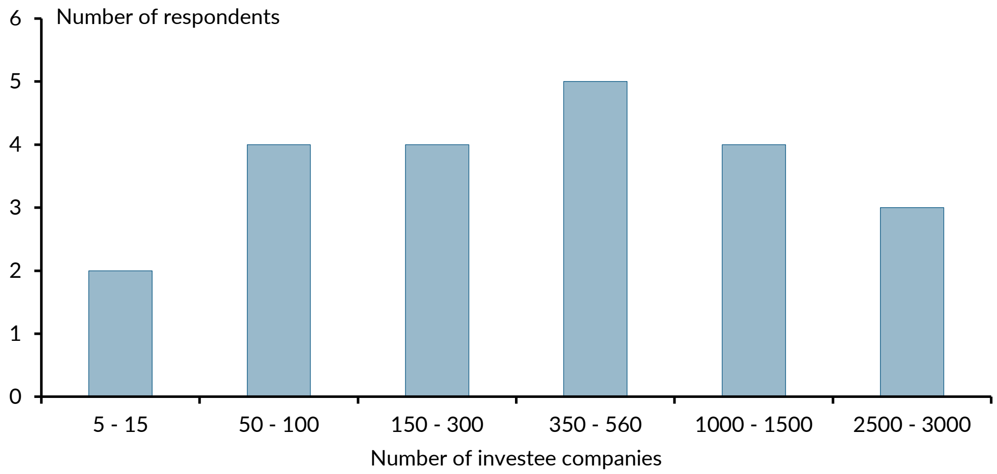
(Note: All figures quoted in this section exclude three Japanese members who responded to our survey. Foreign funds based in Japan are included.)

The most common portfolio size is 350 to 560 companies

Another way to show the extent of investment in Japan is to group portfolios by size. As the following figure shows, the most common holding is between 350 to 560 companies, while several respondents own 1,000 or more, and the remainder less than 300. Note that two respondents are boutique investors with only five to 15 holdings.

Figure 10

Foreign investors in Japan: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Most respondents vote in 100% of AGMs and vote against in 45% of meetings

As expected, respondents take voting seriously in Japan and voted against management resolutions in almost half the AGMs they participated in in 2020:

- Nearly all respondents with holdings in Japan vote in 100% of their investee-company AGMs each year. Two said they vote in 90% to 95%, and one in around 40%.
- On average, they voted against at least one management resolution in 271 meetings in 2020. The median figure was 168 meetings, with a range from zero to 972. Again, this is the largest volume of voting against in the region. The comparable figures for China, the next biggest market, were 155 (average), 30 (median), and one to 1,386 (range).
- As a proportion of their holdings, respondents voted against at least one management resolution in 42% of meetings in 2020. This ratio is comparable to China (36%).

Poison pills, director elections and board independence all drive voting against

The survey also asked respondents what type of issues they tended to vote against and the responses specific to Japan included such things as: Poison pills; director elections; lack of board independence; and the election of statutory auditors (Kansayaku). One limitation of this first survey was that it did not delve deeply into the focus of voting against in each market - something we intend to correct in the next iteration. Nor did we ask investors why they voted against certain issues - although some respondents provided brief answers. However, it is well-known in Japan that most foreign institutional investors are not in favour of poison pills, have concerns about board independence, and will vote against certain directors such as the chairman or president/CEO is the board lacks a sufficient number of either independent directors or women directors.

Japan accounts for the largest slice of the foreign engagement budget in Asia-Pacific

Company engagement

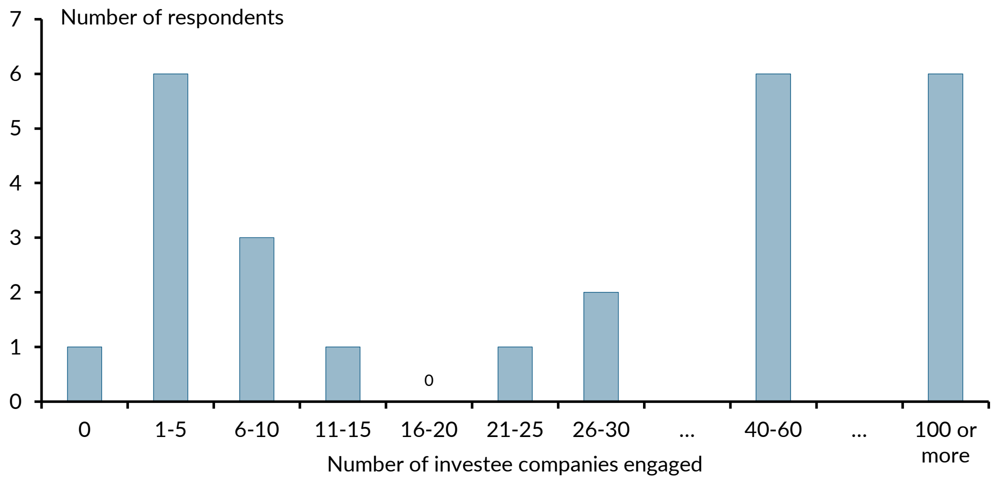
In aggregate terms, Japan accounts for by far the largest slice of the foreign-investor engagement budget in the region, followed by China, Australia, Hong Kong, Korea and India. The total for Japan was 1,991 companies with an average of 77 per respondent. The next biggest market for engagement was China, with 487 companies and an average of 16, followed by Australia, with 386 and 15, respectively.

But a small of big investors are responsible for most of the meetings

Not surprisingly, the figures for Japan are heavily skewed by a small number of investors - a phenomenon we observe in most markets but generally more pronounced in Japan. Just six engaged with 100 or more issuers over 2019 and 2020, while a mere three of them accounted for 1,210 of the 1,991 total. At the other end of the scale, just one of the 26 members who answered this question said they did not engage at all in Japan. Of the remainder, a total of nine engaged with 10 issuers or fewer. A small number met with between 11 and 30 companies, while the remainder engaged with 40-60.

Figure 11

Foreign investor engagement prevalence in Japan, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Top engagement issues include parent-child listings, cross-shareholdings, CG and ESG reporting

What do foreign investors engage on? The range of issues is extensive and overlaps to a large degree with the systemic issues raised by Japanese investors, namely cross-shareholdings, conflicts of interest between listed parent and subsidiary companies, and corporate CG and sustainability reporting. On the latter point, foreign investors are increasingly focussed on the use of TCFD to disclose climate risk and SASB as a starting point for thinking about materiality. We received further input from our Japan Working Group, a sub-group of around 30 ACGA investor members comprising mostly foreign institutions but including some Japanese as well. They highlighted the following:

Other issues include AGM timing, capital efficiency, and board independence, among others

- **Timing of AGMs**: Some members would like to see meetings pushed beyond June (ie, the normal three-month window) to encourage less clustering of AGM dates.
- **Capital management/dividend policies**: A recurring issue for many members. One said, “We take a company specific view and may give a one-year grace period” to allow a company to make improvements, after which they may decide to vote against a senior director at the next AGM.

- **Board independence**: A perennial issue for most foreign investors and not just about quantity, but also the quality of directors, including skills, training, experience, and personal attributes. One Japanese member of the group noted that, with regard to engaging larger listed companies, his firm focusses less these days on pure board independence and more on succession planning and independent director skills. "But for mid and small caps, the topics are the same as before. Larger companies have improved a lot, though it may be superficial," he said. One positive area of change: It is getting easier to have meetings with independent directors in Japan.
- **Board diversity**: Another perennial issue. There is recognition that this needs to go beyond just the board and address the limited pipeline of women in middle and senior management roles.
- **Mid-cap focus**: Some members engage largely with smaller listed companies. One noted they tend to separate governance issues and environmental/ social issues.

Next steps

Should Japan have a lead investor body driving CG and ESG?

It would be worth considering whether Japan might benefit from having a lead national investor association dedicated to raising standards of CG and ESG. This is not intended as a criticism of the hard work or efforts of existing groups. Rather that a lead association could help to pool resources, provide for a well-resourced secretariat, support original research, and present a consistent point of view on advocacy. A policy statement from a group representing a majority of investors in Japan could have a powerful effect and help to break through some of the seemingly intractable bottlenecks in regulation and corporate practice.

More dialogue between investors worth exploring

A deeper exchange of views between Japanese and foreign investors on pertinent CG and ESG issues and best practices in Japan and around Asia would be worth exploring. This could add to the richness of the dialogue with companies and regulators.

More research on value of stewardship would help

Further academic research on the value of stewardship and any enhanced returns to shareholders would be valuable.

More substantive reasons for voting against would be good

More substantive reasons for voting against management resolutions at shareholder meetings would help to inform the market why large asset managers have voted the way they do. Formulaic explanations are of limited value.

AGM activism: emboldened

Voting is becoming less deferential to management

In our last CG Watch we lamented the fact that shareholders in Japan have considerable powers, yet mostly vote in line with company management. Fast forward to 2020 and the prevailing wind was much less deferential. It was a record year for shareholder proposals at Japanese listed companies: in all, 55 corporates were forced to put proposals by institutional and retail investors to the vote, a small increase on 2019 when 54 companies faced shareholder proposals but a not-insignificant rise on the 2017 figure of 40.

Shareholder proposals receiving solid support

Among the 183 shareholder proposals in 2020, a third received respectable support of 10% and above, while nearly one in five amassed at least 20%. Twenty proposals gained approval of 30% and up, the highest vote of 46.2% being cast in support of the election of a director at chemicals firm Tenma Corporation.

Activist funds are prevalent

A core group of activist investors was conspicuous, including local fund Strategic Capital, New York-headquartered Fir Tree Capital Management and Asia-focussed Oasis Management. All pitched multiple proposals with varying degrees of success: Fir Tree's attempt to instal "truly independent" directors at Kyushu Railway gained support of 32.6% in respect of one director (at the time Fir Tree held 6.1% of Kyushu). Activist funds are growing in number, according to investor relations services firm IR Japan: it counts 44 such funds as active in Japan in 2020, up from just seven in 2014. While US and European firms dominate, Asian and domestic firms are on the rise. In fact, the number of Asian activist investor firms nearly doubled to 13 in 2020, up from just seven in 2019 and five the previous year.

A climate rebellion from the little guy

Retail investors meanwhile put forward 75 proposals, including a climate-related bid to change articles of association at Mizuho Financial. The resolution, filed by Kiko Network, called on Mizuho to disclose a plan to align investments with the Paris Agreement on climate change. It gained shareholder support of 34%.

Director pay is targeted after graft scandal

Corruption-plagued Kansai Electric Power (KEPCO) faced 26 shareholder proposals in 2020, including three related to the remuneration of directors. A proposal that the company's articles be amended to disclose individual pay for directors gained support of 43.2% and came on the heels of a gift-giving scandal in 2019 in which 75 executives were accused of pocketing cash and goods of ¥3.36m from a former deputy mayor in Takahama, Fukui Prefecture. Elsewhere, other CG-related proposals included a bid to amend articles at Inui Global Logistics to require shareholder approval of share issues to third parties (40.65% supported this), an attempt to force Mitsui Mining and Smelting to separate its chair and CEO (36.99% were in favour) and at information services firm Densan, 19.21% of shareholders voted to force the company to introduce a mandatory retirement age for directors.

Shareholder proposal leader board

Figure 12

Activist funds: where they agitated most successfully in 2020

Fund name	Company	Number of proposals	Highest approval rate (%)
Alpha Leo Holdings	Inui Global Logistics	6	40.65
Oasis Management	Fujitec	1	32.91
	Hazama Ando	2	27.87
	Mitsubishi Logistics	5	22.47
Fir Tree Capital Management	Kyushu Railway	4	32.60
Strategic Capital	Seikitokyu Kogyo	2	27.29
	Arisawa Mfg	3	20.63
	Chori	5	15.83
RMB Capital Management	TV Asahi Holdings	1	14.98
Dalton Investments	Shinsei Bank	1	7.97

Source: Japan Shareholder Services

6. Auditors & audit regulators

Japan ranks 5th on an increased score of 77%

Japan's score increased by six percentage points to 77% and its ranking remained at 5th. Of the 14 questions in this category, Japan scored better on five, worse on two, and the remainder were unchanged. Improved scores related to the independence of external accounting auditors, "key audit matters", preparation by mid-cap firms for their annual audit, the effectiveness of the audit regulator and the quality of its enforcement disclosure. Scores fell slightly on accounting and auditing standards.

Accounting standards

We docked a point because IFRS is not mandatory, unlike other markets

IFRS remains voluntary for listed companies in Japan. Most financial statements are prepared in accordance with accounting principles generally accepted in Japan (J GAAP) as issued by the Accounting Standards Board of Japan (ASBJ). For consolidated financial statements of listed companies, the use of Japan's Modified International Standards (JMIS) and US GAAP are also permitted in addition to IFRS. JMIS were a new set of accounting standards inaugurated by ASBJ in 2015 and developed based on the endorsement process of accounting standards and interpretations issued by the International Accounting Standards Board (IASB). With the introduction of JMIS there are four accounting frameworks that listed companies may use. The voluntary application of IFRS standards is growing. According to the last update from the IFRS Foundation in September 2020, the IFRS standards in use in Japan are fully converged with IFRS. However, we deducted a point on this question since IFRS are not mandatory - unlike most other jurisdictions in the region.

Auditing standards

We docked a point because of delays in adopting standards

Auditing standards in Japan are set jointly by the Business Accounting Council (BAC) under the FSA and the Auditing Standards Committee (ASC) of the Japanese Institute of Certified Public Accountants (JICPA). The ASC comprises practitioners as well as academics and executives of major companies. In practice, JICPA carries out most of the auditing standard-setting and responds to proposals issued by the International Auditing and Assurance Standards Board (IAASB). Its work is overseen by the CPA Auditing Oversight Board (CPAAOB), the country's lead audit regulator and also an entity under the FSA.

ISA 720 will only be mandatory from March 2022

While most of the International Standards on Auditing (ISAs) issued by the IAASB have been adopted in Japan, the latest updates on ISA 720 regarding "The Auditor's Responsibilities Relating to Other Information" (ie, information a company may disclose that is non-GAAP) had not been at our time of scoring. ISA 720 will only be mandated from the fiscal year ending March 2022, although early adoption is allowed from March 2021. As with our question on accounting standards, we deducted a point for standards not being fully converged with ISAs.

Auditor independence

Japan's rules on auditor independence are robust

Japan's policies on auditor independence are quite robust, with standards of independence legislated for in the CPA Act and contained in JICPA's Code of Ethics that is in conformity with its international counterpart, the International Code of Ethics for Professional Accountants from the International Ethics Standards Board for Accountants (IESBA). JICPA last amended its Code of Ethics in July 2019, right after a new and substantially revamped IESBA Code came into effect in June 2019. The institute did not waste time, therefore, in amending its code.

Auditor rotation rules are a little stricter than elsewhere

Audit partner rotation rules also follow international standards. According to JICPA, the CPA Act of Japan prohibits CPAs to engage in "continuous long-term audits of companies that fall under the definition of large companies". Specifically, the Act and a related enforcement order stipulate that key audit partners of certain large companies must rotate every seven accounting years with a two-year cooling-off period. In the case of the lead engagement partners of certain large audit firms (Big Four), such partners must rotate every five accounting years at an interval of five years. Furthermore, auditors are prohibited from working for companies where they have served as independent auditors until the end of the following accounting year after their resignation. These rules make Japan's standards a little stricter than the comparable IESBA ones. Moreover, JICPA has set a maximum cumulative period that any CPA can engage with the same company to no more than 10 years.

An amended whistleblower law will come into effect in June 2022

While Japan's score improved on this question by a point to 4/5, it failed to get full marks because amendments to a new Whistleblower Protection Act do not come into effect until 12 June 2022. The new law will certainly be much better than the old one, typically derided as "toothless". As summarised in a note by the law firm Jones Day, amendments passed by the Diet on 8 June 2020 include key changes such as:

- Business operators must develop internal systems to respond to whistleblowing claims, including appointing a "whistleblowing coordinator". (These rules are not mandatory for small- and medium-sized companies with 300 or less employees.)
- People who blow the whistle to administrative authorities will receive greater protection from being dismissed.
- The definition of "whistleblowers" is expanded to include people who have retired during the past 12 months in addition to current employees.

KAMs can't wait anymore

KAMs is finally here

An area where Japan has lagged in the past, "key audit matters" (KAMs) has finally become mandatory for the audits of companies from fiscal years ending 31 March 2021. KAMs refers to the extended auditor reports that have been in force in many other parts of the region since late 2016. They require auditors to highlight areas when financial accounts may be at risk from material misstatement and to explain the auditing procedures adopted to ensure the accounts are true and fair. Japan's score increased from 0/5 to 2/5, a recognition that while progress was being made the rule had yet to take effect during the period of our survey and it is still early days in the adoption of KAMs in Japan.

Early adoption of KAMs was encouraged

It should be highlighted that early adoption of KAMs for the fiscal year ending 31 March 2020 was permitted. JICPA encouraged its members to do so, especially for audits of companies listed on the 1st Section of TSE. There were 48 early adopters including one, Canon, which had its auditor apply KAMs to its 2019 calendar year accounts. JICPA earlier conducted a "Trial Run of KAM Communication" during 2017 with the cooperation of seven audit firms (including the Big Four) and 26 companies. This trial was intended to identify practical issues related to the adoption and communication of KAMs. JICPA published a detailed analysis of the results.

CPAAOB effectiveness

Assessing the impact of regulation on audit quality is challenging

It is challenging to assess whether an audit regulator is having a positive impact on audit quality in any market. Regulators typically provide a lot of information on the prevention of problems, primarily through their firm-level and audit-engagement inspection programmes. There is generally much less transparency on disciplinary action.

The CPAAOB applies a 5-level quality rating system

The CPAAOB in Japan applies a five-level rating system to CPA firms following its inspection programme, where "5" is best and "0" is worst. This is meant to accurately communicate its assessment results to audit firms and to enable the directors or supervisors of audited companies to "appropriately understand the quality control level of the audit firm".

Big CPA firms mostly score well, but two are considered "unsatisfactory"

In its 2019 Monitoring Report, the CPAAOB rated most of the big CPA firms (eight out of 10) as a 4/5, meaning "satisfactory with minor deficiencies". The other two got only a 3/5, which is categorised as "unsatisfactory". Half of the SME auditors were graded just 1/5 ("unsatisfactory and in need of immediate remediation") or 0/5 ("extremely unsatisfactory"). The 2020 Annual Report contained updated figures as of March 2020. This showed a higher number of big CPA firms getting a 4/5, although this time 13 firms were assessed with nine earning a 4/5 and the other four getting 3/5. There was not much change among smaller auditors.

There is a notable difference between quality controls in big vs small audit firms - although a few big firms need to pull up their socks

While it is not possible to draw firm conclusions about audit quality from these results, they do show a clear demarcation in the respective quality control systems and performance of most of the big CPA firms versus the small and medium ones. It is notable, however, that 30% of the big firms in the last survey (ie, four of 13) were rated as "unsatisfactory" by the audit regulator. It is also worth highlighting that this rating system is more structured and transparent than those found in most other markets, which at best use a more generalised system of "audit quality indicators". For all these reasons, we increased the score on this question from 2/5 to 3/5.

CPAAOB disclosure

CPAAOB puts considerable effort into reporting

As highlighted in previous editions of CG Watch, the CPAAOB produces extensive reports on its inspection work and the nature of the auditing industry in Japan. Each year it publishes a "Monitoring Report" that provides data on the audit sector (including HR statistics), the Board's monitoring and inspection programme (including quality control reviews undertaken by JICPA), the operation of audit firms (the adoption of IT and other things), and changes in the global environment surrounding audit. It also produces an Annual Report that more succinctly summarises the examination and inspection work done with regard to audit firms. And it produces a "Case Report" that gives examples of major deficiencies found in the CPAAOB's inspection of the quality control environment within firms and in individual audit engagements. The overall aim is to help CPA firms improve their audit quality voluntarily.

Next steps

A simple table in English of adopted standards would be very helpful

It would be helpful if accounting and auditing standard setters could provide a simple list in English of international standards adopted or to be adopted in Japan. We find it more time-consuming to get clear answers on specific standards than we would expect.

Tracking the use of KAMs reporting is important

With KAMs about to be adopted, it would be useful if the CPAAOB or JICPA could track how the new long-form auditor reports are viewed and used by the market, in particular institutional investors and other professionals.

Time to try to assess actual audit quality?

Although extremely difficult, a survey on actual audit quality in Japan and how it is changing would be welcomed. This could be done, at least initially, through a perception survey of companies, directors, investors (institutional and retail), other users of accounts, and auditors themselves.

7. Civil society & media

Japan ranks equal 4th with a score of 62%

Japan scored 62% in this category and shared equal 4th with Taiwan, behind Australia at 80%, India at 78% and Singapore at 64%. The overall score for Japan is identical to our 2018 survey, although there were some variations on individual questions. Our rating for the availability of director training increased by one point, while it fell the same amount for company secretary training. In the media section the score for active and impartial reporting on CG developments dropped by a point, but it increased for the quality of research undertaken by academics and associations on CG and ESG.

Japan has a fertile, if somewhat fragmented, civil society supporting CG and ESG

Overall, Japan has a diverse and fertile civil society ecosystem for corporate governance and ESG. One wonders, however, if the whole is sometimes less than the sum of the parts? In some areas of activity, such as director training, there is a plurality of organisations promoting their services. On the positive side this allows a range of courses and related activities for different groups of individuals and companies. Yet it also means that there is not a single entity coordinating this effort nationally and setting standards. In contrast, seven of the 12 markets we cover - and all the top three - have one institute taking the lead on director training. There is a corollary in the investment industry, where a number of different discussion groups and organisations are promoting stewardship and company engagement.

Training

The quality and quantity of director training has steadily improved

Despite our comments above about civil society fragmentation, Japan earned full marks for our question (Q7.1) on the availability of high-quality director training. The Japan Association of Corporate Directors (JACD), which was formed in 2002, is the most established association and provides regular training and other events for members, mostly from the larger firms. It offers courses for new directors (10 courses of 90 minutes) and independent directors (six courses of 90 minutes). The Board Director Training Institute (BDTI), formed in 2009, also provides training for directors, including training in English for non-Japanese directors as well as e-learning options. A third contributing factor was the Japan CG Network (JCGN), the leading CG non-profit in Japan. It offers training through its "Directors University" programme.

Company secretarial-style training remains limited

JCGN also offers training for board secretariat staff. The programme is made up of eight two-hour courses with attendance at six sessions or more required to earn a certificate. Given there is no formal company secretary requirement or association in Japan, and the training volume is significantly smaller than in other markets, the score for this question (Q7.2) fell from 2/5 to just 1/5.

A wide range of CG and ESG research is carried out by academics, non-profits and professional associations

Research
One of the most interesting aspects of Japan's CG ecosystem is the research produced by local professional and non-profit organisations, as well as academia. The Japan Investor Relations Association (JIRA) undertakes an annual survey of its members and in 2020 focussed on progress in corporate governance reforms and ESG disclosure. It found that although there has been steady progress in implementing reforms and much enthusiasm for ESG disclosure, around 30% of respondents said their companies still lacked sufficient cooperation between the IR department and other departments for the disclosure of "non-financial information". The Japanese Institute of Certified Public Accountants (JICPA) meanwhile published an interim discussion paper on issues related to useful and reliable corporate disclosure with the help of its special committee on corporate disclosure and governance.

JCGR surveys corporate compliance with CG principles

Moving into more academic research, the Japan Corporate Governance Research Institute (JCGR) published its Corporate Governance Survey Report 2020 using its JCG Index to measure the degree of compliance with CG principles among Japanese respondent companies. The survey has been updated so it is not possible to compare 2020 scores to previous iterations, which date back to 2002. However, the authors found the mean score was 52/100, with a standard deviation of 12.5, leading them to conclude that while there has been an improvement in CG performance, there is still a long way to go for Japanese firms. (It is worth noting that while ACGA's percentage score for Listed Companies is somewhat harsher, this includes mid caps which brought the overall rating down. The ratio between "good/average" and "poor" scores was 26:25 for large caps - an almost identical result to the JCGR survey.)

Academic research is growing

Research in scholarly publications from academics on CG in Japan continues to grow. The topics of articles published in reputable journals over the past two years include frequency and timeliness of disclosure, environmental performance, hedge-fund activism, and management control systems, to name just a few.

Mainstream media is declining in influence

Media
The Reuters Institute Digital News Report 2020 found that although the five main TV broadcasters and major newspapers have long been prominent in the media landscape in Japan, now more than half (51%) of respondents to its questionnaire get their news from online aggregators such as Yahoo! News, which the authors hasten to note may under-represent older or less affluent users because the survey was conducted online. The report also found trust in the news has dropped by 10 percentage points over the last five years in Japan to 37% and the most trusted news source is public broadcaster NHK, which 60% of respondents said they trusted.

The Nikkei is broadly trusted, but seen as somewhat biased in favour of "Old Japan"

The *Nikkei* (Japan Economic Daily), the main source of business news, is trusted by 51% of respondents to the Reuters Institute survey. ACGA found that some observers are of the view that the *Nikkei* can be considered as a bit biased in favour of "Old Japan" and criticism of the Keidanren and the establishment can be muted. Another concern is that while senior reporters are skilled in terms of reporting on CG issues, they are outnumbered by less experienced colleagues.

Next steps

A national director training curriculum?

While it may not be practical at this stage for director training bodies to work together, it could be useful to explore what a national director training curriculum would look like.

More company secretary training is arguably needed

Company secretaries are not mandatory in Japan, but it would appear that more of this kind of training is needed for the board administration officers in companies. There is an overwhelming inertia in the AGM system in Japan, with few companies wanting to experiment with later record dates/AGMs and hybrid meetings. The people in charge of running meetings arguably need new skills to provide more options to shareholders.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- ❑ No attempt to address long-standing issues of minority shareholder rights in relation to takeovers, third-party allotments, RPTs, concert-party rules, and the "act of making important suggestions"
- ❑ No progress in raising standards of bank governance, including a clear national policy on green and sustainable finance
- ❑ No improvement in regulatory transparency regarding funding and resources
- ❑ No improvement in corporate reporting, specifically the weaknesses identified in financial, CG and ESG disclosure
- ❑ No progress in the use of hybrid AGMs by listed companies
- ❑ Evidence of business associations continuing to obstruct CG reform

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ Provide new guidance on collective engagement (ie, a safe harbour document) for institutional investors
- ❑ Survey investors on which aspects of Japan's CG regime they find most challenging
- ❑ Require CG reporting to be benchmarked against international best practices
- ❑ Produce a guide to the sources of law and regulation underlying major CG rules, so that researchers do not have to read entire pieces of legislation and still not find the precise rule!
- ❑ Require investors to provide more substantive reasons for voting against resolutions

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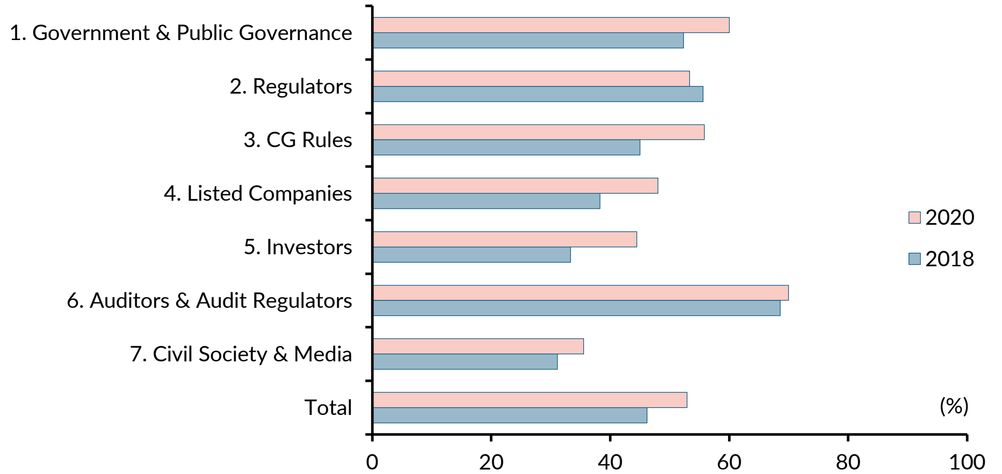
Korea – Catching up, tripping up

- ❑ Korea made progress in public governance and the fight against corruption, but new scandals question depth of change
- ❑ Improvement in securities enforcement, but not in disclosure of regulatory funding and enforcement activities
- ❑ Despite dallying with dual-class shares, significant progress was made in CG laws and regulations - yet entrenched problems remain
- ❑ The written public consultation process in Korea needs a revamp
- ❑ The quality and depth of large-cap CG disclosure has noticeably improved; mid-cap disclosure remains unimpressive
- ❑ Investor stewardship continued to develop, with healthy levels of voting against and disclosure of voting practices
- ❑ Auditor oversight board information releases were still fragmentary - a dedicated annual report would enhance transparency
- ❑ Civil society continued to deepen, some high-quality research on CG and ESG being produced

Figure 1

Korea CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Korea remains 9th on an improved score of almost 53%

Korea's total market score improved by almost seven percentage points from 46.2% in 2018 to 52.9% in 2020, although its ranking remained the same at 9th. As Figure 1 shows, scores improved most in Government & Public Governance, CG Rules, Listed Companies, and Investors. They improved somewhat in Civil Society & Media, stayed basically the same in Auditors & Audit Regulators, and fell in Regulators. These changes were in part due to our more granular scoring methodology in CG Watch 2020 - which benefited all markets to varying degrees - but were also the result of some genuine improvements in the Korean corporate governance ecosystem.

Korea edges closer to the markets ahead of it

It is worth highlighting that while Korea's ranking may not have changed, it finished the race closer to the markets ahead of it than in previous years. Compared to an eight-percentage point gap with Japan and India in 2018, there is now less than a four point difference between Korea and the market now ranked 8th, Thailand. Conversely, the difference in score with China, which usually comes 10th, has widened - from 5.4 percentage points in 2018 to 9.9 percentage points in 2020. If Korea continues to improve at this pace, and depending on how other markets perform, there is every chance it could improve its ranking in our 2022 survey.

But political change could undermine the reform momentum

One risk to this positive prognosis is that Korea might slow itself down through a lack of political will to continue improving standards. The main theme of this chapter is that the Moon Jae-in government has largely managed to maintain the momentum of public and corporate governance reform over the past two years, enacting a series of significant legislative and policy changes - some of which investors and CG advocates have been seeking for years. One near-term challenge is the next presidential election in March 2022, which could hand power to the more conservative opposition and make it difficult for President Moon to enact any further substantive changes in his final year of office.

Or the government might trip itself up with a poor policy decision or an inability to control official corruption

The other risk is the self-inflicted wound, a phenomenon that seems to appear with a degree of regularity in Korea. One egregious example in recent years is a regressive policy proposal we wrote about in CG Watch 2018 - the probable introduction of dual-class shares (DCS). It was disappointing to see the ruling Democratic Party jumping on this bandwagon and talking up something that could, depending on how the rules evolve over time, have a very negative long-term impact on corporate governance in Korea and its reputation as a serious reformer. Another example is the issue of civil service ethics and official corruption, areas where the current government has made a concerted effort to raise standards. Sadly, a recent insider-buying scandal involving employees of the main state-run housing developer illustrates just how difficult it is to change mindsets and behaviour. Governance reform in Korea still has some mountains to climb.

Recapping CG Watch 2018

Korea made progress on half the recommendations in our earlier report

As Figure 2 shows, Korea made progress on four of eight specific recommendations made in our previous CG Watch 2018 report. These included: enhancing shareholder rights; mandating CG reporting; deepening the implementation of the Stewardship Code for institutional investors; and encouraging more companies to invite shareholders to nominate independent directors. Progress varied from good to limited. One key shareholder right that institutional investors would like to see is the reintroduction of a mandatory bid rule for takeovers. Korea used to have a "general offer" rule but removed it after the Asian Financial Crisis of 1997-98 in order to allow easier corporate restructuring through M&A. The lack of such regulation means Korea is badly out of sync with other developed markets in Asia-Pacific and around the world. It also allows takeovers that are unfair to minority shareholders, who are not given the opportunity to sell their shares to the bidder at the price being paid to the controlling shareholder.

Reforming civil service appointments would help to create a group of specialist CG policymakers

The four areas where we have not seen any progress include recommendations regarding: dropping the proposal for DCS; reforming the system of short-term appointments of civil servants to key policy and regulatory positions; encouraging the country's audit regulator to publish an annual report on its work; and enhancing the written public consultation process for new regulations. While it seems unlikely the government will drop the DCS proposal, it is noteworthy that it is taking so long to get it through the National Assembly. Reforming civil service appointments has a low chance of success, yet we continue to believe it is crucial for building up a cadre of specialist CG and ESG policymakers such as one sees in

Eight recommendations from 2018 and outcomes as of April 2021

other developed markets. Meanwhile, the other two recommendations are eminently doable and could be implemented in the short term if there was the political will.

Figure 2

Korea: Recap of 2018

	Recommendations	Outcomes
1.	Do not introduce dual-class shares.	Negative. The ruling party presented a bill to the National Assembly in December 2020. As of end-April 2021, however, it had yet to pass.
2.	Reconsider short-term appointment system for key officials working in specialist areas.	No change.
3.	Address weak shareholder rights (eg, introduce a rule on mandatory takeover bids).	No change on takeover rules, some progress in other areas of shareholder rights (eg, voting on audit committee members).
4.	FSS to publish a separate report on the regulation of auditors.	No change.
5.	Regulators to enhance the (written) consultation process for new policies and regulations.	No change. Regulators and the National Assembly hold public hearings, but foreigners rarely participate. Written consultations remain rudimentary.
6.	Corporate CG disclosure needs to improve.	Good progress. New CG Report has expanded the quality and quantity of disclosure from large caps. But only mandatory for large caps.
7.	Deepen implementation of Stewardship Code.	Good progress.
8.	Companies to invite shareholders to nominate candidates for independent directors.	Some progress.

Source: ACGA

1. Government & public governance

Korea ranks equal 4^{th} on an improved score of 60%

Korea's score increased by eight percentage points in this category to 60% and her ranking jumped from 6^{th} to equal 4^{th} with Japan and Singapore. To a degree this improved score was due to methodological changes in our survey and a consequent re-rating of some questions, in particular on the powers of the anti-corruption agency and efforts to enhance civil service ethics and accountability. But Korea also made progress in public governance, including a clearer government policy on CG and ESG reform, more consistent political support for financial regulators, and legislative amendments designed to tackle senior civil servant corruption. Conversely, Korea lost points on the independence of the judiciary and the extent to which the legal system provides robust legal remedies for minority shareholders.

Time for a CG roadmap?

Korea could benefit from a more structured approach to CG policy

A theme we have often written about in CG Watch is the value of a coherent government policy document that sets out the way forward on corporate governance reform over a three to five year period. Called "roadmaps" or "blueprints", these documents allow - or indeed force - governments to think through how to approach CG reform strategically and in relation to the broader economy and society as well as the capital market and shareholders. The process of developing such high-level policy statements gives governments and regulators an opportunity to systematically review the entire CG ecosystem, assessing strengths and weaknesses, and producing comprehensive rather than piecemeal and reactive solutions. Financial regulators are often fighting the previous war. A roadmap requires they look forward and survey the capital market terrain with a clearer head and longer term perspective. Two markets in the region that have benefited from this process - and over time improved their scores in our survey as a result - are Malaysia and Taiwan.

The Moon government has introduced a series of important CG reforms

While Korea has never produced a CG roadmap per se, the Moon government has produced a broad array of policies over the past two years that are potentially far-reaching and largely point in a reformist direction. Long-awaited reforms to the management of annual general meetings (AGMs) and the notorious 5% substantial-ownership disclosure rule were introduced in 2019. The Ministry of Justice (MOJ) carried through as promised with solid reforms to the Companies Act, as did the Financial Services Commission (FSC) and the Korea Exchange (KRX) on new CG reporting rules for large listed companies. A requirement for one woman director took effect in August 2020 and the government signalled its intent in early 2021 to phase in mandatory ESG reporting from 2025.

Government is taking securities enforcement more seriously

The government has also taken the implementation and enforcement of laws more seriously. It initiated a plan to reform the prosecutors' office in 2019 and later the same year announced a new anti-corruption unit for senior civil servants. It has also given the Financial Supervisory Service (FSS), the enforcement arm of the FSC, greater enforcement powers through a new special investigation unit that works with prosecutors.

Policy contradictions undermine the good work being done

Inevitably, there are contradictions. The most glaring is the ruling party's infatuation with dual-class shares (DCS) and its decision to push ahead with legislative amendments allowing them for unlisted SMEs planning to list on Kosdaq. What seems to the Moon government as a smart idea for assisting the tech industry grow and create jobs looks to sceptics as the thin edge of the wedge - that over time the policy could be extended to existing listing companies and eventually the *chaebol*, the family-controlled conglomerates that dominate Korean business. This would be a significant step backwards for corporate governance in Korea.

Some reforms are limited in scope or ambition

Not surprisingly, many of the new reforms are far from perfect. The new CG reporting rules only apply to a limited number of large companies. Some promised changes to AGM rules, such as 28 days' notice for meetings and a quota for the number of AGMs that could be held on one day, were subsequently not adopted. And Korea is well behind the regional curve on mandating ESG reporting.

Written public consultations are skimpy

The policymaking process in Korea also suffers from systemic flaws, two of which deserve a special mention. First, the public consultation process falls well below the standards of transparency and professionalism set by leading markets in the region. Second, the continuation of the official rotation policy constantly undermines institutional memory and expertise.

How would a CG roadmap help?

How would a roadmap help? It would integrate the disparate components of the government's CG reform programme into a more consistent set of policies and ensure all parts of the ecosystem were covered, especially areas long ignored such as the lack of a mandatory takeover bid rule. It could address internal contradictions like DCS head on, such as developing ways to enhance shareholder rights to compensate for the loss of voting power. A roadmap would provide a more coherent and overarching rationale for CG reform and explain how it would benefit the Korean economy and corporates over the longer term. It would also explain how different agencies of government are working together to achieve reform priorities and the timeframe in which they intend to do it. In short, Korea needs a more structured and clear-sighted approach to reform if it is to rise up the regional rankings.

Korea's anti-corruption agency has limited powers and resources

Preventing corruption

Like Hong Kong and Singapore, Korea has a single agency that takes the lead in fighting corruption. Unlike those two places, however, its Anti-Corruption and Civil Rights Commission (ACRC) has fewer powers of investigation and enforcement, a smaller budget (at least compared to Hong Kong; see Figure 3), and a generally lower profile. The ACRC was created in 2008 by integrating three previous institutions - the Ombudsman of Korea, the relatively weak Korea Independent Commission Against Corruption, and the Administrative Appeals Commission. The agency describes its function as preventing corruption and protecting people's civil rights from "unreasonable administrative actions", a double-barrelled role that some would argue has held back the Commission's anti-corruption work in the past. Indeed, a review of its organisational structure shows that the Ombudsman Bureau is notably larger than its Anti-Corruption Bureau, Inspection and Protection Bureau (only established in July 2018), and its Administrative Appeals Bureau.

Hong Kong's ICAC has a bigger budget

Figure 3

Anti-corruption budgets and staffing: Korea vs Hong Kong, 2019

	Total budget (US$m)	Total staff
Korea ACRC	78	551
Hong Kong ICAC	155	1,522

Note: The Korean figures are for the 2019 calendar year, while the Hong Kong ones relate to the April 2019 to March 2020 fiscal year. Source: ACRC Annual Report, 2019; Hong Kong Government budget accounts; ACGA analysis

The ACRC is more a prevention and education organisation

A direct comparison of budgets and staff numbers is interesting, but has to be qualified by noting that the scope of work of the two agencies is different. The bulk of the Hong Kong ICAC budget - almost 80% - goes on operations (ie, investigations, prosecutions, disciplinary sanctions). The remainder is dedicated to prevention, education, and enlisting community support. In contrast, the ACRC is very much a prevention and education organisation, though it also carries out initial inspections upon receiving complaints. As its name suggests, its mission is not just to minimise corruption but to tackle administrative abuse - which has a long history in Korea - and raise public confidence in government at all levels. Indeed, it talks a lot about the need to change mindsets and build a cleaner society. As it noted in its 2019 Annual Report (p57), the September 2016 enactment of the new Improper Solicitation and Graft Act, targeted at government officials, was "based on the public aspirations for a society of integrity", while the Act was "now changing people's perceptions about solicitations or the act of offering entertainment that have been condoned as a common social practice".

Beefing up the corruption whistleblowing system in Korea

In terms of its formal powers, the ACRC has responsibility to look into both public- and private-sector corruption. It relies to a large extent on public complaints through two channels: its "Corruption Reporting" system for civil-service corruption and its "Public Interest Reporting" system for private-sector corruption. The former began operating in January 2002 and the latter in September 2011. After reports are received, the ACRC examines them, carries out an initial inspection, then decides whether they need to be elevated to government auditors for deeper inspection, passed to an investigative authority for prosecution (criminal cases), or to the supervisory institutions of other relevant public agencies. The ACRC expects these agencies to report results within 10 days and the Commission will inform the person reporting the corruption. A full assessment, therefore, of Korea's annual anti-corruption budget would need to take these other agencies into account as well.

How well is the system working?

Korea seems to be getting steadily cleaner

The broad consensus is that Korea is steadily getting cleaner. According to Transparency International's closely followed Corruption Perceptions Index (CPI), Korea improved from 51st place and a score of 54/100 in 2017 to 39th and a score of 59/100 in 2019. In the latest CPI, which was published after we finished our scoring for CG Watch 2020, Korea's ranking rose even further to equal 33rd with Portugal and a score of 61/100. This is an impressive achievement over four years, although the excitement should be tempered by noting that over the same time period Korea's ranking in the Asia-Pacific region only moved from 9th to 8th. It still ranks (in descending order) below New Zealand, Singapore, Australia, Hong Kong, Japan, Bhutan and Taiwan.

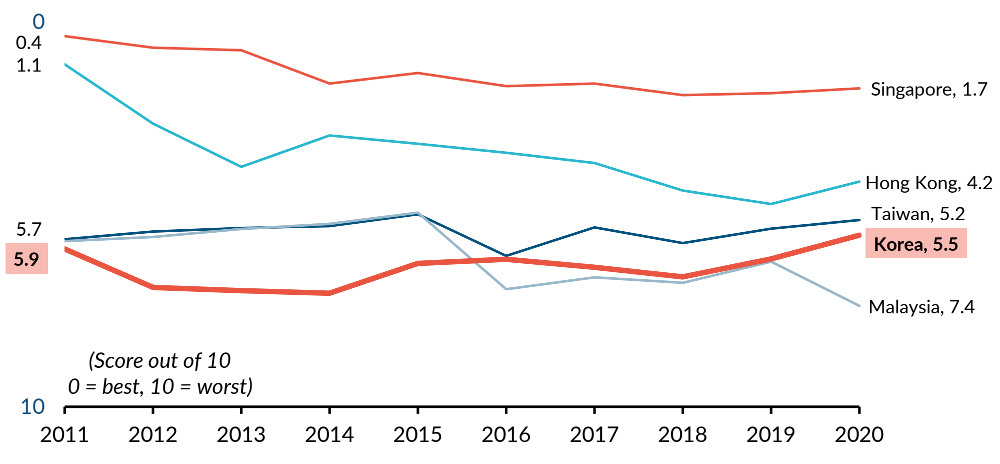
Corruption perception surveys all rate Korea more positively

As Figure 4 shows, Korea is also doing better in the annual perceptions of corruption survey from the Political & Economic Risk Consultancy (PERC). This survey rates countries from zero to 10, with zero being the best score. Although Korea's 2020 score of 5.54 is not too much ahead of the 5.90 it earned in 2011, it has at least improved over the decade and especially since 2018. In contrast, PERC scores for many other jurisdictions in Asia-Pacific, including regional leaders like Australia, Singapore, Hong Kong and Japan, have all fallen over the same period - a point we emphasise in other chapters in this report. Korea and Taiwan, on the other hand, are both above where they were in 2011.

Korea and Taiwan are among the few markets whose PERC score has improved since 2011

Figure 4

Improving: Perceptions of corruption in Korea, 2011-2020



Source: Political & Economic Risk Consultancy

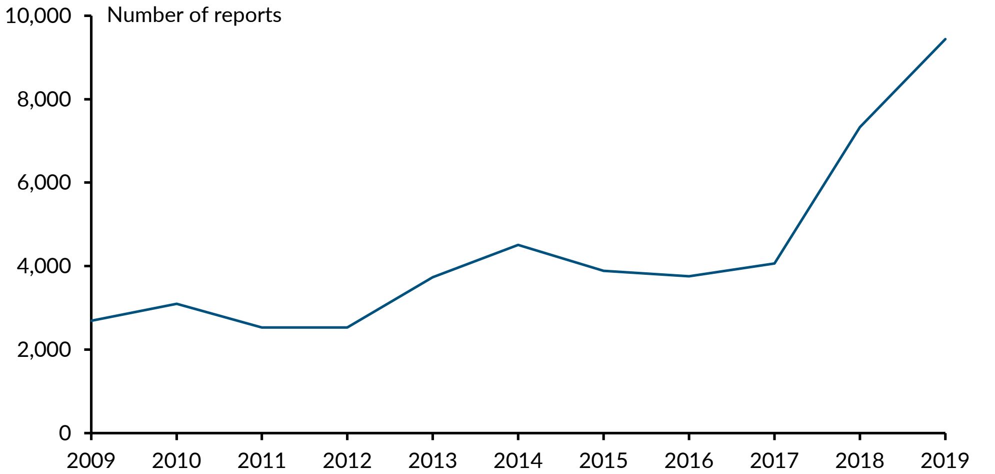
Public-sector corruption

A more bottom-up view is provided by ACRC statistics. Figure 5 illustrates the increase in the number of reports received from citizens about official corruption since 2009. Note the sharp increase from 2017, the year when former president Park Geun-hye was impeached for corruption and President Moon came to power. As we said in CG Watch 2018, it very much felt that 2017 was the turning point in societal attitudes towards both public- and private-sector corruption.

2017 was the turning point in societal attitudes towards official corruption

Figure 5

Turning point: Corruption reports against public officials, 2009-2019



Source: ACRC Annual Report, 2019

More than 60,000 complaints were made against official corruption between 2002 and 2019

Between the start of the reporting system on official corruption in 2002 and the end of 2019, a total of 61,346 reports were submitted by the public to anti-corruption agencies. Of the 60,274 cases resolved, 2,833 were referred to investigative authorities, 954 led to a notification that the Code of Conduct for Public Officials had been violated, and 10,847 were forwarded to public institutions for further inspection. The remaining cases, more than 45,000, were closed. Meanwhile, of the 2,833 more serious cases, corruption was confirmed in 74% of the 2,407 cases concluded by the end of 2019 (with the remaining 426 cases ongoing). This led to 4,452 people being prosecuted, around 2,000 disciplined, and slightly more than ₩820 billion (US$730m) recovered.

Private-sector corruption

Public complaints about private-sector corruption have been on the rise too, with a noticeable increase after 2017:

Complaints against private corruption have doubled since 2017

Figure 6

Doubling: Public complaints on private-sector corruption, 2015-2019

Year	Total	Health	Safety	Environment	Consumer interests	Fair competition	Others
2016	**2,611**	937	377	232	149	69	847
2017	**2,521**	543	524	191	190	121	952
2018	**3,923**	821	706	179	202	161	1,854
2019	**5,164**	1,129	822	535	609	130	1,939

Source: ACRC Annual Report, 2019

More than 33,000 reports of private corruption lodged from 2011 to 2019

Between the start of this whistleblowing system in 2011 and the end of 2019, a total of 33,452 reports were submitted by the public. Of the 33,092 cases resolved, more than half - 17,711 - were referred to investigative agencies. Of these, a suspicion of corruption was confirmed in 7,421 cases, leading to prosecution or accusation in 1,874 cases and fines in 130 cases and administrative fines/penalties in another 1,923 cases. As Figure 6 shows, the areas where the public typically report private-sector corruption are, in declining order of importance: health (eg, harmful food products, sales of unlicensed medicines), safety (eg, faulty construction, lack of fire equipment), the environment, consumer interests, and fair competition.

Legislative reforms undertaken to strengthen whistleblowing against official corruption . . .

Legislative reform over the past two years, meanwhile, should strengthen whistleblower protections and make the system more effective. Firstly, amendments to the Act on the Prevention of Corruption and the Establishment and Management of the Anti-Corruption and Civil Rights Commission (the ACRC Act) took effect on 17 October 2019. The ACRC said this would strengthen the level of protection provided for corruption reporters (ie, for civil service corruption). "The system of charge for compelling compliance, recommendation of reconciliation, and relief fund were newly introduced, and legal grounds were established to punish those who force withdrawal of reporting or interrupt the reporting process, which offer corruption reporters a protection comparable to what is provided by the Protection of Public Interest Reporters Act." The ACRC Act was amended again on 10 December 2019 and the changes "substantially strengthened the level of punishment for those who violate the duty to protect corruption reporters".

. . . and private corruption

Secondly, during 2019 the ACRC reviewed the Public Interest Whistleblower Protection Act, which covers reporting on private-sector corruption, and increased the number of laws subject to such whistleblowing from 284 to 467. This passed Cabinet in May 2020 and came into force later that year.

The Land & Housing scandal

Just when you thought things were getting better . . .

Despite government efforts to clean up the Korean civil service and private sector, it seems that it will take a lot more than worthy legislative reform and increased whistleblowing protection to change mindsets and behaviour. The bribery scandal that not too long ago sent the former president, Park Geun-hye, and the head of Samsung, JY Lee, to prison reflects how high corruption can sometimes go in the country. But just when things seemed to be stabilising, another scandal blew in.

. . . 20 employees of a state-run housing developer engage in insider-buying

The latest tabloid fodder involves allegations of improper property speculation involving around 20 public employees at the Korea Land & Housing Corporation (N-R) (LH), the top state-run housing developer. In mid-March 2021, the media reported that they used inside information to buy undeveloped farmland in Gyeonggi Province, whose name means the "land surrounding the capital", before the government announced plans to develop a major new residential town there.

Growing public anger about rising housing costs

The issue is particularly sensitive due to growing public anger about rising housing prices and rents. The situation is so bad that the president's chief of staff for policy, Kim Sang-jo, a highly regarded official, was forced to resign in late March 2021 after it emerged that he had increased the rent on an apartment he owns in Gangnam by 14%. While this may seem a non-issue, the problem was that the rental increase took place just two days before a new law limiting increases to 5% was due to take effect.

Moon's approval rating fell to its lowest ever

But Kim was not the only politician to suffer. President Moon's approval rating fell to less than 35% by early April 2021 - his lowest ever - and the ruling Democratic Party lost out to the opposition People Power Party in mayoral by-elections in Seoul and Busan on 7 April 2021. The ruling party's credibility also suffered from allegations of sexual harassment aimed at the former mayor of Seoul, Park Won-soon, who committed suicide as a result and triggered the by-election.

New law needed to stop abuses like LH

Meanwhile, Moon's answer to the LH scandal was to tell the public that new legislation was needed to prevent civil servants seeking private advantage through their public positions. It is surprising that such a law is not already on the books.

Questions about judicial independence and integrity

Judicial independence

We reduced our score on the extent to which the judiciary is seen to be independent and clean in relation to company and securities cases for a couple of key reasons:

- On 11 February 2019, the Seoul Central District Prosecutors' Office indicted former Supreme Court chief justice, Yang Seung-tae. He was the first chief justice, either former or sitting, to be indicted. Yang faced 47 criminal charges on abuse of power, dereliction of duty, and leaking official secrets. The investigation also uncovered National Court Administration documents drafted during Yang's reign which contain directives calling judicial independence into question. The documents say, "Regarding cases that may have strong national or societal influences, or are about sensitive political issues, communicate with the Blue House unofficially, and in advance, to make sure that the Supreme Court does not dole out unexpected rulings."
- Judges in Korea have unusual discretion in sentencing: In the JY Lee political corruption trial in 2019/20, the judge used discretion in his sentencing and allowed Samsung to create a compliance committee in return for a lighter sentence for Lee. Judges have wide latitude to make such decisions under sentencing guidelines in Korea and precedent does not need to be followed - it is only there for guidance. Moreover, in contrast to judicial opinions in common law jurisdictions, opinions in Korea are usually brief and often lack detailed supporting reasons. (See box below, "The saga of JY Lee", for a detailed outline of the charges he has faced.)

Legal remedies for minority shareholders not as strong as they seem

Weak legal remedies

We also reduced our score on the extent to which the legal system allows minority shareholders and other stakeholders fair and efficient access to courts to settle disputes. Shareholders can go to court and some derivative actions have been launched by public-interest advocacy groups, such as the Solidarity for Economic Reform (SER). But the class-action law of 2003 has been fairly underwhelming in its impact. According to SER, shareholders had filed class actions against just 15 firms over the 17-year period to mid-2020. Of these, seven secured approval from the court to proceed and the result was as follows: two won, three settled, and the outcome of two were still pending.

Legal costs can be an issue

As to whether lawsuits can be filed at a reasonable cost, the system in Korea is somewhat cost-effective for plaintiffs. The derivative actions initiated by SER have all involved lawyers working pro-bono, while lawyers in class-action suits work on a contingency fee basis. Law firms also need to pay a ₩50m (US$45,000 approx) filing fee for class actions. But as SER notes in a November 2020 submission on the proposed new class action law, even ₩50m can be high for "plaintiffs who are not sure of winning or losing".

Proposed revisions to the class action law should help minorities

Overall, the system could not be described as fair to minority shareholders: there is a six-level approval process, cases move through the courts slowly, and payouts are limited. The good news is that the new class action law should remove or improve some of the hurdles, including the convoluted approval process and low payouts (one amendment envisages much larger punitive damages of five times for both existing and new cases). All of this should lead to a higher number of cases, but probably not dramatically more, says SER. As of early May 2021, the government had not yet submitted the bill to the National Assembly.

Next steps

Develop a national CG roadmap

Develop a national "CG Roadmap" for the next three years. This job could be given to the FSC to try to depoliticise the process, given that President Moon's five-year term ends in March 2022.

ACRC could enhance disclosure of its budget and enforcement work

More disclosure by the ACRC on how it applies its budget to different functions would be welcome. More disclosure also about which agencies it refers cases of public and private-sector corruption to would help to enhance understanding of the wider government anti-corruption system.

LH cannot happen again

Government needs to ensure that cases such as the Land & Housing Corporation scandal do not happen again.

Judicial soul-searching

The judiciary evidently needs to do some soul-searching after the Yang Seung-tae and JY Lee cases.

New high-level corruption unit: the knives are out

New anti-corruption unit for senior civil servants given wide powers

On 30 December 2019, the National Assembly passed a bill to instal an independent unit to investigate corruption of high-ranking officials, including the president, lawmakers, police (above the rank of Inspector General), judges and prosecutors. The unit, called the Corruption Investigation Office (CIO) for High-ranking Officials, has an authority to indict police, prosecutors and judges. Indeed, it is an important part of the Moon government's efforts to reform the public prosecutor's office, which it sees as having too much power.

Original kick-off time in mid-2020 delayed

While the bill took effect on 15 July 2020, the kick-off of the unit was initially delayed pending parliamentary appointment of a seven-member committee tasked with recommending two chairman nominees for the unit, from which the president was to choose and appoint one. On 4 August 2020, parliament passed follow-up bills to facilitate the installation of the investigation unit. This included establishing rules requiring the chairman of the National Assembly to set up the committee "without delay". However, the rules did not stipulate clear timelines. Opposition parties have been fighting the formation of the new unit, which they claim will not be independent and whose existence they appear to find offensive.

Finally launched in early 2021, the unit quickly faced opposition

Finally, on 21 January 2021, President Moon appointed Kim Jin-wook, a former judge, as the first head of the CIO. It did not take long for the knives to come out. In mid-March, Kim was criticised for not fully reporting the contents of a meeting between him and a suspect, Lee Sung-yoon, who heads up the Seoul Central District Prosecutors' Office and is an ally of President Moon. Kim was lambasted in the media again in early April for allegedly sending his official car to secretly pick up Lee for a meeting in early March.

2. Regulators

Korea improves in rank to equal 6th on a lower score of 53%

This was the only category in our survey where Korea lost points in 2020, dropping three percentage points to 53%. Despite the lower score, Korea's ranking improved from 7th in 2018 to equal 6th with India and Malaysia, a result of these two markets losing even more points than Korea. China, which had ranked equal with Korea here in 2018, also lost points.

A much weaker score in Funding was offset by a much better one in Enforcement

Yet Korea's performance in Regulators was very much a game of two halves: a much-reduced score in the first sub-category - Funding/Capacity Building/ Regulatory Reform - that was in large part due to regulatory disclosure weaknesses; and a much-improved score in the second - Enforcement.

Korea's financial regulatory structure is similar to Japan's

Within the region, the Korean financial regulatory system is closest in structure to the Japanese framework: a peak financial regulator overseeing banking, insurance and securities, a separate supervisory and enforcement arm, a monopoly stock exchange, and a ministry responsible for company law. In Korea, these entities are, respectively, the Financial Services Commission (FSC), the Financial Supervisory Service (FSS), the Korea Exchange (KRX), and the Ministry of Justice (MOJ). Korea also has a Fair Trade Commission (FTC) that regulates competition and transactions among companies, in particular the large conglomerates *(chaebol)* that dominate the economy and are the source of many of the country's corporate governance problems.

The FSC in Korea has limited autonomy from government

As in Japan, financial regulators have limited autonomy from government. The FSC chairman and vice chairman are career civil servants appointed by the President, while a further four commissioners are ex-officio positions filled by the heads of major economic and financial agencies. The FSC chairman recommends two "standing" (full-time) commissioners, drawn from within the FSC, and an industry body, the Korea Chamber of Commerce and Industry, nominates an industry representative as a "non-standing" commissioner - taking the total to nine commissioners. Contrast this with the board of the Securities and Futures Commission of Hong Kong, for example, where nine of the 15 directors are non-executives drawn from the professions and business sector. Our view is that a mixed board allows for more independent decision-making by a securities commission.

2.1 Funding, capacity building, regulatory reform

Korea's rank fell to 9th and its score to 45%

Korea's score fell a sharp 11 percentage points in this sub-category to 45% and its ranking dropped from 5th to 9th. While it typically performs well in regulatory funding for the FSC/FSS and we again rated the regulatory reform efforts of the FSC and MOJ quite highly, Korea lost points for continuing poor disclosure by KRX of its regulatory budget and the extent to which the listing rules were enhanced to improve corporate governance. We also deducted points for the ongoing challenges one faces in finding answers to legal questions on regulatory and government websites - a weakness Korea shares with Japan - and the fragmented and incomplete company report databases provided by KRX and the FSS. Moreover, Korea scored poorly on a new question we added on the transparency and professionalism of regulatory consultations. The one area where it scored higher in this sub-category was for its electronic-voting infrastructure.

IOSCO - "Proper funding is key for effective regulation"

A new avenue of investigation for ACGA in recent years has been the level of funding and human resources utilised by securities commissions and stock exchanges. There is broad agreement that financial regulators need to be properly funded if they are to do their jobs properly, including hiring experienced staff, investing in new regulatory technology ("RegTech") and initiating sustained enforcement action. The International Organization of Securities Commissions (IOSCO) states in its Objectives and Principles of Securities Regulation (2017) that: "The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers." Interestingly, neither IOSCO nor any of its members appear to have developed any way of assessing how much funding is enough relative to the scope of a regulator's responsibilities and the size and complexity of the securities market. The issue is further complicated by the fact that funding mechanisms are not independent in many markets (ie, budgets allocated by government rather than a form of user pays).

ACGA assesses the volume of regulatory funding, how it is changing, as well as staff numbers and expertise

As a preliminary line of inquiry, ACGA assesses the volume of regulatory funding, how it is derived, whether it is increasing over time, total staff numbers (as well as any breakdowns provided between administrative and professional staff), and what salaries are based on (ie, a rigid civil service pay structure or a more flexible commercial system). We accept that this provides only a limited answer to the question of funding adequacy, but believe it is a useful starting point. We intend to develop this analysis further in coming years.

FSC/FSS funding and capacity building

Financial regulators in Korea are funded through an industry levy

Like Australia and Taiwan, but unlike Japan, Korea funds its financial regulators through a levy imposed on the financial services industry, as well as fees earned from securities issuance and a modest contribution by the Bank of Korea. This ensures that the FSS, which accounts for the bulk of the regulatory budget, is reasonably well-funded. It must balance its books each year and pay back any funds it does not use. Key figures for the years 2017 to 2019 (the latest data available, numbers rounded) are as follows:

FSS has to match income and expenses

- Total FSS income in 2017 was ₩342 billion (US$303m), falling slightly to ₩337 billion in 2018 and then increasing to ₩341 billion in 2019. Most of this is operating income, with "supervisory fees" paid by financial service firms accounting for 70% of total income and "registration fees" earned from the issuance of securities making up a further 24%. Non-operating income is minor and includes such things as interest income, rental income, government subsidies and CPA test fees.
- Total FSS expenditure in 2017 was ₩342 billion, falling to ₩337 billion in 2018 and rebounding to ₩340 billion in 2019. In other words, expenses and income match, as noted earlier. The largest component of expenses (64%) are "employee salaries and wages", followed by "operational expenses" (22%).
- While most expense categories remained fairly stable over the three-year period, the one that changed was employee salaries - rising from ₩203 billion in 2017 to ₩219 billion in 2019.
- FSS staff numbers have held steady: falling slightly from 1,970 at the end of 2017 to 1,961 at the end of both 2018 and 2019. Unfortunately, no breakdown is given as to the experience or skill sets of the agency's employees.

FSS could provide more details on its budget, but main problem is the long wait for its annual report

As these numbers indicate, the FSS is reasonably transparent in reporting its financial results for each year. Although the information is not as detailed as one finds in annual reports from securities regulators in Australia and Hong Kong, it is considerably better than the limited numbers given in Singapore. Our main complaint with the FSS is the long wait one must endure to get its annual report: the 2018 English version was not published until February 2020 and the 2019

English report came out only in December 2020. This meant that when we carried out the bulk of our survey scoring in 3Q20, we had no access to the 2019 report. Indeed, the Korean version did not come out until early 4Q20. We did not deduct points for late publication in CG Watch 2020 but intend to do so in our next survey.

KRX funding

KRX annual report provides no details of its regulatory resources

The funding picture is considerably more opaque at KRX. Although the exchange publishes an annual report and says it is doing more to enforce the listing rules, including investing in new technology, it discloses precious few details of its regulatory budget. The overriding message instead is of an organisation that, like most exchanges, manages its finances carefully and is highly focussed on producing a surplus. Some key financial figures for the past two to three years (note that its 2020 annual report has not yet been published):

- In 2018 the exchange earned operating revenue of ₩414 billion (US$359m) and had operating expenses of ₩303 billion. It made a net profit of ₩96 billion, an increase of 34% on 2017.
- In 2019 its operating revenue dropped to ₩386 billion and its expenses remained roughly the same at ₩302 billion. However, its net profit increased 29% to ₩124 billion on higher non-operating income.

Total staff numbers given, but no breakdown

KRX does provide figures on its total staffing, which increased from 831 employees at the end of 2017 to 867 at the end of 2018 and 883 in 2019. But no breakdown is given by function, skills, or experience. Hence, it is not possible to ascertain whether the exchange is investing more in HR related to its regulatory work.

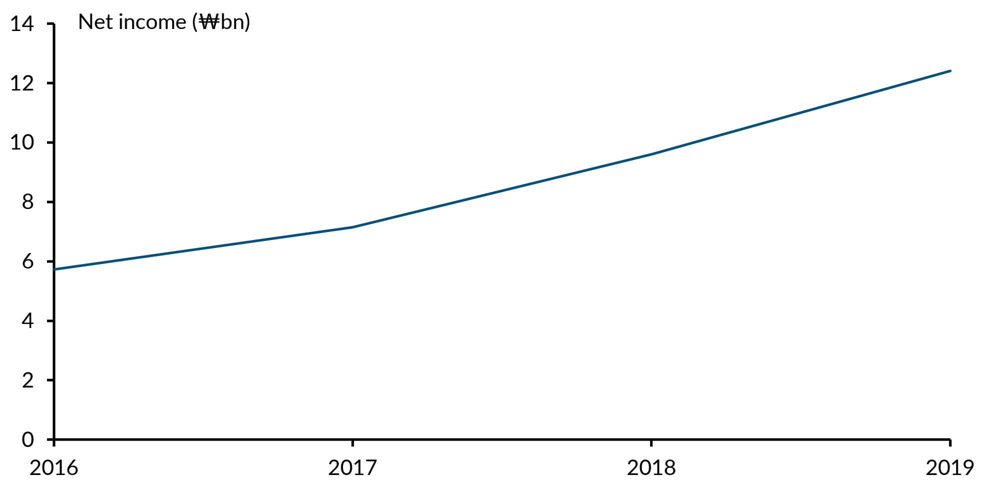
Exchanges should disclose what they spend on regulation

As we have noted in other market chapters, it is rather surprising that stock exchanges are not mandated to disclose their expenditure on regulation and how they are investing to become more effective and/or efficient in surveillance, enforcement and policymaking. Given they are the frontline regulators of the capital markets, such transparency would go some way in relieving doubts about the inherent conflict of interest between their regulatory and commercial roles. It might also surprise readers in Korea to know that securities exchanges in India are required to publish a transparent statement of regulatory expenses.

KRX keeps a close eye on its profitability

Figure 7

Making money: KRX net profit, 2016-2019



Source: KRX annual reports, ACGA analysis

Korea's system for public consultation is different to other markets

Public consultations: Verbal jousting

Public consultations on regulatory and policy reforms in Korea follow a different path to leading markets around the region. Regulators in Korea do not run large-scale formal public consultation exercises starting with a detailed consultation paper, a four- to eight-week consultation period (or more), and then a consultation conclusions paper that outlines arguments for and against the original proposals, what the regulator has decided, and who has made a submission. Such a process is typically followed, with variations, in places like Australia, Hong Kong, Japan, Malaysia, Singapore and Taiwan. Some regulators also provide links to all submissions, unless their authors have requested anonymity.

Written consultations are much less prevalent and well-organised

The process in Korea for written consultations is less high-profile and usually swifter. Regulators publish announcements on their websites about rule changes - only summaries of which are available in English, if at all - and then typically allow between two to six weeks for responses. Sometimes the deadline is even tighter: in September 2020, for example, the FSC allowed only 10 days for public comment on an amendment to the Enforcement Decree of the Joint Stock Act on Auditors. And there are other challenges: the invitation to comment is usually buried at the bottom of the regulatory announcement and is easily missed. There are no detailed consultation documents and no conclusions papers. Written submissions made by market participants are not made public by regulators, although organisations will often publicise their submissions on websites. And regulators mostly do not respond to those who have contributed. As one veteran market observer said: "One minor advancement in recent years is that the Fair Trade Commission (FTC) sends back response letters to outside comments. But the FTC is the only ministry that does that. Other ministries receive outside comments, but never send back responses."

Public hearings are common, but foreigners rarely participate

Where Korea is more interesting is in its use of public hearings organised on an ad hoc basis by regulators or held in the National Assembly. There were several such hearings on CG-related topics over 2020 and 2021, the most recent of which was held in mid-April 2021 on a new law allowing dual-class shares (DCS) for unlisted venture-capital backed firms. These typically attract a wide range of participants from different sides of an issue, each of whom is allocated about 10 minutes to make their case. While highly participatory in one sense, such hearings are only in Korean and usually do not involve foreign investors or experts. The organisers do however produce a summary of the discussions, the hearings are broadcast to the public in real time, and recordings are also provided.

The FSC and MOJ introduced key reforms over 2019 and 2020

Regulatory reform

On a more positive note, regulators in Korea introduced a series of important reforms over the past two years. Although some of the measures fall short in certain respects, in aggregate they mark quite a bold step forward and answer some of the criticisms that institutional investors have made of Korean corporate governance over the years. Key initiatives include:

Higher standards for AGMs and corporate reporting introduced

- **New AGM and related disclosure rules**: On 24 April 2019, the FSC and MOJ jointly proposed nine new measures to improve the transparency and efficiency of AGMs. Some measures took effect in early 2020, including: allowing companies to contact shareholders by email; making electronic voting easier by allowing retail shareholders to authenticate their identities more easily; requiring companies to disclose more information on executives being nominated to the board; and disclosure of "actual" remuneration paid to directors in the past year. One of the more ambitious measures - requiring "business reports" (ie, the detailed annual securities report published by listed companies) to be attached to the AGM notice that must be sent no later than two weeks before a meeting - was delayed until January 2021. Meanwhile, some of the proposed measures, including extending the AGM notice period from 14 days to 28 days and introducing daily quotas for annual meetings, have not been adopted.

Korea leaps ahead of Japan

Full annual reports used to come out after AGMs . . .

Historically, listed companies in Korea have only needed to produce a condensed "audit report" containing final audited accounts one week before their AGMs, which is much later than the minimum of two or more weeks in other markets. Their full annual report - called a "business report" and running to several hundred pages, usually only in Korean - must be published by the end of March, by which time AGMs have already been held.

. . . but new rules require them before AGMs

The regulatory push for full business reports before the annual meeting is a significant change and brings Korea into line with developed capital markets. It also means Korea has now leapfrogged over Japan, where the full "annual securities report" (same type of report, different name) is still not required until the end of June (for most issuers), which is after the AGM.

Did companies comply? It appears so. Samsung Electronics released its business report, all 536 pages of it, on 9 March 2021. Hyundai Motor followed suit one week later with a 376-page whopper. Both reports were only in Korean.

Allowing flexibility on AGM timing

- **Change of dividend "record dates"**: Requiring the publication of business reports before AGMs necessitates some flexibility around the timing of annual meetings. Again, Korea (and Japan) stand out for having the shortest AGM windows in the region - annual meetings must be held within three months of the dividend record date (ie, the date on which the list of shareholders eligible to receive dividends is set). In Korea this date is normally the financial year-end, 31 December, meaning AGMs must be held before the end of March. In June 2020, the MOJ sensibly proposed an amendment to the Commercial Act to allow boards to set later record dates and be able to hold annual meetings after March. This was approved by Cabinet in late August 2020 along with other amendments to the company law (see "Company law amendments" bullet point below) and passed the National Assembly in December 2020.

Fixing the notorious 5% rule

- **Amended 5% rule**: On 5 September 2019, the FSC announced a plan to reform the country's controversial "5% rule". Normally disclosure of "substantial ownership", defined as 5% in most markets, is not controversial. But in Korea large shareholders have been required to state whether they are general financial investors or intend to influence management through such things as making proposals to appoint or dismiss executive officers to/from the board, asking for higher dividends or pushing for other corporate governance changes. If the latter, they have historically been subject to tighter reporting deadlines (five days) and more detailed reporting requirements. Failure to abide by the law comes with quite harsh penalties.

In the past, the 5% rule dampened investor activism and complicated stewardship

Not surprisingly, this rule has put a dampener on the governance activism of large domestic and foreign asset managers in Korea. With the advent of the Korean stewardship code for institutional investors, which explicitly encourages them to actively engage with listed companies, the old 5% rule has passed its use-by date. As the FSC said in its press release: "Growing shareholder activism with regard to a company's dividend policy or corporate governance makes it difficult to draw a clear line between activities with the purpose of "exercising influence over management" and those without such purpose. Institutional investors are concerned that their shareholder activities might lead to unintended violation of the 5% rule, as the scope of "exercising influence over management" under the current rule is defined broadly and ambiguously".

The new rule allows large shareholders to more freely engage on governance issues

The revised rule essentially creates a new category for large shareholders who intend to engage with companies on issues such as dividends and executive pay, but who are not trying to influence management through changes to the board. Such activities are deemed acceptable and subject to longer (10-day) and simpler reporting requirements. Public pension funds that fall into this category are given even more time to report (one month). The new rule became effective in February 2020.

MOJ amends company law to enhance minority voting powers over audit committee elections, and many other things

- **Company law amendments**: In June 2020, the MOJ tabled amendments on a number of governance-related amendments to the Commercial Act, including: allowing for multiple derivative actions; requiring a separate election at the AGM for independent directors being appointed to audit committees (the aim being to reduce the voting power of controlling and large shareholders on this resolution to a cap of 3%); more flexible dividend record dates to allow for later AGMs (see bullet point on previous page); and more flexibility allowed to minority shareholder who wish to exercise different rights. The bill was passed by the Cabinet on 25 August 2020 and sent to the National Assembly at the end of that month. It was enacted in December 2020.

Other reform measures, including mandating gender diversity on boards and plans for ESG reporting, are addressed in the CG Rules section.

Next steps

A quicker annual report from the FSS please!

The FSS should publish its annual report within six to nine months after the calendar year-end.

More clarity on regulatory expenditure

The FSS could provide more explanation of how its supervisory budget is applied by function and sector. A breakdown of staff by function, experience and skill would also be welcome.

A regulatory budget from the KRX please!

The KRX should also publish a regulatory budget by function and give a breakdown of staff by function, experience and skill.

Public consultations need a revamp

Korea's system of written public consultations needs to be revamped and brought into line with best practices in leading markets around the region. While public hearings can be an effective tool to gather a range of views, they effectively disenfranchise foreign parties.

With Covid cases peaking early, and AGMs held in March, Korea missed the e-meeting revolution

Korea's response to Covid: Limited

The pandemic was initially short-lived in Korea, with daily cases of Covid-19 surging at the end of February 2020, peaking at 1,062 cases on 1 March 2020, then under control with less than 200 by 11 March 2020. Regulators reacted quickly in late February with financial reporting deadline extensions and, later, accounting flexibility. But with company AGMs held in March, the regulator felt no compunction to rapidly amend company law or regulation to allow for virtual or hybrid shareholder meetings, as was the case in some other markets: Australia, India, Malaysia, Philippines and Singapore. Most issuers went ahead with their AGMs in March as usual, taking precautions on social distancing and encouraging shareholders to vote by proxy rather than attend meetings in person. As a result, Korea had one of the lowest take-up rates for electronic meetings in the region (see box in Listed Companies section, "Electronic meetings in Korea: What meetings?").

FSC took proactive measures to extend annual reporting deadlines

Financial reporting extension and relief

While regulatory action on AGMs was sparse, the FSC did take proactive measures on financial reporting. On 26 February 2020 it said it would exempt listed companies with December 31 year-ends from administrative sanctions if they failed to submit their annual financial statements, audit reports or business reports within the statutory deadlines due to Covid (eg, if they were based in China or a part of Korea badly affected by the virus). While the deadline for such companies was extended from 30 March to 15 May, they would need to submit an application for an exemption to the FSS. The regulator also said it would exempt auditors from penalty if they were unable to perform audits due to the pandemic. Auditors were instructed to apply to the Korean Institute of CPAs for an exemption.

Then opened a longer window for quarterlies

On 24 April 2020, the FSC opened an additional window for issuers unable to meet first-quarter and semi-annual reporting deadlines. Then on 15 July it allowed a further extension for second-quarter or semi-annual reports from 14 August to 14 September. KRX also put off placing companies on its watch list for supervision during this period. To be eligible for these exemptions, companies or their auditors, again, needed to submit applications to the regulator. A total of 15 companies applied for the second-quarter extension and were granted exemptions.

Regulators urged flexibility on assessing impairments in 1Q20

Accounting flexibility

On 10 April 2020, the FSC and FSS urged companies and auditors to adopt a flexible approach when recognising the impairment of financial instruments in their first-quarter 2020 reports. They noted concerns about a "looming uncertainty" about the impact of the pandemic on expected credit losses (ECL) and specifically recommended against a "mechanical application" of IFRS 9 standards when determining these losses. They advised companies and auditors, when determining ECLs, to "consider the unprecedented financial and economic relief measures taken by the government" and expressed confidence that the "government's market support measures are expected to lower the risk of a default on a financial instrument".

Officials pointed to similar guidance from the IASB

The two regulators also referred to a similar 27 March statement from the International Accounting Standards Board (IASB) to support their guidance. As the IASB said at the time, "estimating ECL on financial instruments is challenging in the current circumstances and highlights the importance of companies using all reasonable and supportable information available - historic, current and forward-looking to the extent possible - when determining whether lifetime losses should be recognised on loans and in measuring ECL." It added that IFRS 9 did "not provide bright lines nor a mechanistic approach in accounting for ECLs".

2.2 Enforcement

Korea moves up to 7th on enforcement with a score of 62%

Korea's score for Enforcement improved by seven percentage points to 62% and its ranking moved from 9th in 2018 to 7th in 2020. While the higher score was due in part to methodological changes in our survey, with other markets benefiting as well, there were also areas of progress in Korea relating in particular to the prevention of "unfair trading" (insider trading, market manipulation, deceptive and fraudulent trading, and so on). Conversely, we reduced the score for the quality of disclosure by financial regulators on their enforcement activities. This is not because reporting is getting worse, rather it is not improving and remains fragmented and lacking in coherence. We address this disclosure problem first in our analysis below, then end on a more positive note.

Presentation and research hurdles

The frustrations of scoring Korea with outdated data

As noted in previous issues of CG Watch, the FSS provides limited statistics in its annual reports on enforcement and even less narrative explanation of what the numbers mean. A second problem is that unlike regulatory websites in many other markets, the FSS version (Korean as well as English) lacks a dedicated section showing enforcement statistics. There is a page on its Korean website listing companies sanctioned under different categories (eg, inspection, unfaithful disclosure, market manipulation), but aggregate statistics are only available in its annual report, which is always well out of date, or in intermittment press releases that take time to find. Trying to get a rounded and up-to-date picture of FSS enforcement is a laborious exercise, made more difficult by the fact that the vast majority of information is only in Korean.

Aggregate enforcement data was more than 18 months old

When completing our scoring for CG Watch 2020 in 3Q20, the only aggregate enforcement statistics available in English were to be found in the FSS annual report for 2018, published in February 2020, and covering years more relevant for our previous survey. As noted earlier, the agency's 2019 report was not published in Korean until October 2020 and in English in late December 2020.

Statistics come with very little narrative explanation

Apart from the issue of timing, the statistics provided on securities enforcement are represented in three tables in the annual report - cases of unfair trading initiated or received by the FSS, those investigated, and enforcement actions - that come with very limited narrative explanation. The first table on the number of unfair trading cases initiated/received, see below, is preceded by a short paragraph noting that the total number of 138 in 2018 is similar to the year before and that the increase in the number initiated by the FSS - from 48 in 2017 to 62 in 2018 - was a reflection of its "efforts to strengthen market surveillance".

Total unfair trading cases about one third lower in 2017 and 2018

Figure 8

Number of unfair trading cases initiated or received by the FSS, 2014-2018

Year	FSS identified	KRX referred	Total	Breakdown of Unfair trading			
				KOSPI Market	KOSDAQ Market	Derivatives	Others
2014	105	72	**177**	63	106	2	6
2015	87	64	**151**	43	91	11	6
2016	81	127	**208**	68	130	8	2
2017	48	88	**136**	37	88	9	2
2018	62	76	**138**	39	93	5	1

Source: FSS Annual Report, 2018

A few questions immediately spring to mind when looking at Figure 8:

- ❑ Why did the number of cases, especially the referrals from KRX, rise so sharply in 2016 then fall dramatically in 2017?
- ❑ Why is the FSS identifying notably fewer cases in 2018 compared to the three years between 2014 and 2016?
- ❑ Why are cases relating to the KOSPI market on a declining trend?

The annual report does not seek to answer these questions. This is a shame since there is an opportunity here to inform the reader about trends in enforcement, including possibly some good news about corporate and market behaviour.

Traders became ever more sophisticated in their illegal buying and selling

The next table looked at FSS investigations into unfair trading over 2017 and 2018 and is likewise preceded by only a brief note of explanation. The regulator commented that the "pattern of illegal buying and selling of securities" was getting "ever-more sophisticated and organized". It highlighted that the most frequent cases involved insider trading again, while deceptive and fraudulent trading showed the biggest increase.

Total investigations rose somewhat in 2018

Figure 9

Unfair trading cases investigated and administered by the FSS, 2017-2018

	2017	2018
Deceptive/fraudulent trading	10	27
Market manipulation	23	18
Insider trading	36	36
Failure to report large share holdings or acquisitions	20	23
Short swing profit/violation of lock-up period	19	8
Cases dismissed	31	39
Total	**139**	**151**

Source: FSS Annual Report, 2018

Interesting lines of inquiry on the numbers in Figure 9, but not addressed in the FSS annual report, could include:

- ❑ Why did the numbers of deceptive and fraudulent trading increase so much?
- ❑ Are the patterns of insider trading and market manipulation changing as a result of new technology?
- ❑ Which shareholders are failing to report large holdings or acquisitions?

The annual report then shows the enforcement actions, reproduced in Figure 10:

Enforcement actions remained steady

Figure 10

Enforcement actions against unfair trading, 2017-2018

	2017	2018
Criminal referral to the prosecution authority	77	91
Disgorgement or recovery of short swing profits and ill-gotten gains	7	3
Warning & other disciplinary actions	24	18
Total	**108**	**112**

Source: FSS Annual Report, 2018

No breakdown of enforcement actions by type, nor explanation of what happened to the criminal cases referred

As the table shows, most actions result in the referral of criminal cases to the public prosecutor. A smaller number involve disgorgement of short-swing profits or warnings and other disciplinary actions. Yet there is no breakdown of enforcement actions by type (eg, insider trading) or an explanation of what happened next. For example, how many of the criminal referrals led to a successful prosecution? The report does continue with quite an interesting summary of how the FSS is trying to prevent unfair trading, including thematic investigations into things like cryptocurrencies and bio-health companies. And it set up a special investigation unit to handle unfair trading cases that require a quick response. But all of the above is contained in less than two pages of its report.

Timely announcements to the rescue, partly

Timely announcements fill some gaps

To an extent our research challenges were resolved by scouring the FSS Korean website for updated announcements, such as one on 31July 2020 and titled, "Major examples of enforcement against unfair trading in capital markets, H1 2020". This concise press release summarises enforcement decisions made in the first six months of 2020 by the Securities and Futures Commission (SFC) on cases investigated by the FSC and FSS. The SFC is housed within the FSC and has high-level responsibility for oversight of the securities market.

SFC's ability to undertake investigations hampered by Covid-19

The SFC reported that despite the impact of Covid-19 on the ability to undertake investigations, it referred 18 cases of unfair trading to prosecutors. These cases covered 44 individuals, including some CEOs, and nine corporations. The press release went on to give examples of cases relating to the use of "undisclosed (inside) information" in trading, price manipulation, and other forms of unfair trading.

Limited explanation of statistics too

The press release also gave statistics on the total number of cases deliberated by the SFC annually from 2015 to 2019 - around 120 in 2015 and 2016, then about 100 in subsequent years. And it provided annual figures on referrals to prosecution authorities - typically around 75 to 80 in most years, except for 2019 when it fell to 58 cases. No explanation is given for the drop-off in 2019. Nor does the press release try to reconcile the numbers with those in the FSS annual reports.

Prevention efforts

Korean regulators are adapting and enhancing their enforcement efforts

While their narrative presentation of enforcement outcomes may be overly sparse, securities regulators in Korea do appear to be trying to enhance their enforcement effectiveness in recent years. The FSS 2019 annual report contains a longer section on measures being taken to monitor and prevent unfair trading. Whereas cryptocurrencies and bio-health had been particular areas of thematic focus in

2018, the following year the FSS focussed its surveillance efforts on stock trading relating to inter-Korean economic cooperation, pharmaceuticals, politics, and again bio-health. It also looked into leverage buyouts, accounting and disclosure fraud, and front running by stock analysts. The section goes on to describe the FSS's work to prevent unfair trading and its encouragement of whistleblowing. It talks about how it has sought to make the system fairer for people who are the subject of investigations and, in June 2019, allowed them to engage lawyers. There is quite a detailed description of its new special investigation unit, first announced in 2018 (see box below). For all these reasons, we awarded higher scores in our survey on questions relating to enforcement vigour and consistency (Q2.12) and whether enforcement was improving and evolving (Q2.13).

The Special Investigators

A multi-agency effort to beef up enforcement launched in 2019

Following discussions with the FSC, the MOJ and the Prosecutors' Office, the FSS finalised a set of measures to establish a special investigation unit in April 2019. In July of that year the first unit, called the "Capital Market Judiciary Enforcement Unit", was formed under the FSS and with investigators designated by the Seoul Southern District Prosecutors' Office.

The new unit will have stronger powers of investigation

This unit will have "significantly enhanced" investigation powers covering such things as searches, gathering evidence, and obtaining records of electronic communications. It is staffed by 15 investigators whose job it will be to investigate cases of unfair trading fast-tracked from the SFC to the Prosecutors' Office. The unit also operates under the direction of the Seoul Southern District Prosecutors' Office.

First investigation began in August 2019

The first investigation began on 27 August 2019 and was completed in four months. It involved analysts at a securities firm and resulted in two of them being referred for criminal prosecution.

Next steps

Enforcement statistics could be aggregated and reported in a dedicated enforcement report

The provision of aggregated enforcement statistics by the FSS, with sufficient narrative to understand the patterns in the data, would be very welcome. The agency could, for example, publish an updated "enforcement report" every six months and/or create a dedicated page on its website. This would allow it to communicate its progress on enforcement more effectively - something it is clearly keen to do now that it has formed the special investigation unit.

More narrative please

The securities enforcement section of the FSS annual report could be expanded and more detailed explanations of the statistics provided.

Reconciling data from different regulators

Press releases from the SFC on its enforcement decisions need to be reconciled with the numbers in FSS annual reports.

The first case relates to political bribery and dates back to 2017: Lee was sentenced, later released

The saga of JY Lee

It has been a tough five years for Lee Jae-yong (JY Lee), vice chairman of Samsung Electronics and heir to the country's most successful *chaebol*. Initially sent to prison for five years in August 2017 for bribing former president Park Geun-hye and on other charges including embezzlement, hiding assets overseas and perjury, he won his freedom just a few months later on appeal to a higher court.

Supreme Court orders a retrial in August 2019

As ever in Korea, this was not the end of the story: the Supreme Court ordered a retrial in August 2019 and ruled that Lee's donations to Park had indeed been to secure government backing for a major merger between Samsung C&T and Cheil Industries (N-R). The retrial began in October 2019 and initially resulted in some unusual rulings from Judge Jeong Joon-young, the most controversial of which was a statement that Lee's sentence could be reduced if Samsung formed a new compliance committee. When Lee's case finally came before the Seoul High Court for sentencing in January 2021, he was sent back to prison for 2.5 years.

Prosecutors launch a new case in mid-2020 on succession issues

While the political bribery case was wending its way through the court system, government prosecutors launched another case against Lee in mid-2020: this time for alleged accounting breaches at another Samsung Group (N-R) company, Samsung Biologics, and for other irregularities in his ascension to the top of the group. The trial began in April 2021. See Figure 12 for a list of key dates in both trials.

Samsung Electronics share price has not suffered

One interesting aspect of the JY Lee saga is that despite his personal travails, the share price of Samsung Electronics has been on an upward trajectory since his original arrest, as Figure 11 shows. As one Korean sell-side analyst said to the *Financial Times* in February 2021, "Lee's incarceration makes no difference for investors."

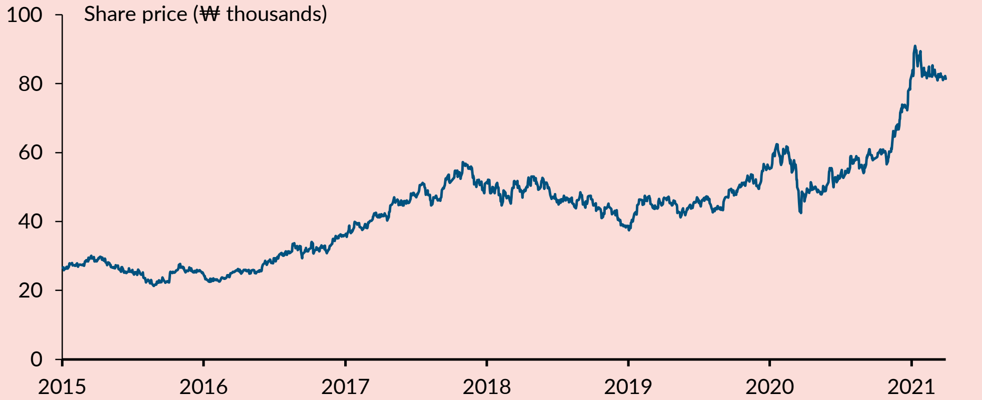
Yet business chambers still ask for a pardon

This simple fact raises doubts about the wisdom of local business chambers who, predictably, are planning to call on President Moon to pardon Lee. In late April 2021 the media reported that five major business groups were preparing to write a joint letter to the government to this effect. A draft of the letter leaked to the media contained the usual arguments put forward whenever a *chaebol* chairman is packed off to jail, namely the economy is uncertain, the company is critical to the national economy, and the chairman's freedom is essential.

"Lee's incarceration makes no difference for investors."

Figure 11

One direction: The rise and rise of Samsung Electronics' share price, 2015-2021



Source: Yahoo! Finance

Figure 12

Twists and turns: key dates in JY Lee's two trials and Samsung responses, 2017-2021

Date	Court / lead agency	Trials of JY Lee	
		Political bribery trial	Samsung succession probe
25 August 2017	Seoul Central District Court	Lee sentenced to five years in prison	-
5 February 2018	Seoul High Court	Lee appeals ruling and wins	-
14 November 2018	SFC	-	Concludes Samsung BioLogic's account breach intentional, refers case to the prosecution
29 August 2019	Supreme Court	Orders retrial	A series of arrests, searches and investigations continue
25 October 2019	Seoul High Court	First hearing for retrial; Judge Jeong says Samsung could set up a compliance committee	
9 January 2020	Samsung establishes a compliance committee		
17 January 2020	Seoul High Court	Fourth hearing; judge changes stance and links compliance committee to a reduced sentence	Probe continues
24 February 2020	Prosecution	Requests recusal of Judge Jeong, questioning his fairness	
17 April 2020	Seoul High Court	Dismisses recusal request, says no evidence of unfair treatment, remedial measures acceptable	
23 April 2020	Prosecution	Appeals to the Supreme Court, which took on review in June	
6 May 2020	JY Lee issues public apology in response to a recommendation from the Samsung compliance committee and gives assurances on succession and labour union rights. Lee pledges not to pass on the business to his children.		
26, 30 May 2020	Prosecution	Judicial machinery grinds on	Lee summoned for questioning
2 June 2020	JY Lee		Lee requests that an external panel of independent experts be formed to review his case (a right introduced only in 2018)
4 June 2020	Prosecution		Files arrest warrants for Lee and two former executives
9 June 2020	Seoul Central District Court		Dismisses prosecution motion on the grounds that their evidence falls short. Prosecutors continue probe
26 June 2020	External Review Panel		Panel votes against prosecution of Lee after 9-hour debate. (Note that this decision has no legal binding.)
18 January 2021	Seoul High Court	Lee sentenced to 2.5 years in prison for bribery	-
22 April 2021	Seoul Central District Court	-	First trial on alleged succession irregularities; Lee pleads not guilty

Note: Blue row highlights significant events happening outside the courtroom. Source: ACGA research

3. CG rules

Korea ranks 10th on an improved score of 56%

Korea's score rose by an impressive 11 percentage points in this category to 56%, but its ranking stayed the same at a lowly 10th place - reflecting the fact that many markets, especially those in the middle of our rankings, enjoyed a boost to their CG Rules score because of changes in our scoring methodology. Another determining factor in Korea's low ranking is that, historically, this category has been one of the higher scoring ones in our survey. The leading market, Australia, regularly scores around 80% for CG Rules, while a group of other markets achieve 75% or more: Hong Kong, Malaysia, Singapore and Thailand.

Korea's CG rulebook is a mix of the good, the mediocre, and the bad

As noted in previous CG Watch reports, Korea typically scores quite highly for financial reporting standards and has quite robust rules on paper regarding material non-public information, insider trading, an investor stewardship code, and limiting the number of directorships that an individual independent director can hold. It is much weaker on things like CG and ESG reporting rules, disclosure of share pledges, disclosure of executive and director remuneration, and having a blackout period for director trading before the release of financial results. And it is well behind the curve in the way it addresses takeover bids and capital raising through private placements.

The government has started to address some long-standing problems

The good news is that partly because of regulatory reforms introduced over the 2019-20 period - as outlined in the section on Regulators - Korea has started to address some of these weaknesses. Hence its higher score for CG Rules is not just about methodology, there are genuine areas of progress too. At the same time, Korea lost points in some areas because: a) it has made no change to a rule while other markets are moving ahead; or b) it has made a change but this will not take effect for some time, whereas other markets are surging ahead. Figure 13 gives a feel for some of these ups and downs in our scoring:

Figure 13

Swings and roundabouts: selected changes in Korea's CG rule scores, 2018 vs 2020

Question	(Scores out of 5)		Comment
	2018	2020	
Q3.2: Do CG reporting standards compare favourably against international standards?	1	3	Mandatory CG reporting standards that took effect for large listed companies in 2019 have brought a welcome level of transparency - yet issuers only need to report against three of the five chapters in the revised 2016 Code of Best Practices for Corporate Governance (see analysis in text below under "Limitations" subheading)
Q3.3: Do ESG/sustainability reporting standards compare favourably against international standards?	2	1	Korea has been a long-term laggard on ESG reporting. In January 2021 the FSC and KRX announced that standards were finally coming, but they will not take effect until 2025 for large firms and 2030 for all issuers. A disappointing outcome
Q3.5: Is timely disclosure of "substantial ownership" required (ie, a 5% stake) as well as "creeping" increases/decreases of 1%?	5	4	We deducted a point following a change in our scoring methodology to take account of the fact that Korea allows a somewhat longer disclosure deadline (5 days) than leading markets (3 days)
Q3.16: Must companies disclose the exact remuneration of directors and top five key management personnel by name?	2	3	Despite much remuneration disclosure still being in aggregate, the new CG reports of large issuers provide useful detail by named director
Q3.19: Can minority shareholders easily nominate directors?	0	5	As for Japan, we re-rated this question and based it more on formal rules than market practice. The rights of shareholders are quite robust in Korea (eg, low ownership thresholds, access to the company proxy statement). And some leading companies are inviting shareholders to nominate independent directors

Source: ACGA

Policy progress

Specific policy changes undertaken over the past two years in Korea to strengthen CG and ESG reporting rules and board governance include the following:

Large issuers told to follow new CG reporting rules from 2019

- **Mandatory CG reporting:** Introduced in December 2018 for large listed companies with total assets of ₩2 trillion (US$1.8 billion) or more, the rule took effect from 2019 through an amendment to the Kospi Market Disclosure Rules (section 24-2). This was preceded by the introduction of voluntary CG reporting in March 2017 and a joint FSC-KRX statement in March 2018 saying they would introduce a mandatory rule for 2019 - and so they did. The press release further said that the FSC was considering expanding the mandatory disclosure rule to all Kospi companies "starting from 2021" and a footnote said it was planning the same for Kosdaq companies. However, KRX told ACGA in September 2020 that the target date for all Kospi companies had been moved to 2026.

The new CG reporting template provides some useful insights into Korean companies

Disclosure guidelines for the new CG reports were produced in April 2019. Although such "template reporting" can lead to highly formualic disclosure - and the Korean reports suffer from this problem along with their counterparts in other markets - some of the disclosure lines provide information that is more probing than found in many other markets, such as:

- Adoption of a lead independent director system and a "council of independent directors", including a list of council meeting dates and topics discussed
- A full list of dates for all investor relations activities, including any non-deal roadshows (NDRs) during the year; (but note that the content of NDRs is not usually provided)
- A full list of any self-dealing transactions involving companies related to individual directors and approved by the board
- A full list of transactions with related parties and the profit/loss made
- Details on the voting decisions of individual directors in board meetings over the past three years, expressed in terms of average percentage approval rates (eg, "100%" would mean a director has voted in favour of all resolutions in all board meetings during the year).

Some CG information is not found elsewhere

Aspects of the types of disclosure rarely found in other markets include the agenda of independent-director meetings, self-dealing transactions involving directors, the profit or loss made from each related-party transaction (RPT), and director voting approval rates. It is this latter data that allows CG experts and the media in Korea to see if independent directors are voting against anything at board level. Usually not!

Large companies must now have at least one female director

- **No single-gender boards:** In February 2020, the Financial Investment Services and Capital Markets Act was amended to prohibit large listed companies with total assets of ₩2 trillion or more to form single-gender boards. While the rule formally took effect from 5 August 2020, firms have a grace period until 5 August 2022 to appoint at least one female director. According to research by the Korea Corporate Governance Service (KCGS), the number of issuers appointing new female directors during the March 2020 AGM season increased significantly despite the new rule not yet taking effect. At the end of that month, a total of 45 firms had at least one female board member - an increase of 21 firms compared to before the AGM season. However, this still left 102 companies subject to the new rule that were without a woman on their board in 2020. KCGS advised firms not to appoint a woman director for tokenistic reasons, but to find someone who could add real value.

ESG reporting guidelines coming - but won't be mandatory until 2025

- **New ESG reporting rule/guidelines:** In January 2021, the FSC unveiled a policy to require ESG reporting by listed companies in phases. Companies listed on the Kospi with assets of ₩2 trillion or more will be required to disclose from 2025, while all listed companies will have to do so from 2030. Prior to these deadlines, the KRX will encourage voluntary disclosure by publishing guidelines and an ESG Index. According to the regulator, around 100 companies already publish internal ESG data, but only 20 regularly disclose this information in a public report. Meanwhile, another driving factor is the growth of ESG investing: one media outlet, the Korea Herald, estimated the volume of ESG-oriented funds now stood at ₩33 trillion (US$29.7 billion), with the National Pension Service accounting for 90% of total "ESG transactions".

Limitations
While the changes above are positive, there remain some significant limitations in Korea's corporate governance rulebook. For example:

Mandatory CG reporting is confined to only 10 core principles

- **Scope of "comply or explain" CG reporting:** Current disclosure rules follow a concept introduced in 2017, the "10 Core Principles", whereby the FSC and KRX simplified the new CG Code of 2016 and encouraged companies to disclose against just 10 major principles from the first three chapters of the Code. These are titled in order: Shareholders, Board of Directors, Audit Systems. This approach was intended to make it easier for companies to comply when reporting was still voluntary, but the low take-up rate by issuers in 2017 (only 71 companies) and 2018 (96 companies) forced the regulator to issue mandatory rules in late 2018, as outlined above under "Policy progress". By then the 10 Core Principles were hard-baked into the amended Kospi Market Disclosure Rules.

Companies do not need to report on two chapters of the CG Code

While the rule change led to a doubling in the number of companies producing CG reports - 209 in 2019 and 221 in 2020, according to KRX data - it meant that listed companies, even the largest ones, could ignore the final two chapters of the CG Code. These deal with Stakeholders and Management Monitoring by the Market, sections which contain some quite far-reaching accountability measures such as the involvement of creditors in the monitoring of management, the participation of employees in management through labour-management councils, and the fair way to handle takeovers and other M&A deals. Korea is therefore in a curious position of being the only market in the region that formally ignores significant parts of its own CG Code.

Minority protections are a mixed bag of goodies and baddies

- **Minority shareholder protections:** This area continues to be a sore point for foreign investors in Korea and has been a frequent topic in our CG Watch reports over the years. To be fair, Korea has some quite enlightened rules in areas such as the nomination of directors and, virtually unique in the region, a few of its leading companies (eg, KB Financial, Hyundai Glovis) proactively invite shareholders to nominate independent directors - and then welcome these people to their boards. On the other hand, Korea continues to lack a proper mandatory bid rule for takeovers (ie, it sets no general-offer threshold of say 25%-20%, thus allowing listed companies to be taken over without a fair price paid to all shareholders) and its rules on capital raising through private placements (third-party allotments) are unfair for minority shareholders: no approval rights in an AGM, no cap on size of issuance, and controlling shareholders are allowed to participate. Discounts are however limited to 10%, which is a positive. Although in practice secondary equity issuances are fairly rare in Korea - companies conserve cash and prefer to raise debt if they need an injection of capital - this is not a good reason not to improve the rules. Indeed, it may offer regulators an opportunity to do so. Takeovers, on the other hand, do occur and routinely offend institutional investors. This reinforces the view that Korea is not a market that treats all shareholders fairly.

Flaws in the composition of nomination committees

- **Nomination committees**: Under the Commercial Act and other relevant laws, "outside-director nomination committees" are mandatory for large listed companies, financial holding companies, commercial banks, and certain other financial institutions. The CG Code, moreover, recommends the establishment of a nomination committee (NC) for both inside and outside directors. While at least one-half of NC members are required to be outside directors, the chairman can be an insider - a major weakness in ACGA's view. According to an October 2019 survey by the Korea Corporate Governance Service (KCGS), a think tank and proxy advisory service funded by KRX, only 18 out of 174 listed companies appointed outside directors to chair their nomination committees. And it gets worse: NCs held on average just 1.2 meetings per year between 2016 and 2018. Most of these meetings were convened to nominate new candidates and only six of the 353 meetings held discussed other agenda items, such as the operation of the nomination committee advisory council, internal policy revisions, and committee operation plans.

Short cooling-off periods

- **Independent director definition**: The Commercial Act is quite progressive in limiting the number of outside directorships to just three per person, thus ensuring "overboarding" is not an issue with independent directors in Korea, and mandates that they account for at least half the board of large companies. But other rules are less enlightened. One of the weaknesses is a requirement that the "cooling-off period" for former executives, employees and auditors only needs to be two years.

Retreating: Dual-class shares

The government became enamoured of DCS for unlisted startups in early 2018

Without question, the most disappointing aspect of CG reform in Korea in recent years has been the government's capitulation to the tech industry's arguments in favour of dual-class shares (DCS). This issue first reared its head in early 2018 and built up steam over 2019 and 2020. The Ministry of SMEs and Startups tasked the Korea Small Business Institute (KOSBI) with undertaking a review of DCS. This review was finalised at the end of December 2019, with KOSBI not surprisingly concluding that DCS was necessary because it would allow startups to raise capital without fear of diluting management control. It claimed that such fears were genuine in Korea: a survey of 209 startups found that 56% were worried about dilution. Conversely, Solidarity for Economic Reform (SER) argued against DCS in a November 2018 paper and highlighted, among other things, that a 2011 amendment to the Commercial Act already allowed for non-voting shares and redeemable convertible preference shares, yet virtually no company had adopted such capital structures as of June 2018. Hence, there appeared to be no reason to institute new management-protection measures to encourage startup IPOs.

The ruling party forged ahead in 2020, making DCS an election promise

The government, nevertheless, forged ahead and in January 2020 said it would include DCS as an election promise for the April 2020 general election. The SME minister, Park Young-sun, then said in late January 2020 that the government planned to institutionalise DCS within the year. A bill was tabled by a Democratic Party politician in the National Assembly in June and the Ministry of SMEs and Startups held a public hearing in July. Interestingly, in early August 2020, the United Future Party, the main opposition party, tabled its own, somewhat more liberal DCS bill. For example, whereas the Democratic Party had sought to put a cap of 10 votes per share, the opposition bill set no cap.

A bill was tabled in late 2020, but had yet to pass as of April 2021

To cut a long story short, the ruling party presented its bill on DCS to the National Assembly in December 2020 and the issue was energised in mid-February 2021 when local ecommerce darling, Coupang, announced it was going public in the US with a DCS structure of 29 votes for each share held by the founder, Kim Bom-seok. At the end of March, the chairman of KRX, Sohn Byung-doo, told the press that dual-class shares were needed to help local unicorns go public in Korea. As of end-April 2021, however, the government's bill had yet to pass. While the government, opposition and tech industry are all in favour, a number of key legislative committee members within the National Assembly are opposed.

Expand CG reporting to the entire CG Code

Next steps

Expand mandatory "comply or explain" CG reporting for large companies from the 10 Core Principles to all five chapters of the CG Code.

Speed up phase in of ESG reporting rules

Bring forward the starting date for mandatory ESG reporting from 2025 to no later than 2023. Since many large Korean companies already produce detailed sustainability reports, this is unlikely to be too onerous for the largest firms. Indeed, they have long produced better sustainability reports than CG reports.

A taskforce to review shareholder rights

Form a taskforce to review the whole gamut of minority shareholder rights in Korea, starting with a reintroduction of the mandatory bid offer rule in takeovers. In particular, benchmark Korea against a basket of leading capital markets around the region and globally.

Consider updating some basic CG rules

Review the composition of nomination committees to ensure greater independence and the definition of independent directors. Are these rules still fit for purpose or do they need to be updated?

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

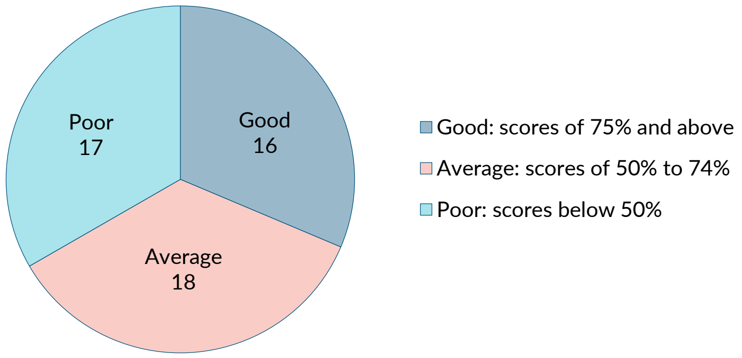
Korea ranks 10th on an improved score of 48%

Korea's score in this category improved a significant 10 percentage points to 48% and its ranking edged up from 11th in 2018 to 10th in 2020. It earned higher scores in six of the 20 market-level questions and lower scores in four, although this was partly due to changes in our evaluation process and scoring methodology: we reduced the number of questions and re-rated the way we scored others. One important change from 2018 - and a reason for improved scores overall for large caps - was our greater use of Korean language reports and announcements. We relied more heavily in 2018 on English-language materials and, given their relative scarcity in Korea, this naturally brought down scores across the board. While corporate disclosure is getting better, Korean issuers still have some way to go: aggregate results showed that large-cap issuers performed well in only 16 of 51 questions, averagely in 18, and poorly in another 17 (see Figure 14).

Korean large-cap CG performance was evenly split between "good", "average", and "poor"

Figure 14

Korea: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where Korea does well

Korean IR is good

In general, companies in Korea provide investors with comprehensive and quick access to financial and business information. Issuers make timely announcements on corporate actions either on their own websites or databases managed by regulators. The larger companies publish AGM agendas and detailed circulars, including the profiles of directors nominated for election, several weeks prior to their annual meeting. And we found that 10 of the 15 firms surveyed publish a precise breakdown of AGM voting results on their websites shortly after the meetings. (Note: The other five publish the full voting results only in their "CG reports", which are not released until June. Such a delay is excessive, in our view, and should be addressed by regulators. Another best practice that Korean firms have yet to adopt is the publication of the Q&A with shareholders during the AGM.)

Financial and business reporting is high quality

Due to stringent financial reporting rules, Korean firms mostly score well on a series of questions we asked about reporting on specific areas of financial and business performance. Issuers generally provide a detailed outline of trade receivables and payables in their balance sheets, as well as clear explanations of acquistions and divestments. They also score highly for the comprehensiveness of the management discussion and analysis sections in their annual reports. (Note: They do less well on disclosure around loans, however, and poorly on giving a detailed breakdown of operating expenses by function and nature or, conversely, have a substantial amount of unexplained "other expenses".)

All 15 large caps have independent AC chairmen

The 15 firms surveyed did extremely well on the independence of audit committee (AC) chairmen, with all scoring full marks. Looking at the expertise of AC chairmen, we found that 11 out of 15 appeared to have clear competence in finance or accounting. Disclosure of audit and non-audit fees is also comprehensive.

Korea is unique in asking how directors voted during the year

A further area of strength is the provision of statistics on director attendance at both board and committee meetings. As noted in the CG Rules section above, moreover, Korea is unique in asking companies to disclose how their directors have voted in board meetings during the year. These figures come only in aggregate form, however, and typically show the percentage of votes cast in favour by each director on all board resolutions during the year.

Where Korea performs averagely

Not much divulged on interactions with shareholders, stakeholders

The quality of disclosure on engagement with shareholders and other stakeholders is less impressive. For shareholders, issuers tend to disclose only the frequency and types of investor relations engagements: none share details on the nature of the discussions, while one disclosed no shareholder engagement. It was a similar story for stakeholder engagement: most annual reports assessed include only a generic discussion that is not specific to the year in question.

Shallow reporting on board activities

The depth of reporting on board activities remains shallow. Many companies disclose only a generic agenda for their committees. Board evaluation is mentioned, but most issuers say little about the results of this exercise. Only one of the 15 issuers discloses that it periodically appoints a third-party consultant to assist with its evaluation.

Policies on mitigating internal corruption are mixed

Policies and performance on mitigating internal corruption are mixed. A high number of large-caps - 12 of 15 - do well in informing employees and others on how to make whistleblowing complaints and give assurance that the process will be confidential. While a similar number have public whistleblowing policies, only two of the 15 scored full marks for having policies that met all the criteria we were assessing. Three have no policy, which brought down the aggregate score. As for codes of conduct, we found that seven of the 15 had no publicly available code or only briefly mentioned its existence within their annual report or websites. More positively, of the eight issuers that published a public code, six extended it to their suppliers.

The handling of materiality in ESG reports could be improved

Issuers in Korea scored averagely on the issue of materiality in ESG and sustainability reports. Most large-caps - 13 out of 15 - provide a summary of materiality in the form of a matrix, table or list, but only six have a detailed discussion as to how materiality is determined and how it is relevant to their business. On the management of material issues, companies generally discuss most of their respective SASB-identified issues. But they could improve on the quality of this discussion by disclosing quantitative and/or qualitative targets to address these issues.

Disclosure of top shareholders not as detailed as other markets

Finally, the disclosure of top shareholders could also be improved. Although issuers are required to disclose their largest shareholder and related parties in their annual report, as well as any independent substantial (5%) shareholders, they do not provide a complete list of their top 10 to 20 beneficial owners as is becoming more common in other markets. Meanwhile, this disclosure in Korea is typically found only in the Korean-language "business reports" (ie, annual securities reports) that are published shortly after AGMs in late March. While some of the 15 issuers we surveyed publish English versions of these reports - usually recast as glossy corporate annual reports with lots of graphs and pictures - these documents are much shorter than the Korean version and leave out substantial pieces of information, including large shareholder details.

Where Korea does poorly

Disclosure on director training is weak

One area where Korean board governance is clearly underperforming is director training. Most issuers we surveyed provide it to outside directors only. Two companies made a virtue out of not providing training, stating rather arrogantly that "all outside directors are deemed to have sufficient knowledge and expertise", but that "we will consider it in future if necessary". On a more positive note, the issuers that did organise training described it in some detail, giving director attendance statistics, training dates, organisers and objectives.

Do audit committee members have sufficient expertise? It is hard to tell

While on the subject of director skill, one matter in need of attention is audit committee (AC) expertise. While most AC chairmen hold relevant accounting or financial expertise, as noted above, only two companies have committees where a majority of members have similar skills. Some AC members come from a general business and economic background, while others have worked in PR, marketing, technology, social work, engineering, the law and so on. While there may be value in having such people on the AC, it would help if companies disclosed the reasons and their level of financial literacy. Since disclosure of AC training is mandatory, this is an area that companies should be able to address quite efficiently.

Disclosure of director pay is mostly aggregated, not by individual name

Remuneration disclosure could also be improved: while most issuers disclose the packages of their top five executives, since earnings above ₩500m (US$450,000) must be disclosed, only aggregate numbers are given for directors who are not executives. General practice is to disclose total remuneration per group - that is, for inside directors, audit committee members, and other outside directors. Only two issuers disclosed fees by individual director. Moreover, clear policies on how independent director fees are derived are usually not disclosed, with only one company doing so.

Only 3 of 15 issuers had a plan for improving board diversity

Like many other markets in our survey, Korea underperforms on the discussion of board diversity. Although most large caps mention the issue, only three of the 15 have a plan for improving it. Ideally, companies should also provide a "skills matrix" illustrating the broad range of skills that each director brings to the board, with a link to the business and future challenges. But issuers typically disclose individual director biographies only, with just two of the 15 having a skills matrix (but with no clear link to their business).

Independent board chairmen are rare

Lastly, truly independent chairmen are fairly rare in Korea. Of the 15 large caps, seven have a chairman whom they designate as independent. After a deeper look at their background and relationships, however, we concluded that four of them were probably not independent. Meanwhile, of the remaining eight large caps, only one has appointed a lead independent director.

Korean corporate scorecard

Figure 15

Helicopter view: Rating Korea's CG disclosure and governance, 2020

Good	Average	Poor
❑ Corporate announcements beyond five years ❑ Detailed AGM circulars and prompt release of voting results (most large issuers surveyed) ❑ Disclosure of trade receivables and payables ❑ Clear explanation of acquisitions and divestments ❑ Audit committees chaired by independent directors ❑ Disclosure of audit and non-audit fees ❑ Director attendance statistics ❑ Top 5 manager remuneration provided for ₩500m or above	❑ AGM reports lack Q&A discussion with shareholders ❑ Companies disclose controlling and substantial owners, but limited disclosure on other beneficial owners ❑ Generic discussion of shareholder and stakeholder engagement ❑ Board committee reports remains basic ❑ Companies do board evaluations, but do not use third-party assessors, nor share results ❑ Policies for mitigating corruption are mixed ❑ Limited discussion on the management of ESG materiality	❑ Incomplete breakdown of operating costs, explanation of "other expenses" ❑ Director training often limited to non-executive directors only ❑ Limited discussion of remuneration policy for INED fees ❑ Director remuneration disclosure aggregated by group: inside, AC, and other outside directors ❑ Board skills matrix and targets for improving board diversity are mostly lacking ❑ Independence of board chairmen limited, and only one case of a lead independent director

Source: ACGA, ARE

ACGA recommendations for Korean companies

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- Issuers to publish detailed voting results on websites immediately after AGMs; and share AGM minutes or recordings, with shareholder Q&A
- Disclose beneficial ownership in a top 10-20 shareholder list
- Better disclosure on operating costs, with minimal aggregation of "other expenses". If the latter are aggregated, they should be explained
- Train all directors, not just non-executive directors
- Disclose director remuneration by individual and have a clear independent director fee policy
- Discussion of board skill matrices to ensure an appropriate mix of skills relevant to the business, plus plans and targets to improve board diversity
- Sharing clear whistleblowing policies and codes of conduct with the public

Medium to long-term challenges

- Audit committee members need more training in accounting and finance
- More proactive shareholder and stakeholder engagement
- Higher quality board committee reporting
- Use external third-party consultants for board evaluations, disclose outcomes
- Improve the quality of ESG/sustainability reports, including the materiality process and the setting of quantifiable targets
- Boards to have independent chairmen, with no links with the company, affiliates or the largest shareholder

No electronic AGMs were held by the top 50 companies in 2020

Electronic meetings in Korea: What meetings?

While there is no explicit regulation prohibiting hybrid AGMs in Korea, the absence of such a rule in the Commercial Act has been interpreted by most as implying they are not allowed. The lack of any official guidance on electronic meetings from the FSC following the start of the pandemic also ensured that none were held in 1Q20, the period when annual meetings are held in Korea, as the figure below shows. What the regulator did, however, was to instruct firms to encourage voting by electronic means, post or through proxies before meetings. It also suggested firms could consider delaying their annual meeting to a date after April if the necessary financial or other statutory submissions could not be made before then, although none of the large caps did so.

Yet Korea has an advanced e-voting system

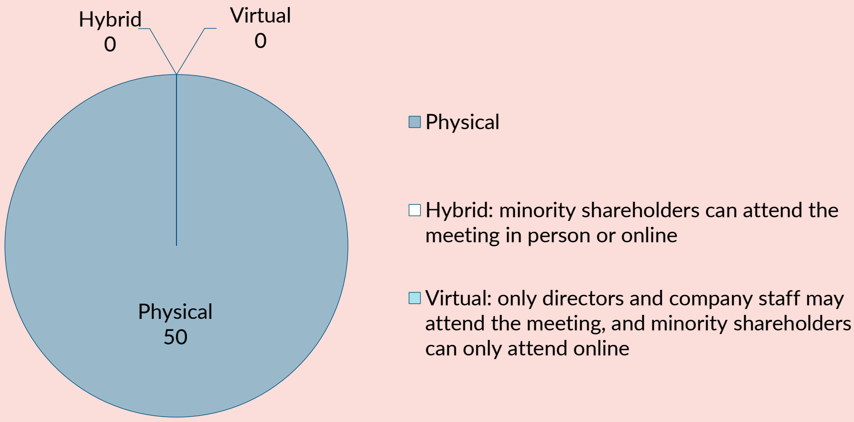
The absence of guidance on electronic meetings would appear to be out of kilter with Korea's generally tech savvy society and the fact that the Korean Securities Depository (KSD) has developed an electronic voting platform - similar to what one sees in Japan and Taiwan - that allows both retail and institutional shareholders to vote more efficiently before meetings. A generous interpretation might be that AGMs come early in Korea - between late-February and the end of March - and planning for them was completed before the pandemic took hold in 2020. Even so, the fact that virtually no listed company offered to webcast its AGM in 2020 was disappointing.

ACGA undertook an analysis of the AGMs of the top-50 issuers by market cap in Korea and found all held physical meetings in 2020.

Physical vs electronic: 50 to 0 final score

Figure 16

AGM modes in Korea: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

Korea ranks equal 3rd on a score of 44%

This has been one of Korea's better performing categories in recent years and it did not disappoint overall in our latest survey, with the score increasing by a substantial 11 percentage points to 44% and its ranking improving from equal 5th with Taiwan in 2018 to equal 3rd with India in 2020. Taiwan meanwhile has dropped to 7th.

Korea's overall score hides underlying volatility

While Korea is definitely making progress in Investors, the points gap with the two leading markets - Australia at 66% and Japan at 60% - is one indication of how much further it could go. Another is that the increase in score hides some volatility in the sub-categories: the score for institutional investors rose an astonishing 20 percentage points, largely due to enhanced effort from domestic investors, while that for retail investors fell 12 percentage points, mainly because of changes in our methodology.

The domestic dimension

Most large investors in Korea have voting policies

First up in our review, undertaken in 3Q20, was the voting policies of the five largest domestic asset owners and 10 biggest domestic asset managers. Two of the asset owners, the National Pension Service (NPS) and Korea Teachers Pension Fund, make their voting policies public and NPS votes explicitly in consideration of ESG factors. We also found that all but one of the domestic asset managers have voting policies, although these tend to be part of their stewardship code statements rather than standalone documents. They largely follow guidelines from the Korea Corporate Governance Service (KCGS), which oversees the code, and the Korean Financial Investment Association. Among those with policies were the largest asset managers, such as Samsung Asset Management and Mirae Asset Management, as well as Shinhan BNP Paribas Asset Management and Heungkuk Asset Management.

Institutions must disclose how they vote, down to the company level

In terms of voting, domestic asset owners and managers do vote their shares. Two of the five asset owners disclosed their voting records, as did all of the asset managers, although we must note that we encountered frequent difficulties accessing the most complete records, which are available in Korean on KRX's KIND platform. Once we had the records, we found asset managers largely followed best practice by disclosing voting to the company and resolution level. Although three had mostly boilerplate disclosure on this point, others offered reasons for voting against, with some providing an impressive level of detail, for example providing the names of individuals and specific relationships that had triggered independence concerns.

Limited information on AGM participation

Although all the asset managers and most of the asset owners in our survey have signed Korea's Stewardship Code, this has not translated into AGM attendance: only two of the asset managers and none of the owners indicated they attended annual meetings in person and these only rarely.

Voting patterns

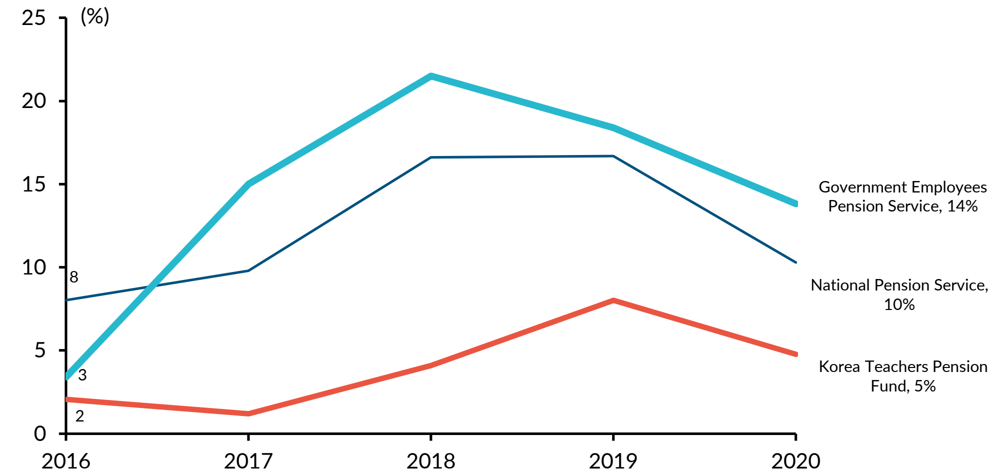
Korean investors are utilising their voting rights more actively

In our previous CG Watch report, we emphasised how both domestic asset owners in Korea, led by the NPS, and domestic asset managers were voting against an increasing number of resolutions since the introduction of the Stewardship Code in December 2016. The ratio of votes against by the NPS doubled from about 8% in 2016, before the code came in, to more than 16% two years later in 2018. As the following figure shows, the level of voting against by the NPS remained steady in 2019 and fell in 2020, a function in part of adjustments to its voting guidelines. There were similar falls in 2020 in the rates of voting against by the Korea Teachers Pension Fund and the Government Employees Pension Service, a trend that suggests the Covid pandemic may have also been a factor in influencing voting decisions. Indeed, some initial data from KCGS on 2021 voting patterns suggest a return to somewhat higher rates of voting against by certain public pension funds. (Note: Data is from KCGS and covers both the Kospi and Kosdaq markets. It excludes non-resolution items, bundled items, and shareholder proposals.)

Korean pension funds vote a material portion of their shares against management resolutions

Figure 17

Korean pension funds: Ratio of voting against, 2016-2020



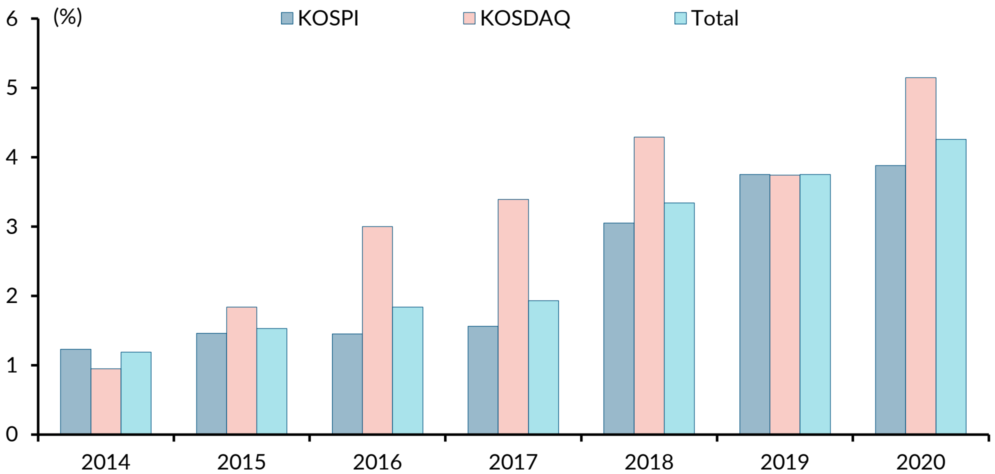
Source: Korea Corporate Governance Service

Asset-manager voting against has also been on the rise

Patterns of voting against by domestic asset managers also show the impact of the Stewardship Code and a heightened awareness of using voting rights diligently. As the figure below shows, from a very low level of 1.19% overall for companies on both the Kospi and Kosdaq indexes in 2014, the ratio of total votes against reached 1.84% in 2016 and 4.26% in 2020. It is interesting to note that votes against the smaller issuers on Kosdaq have been notably higher than for the Kospi in most of these years. (Note: Data is from KCGS and covers both the Kospi and Kosdaq markets. It excludes non-resolution items, bundled items, and shareholder proposals.)

Figure 18

Korean asset managers: Ratio of voting against, 2014-2020



Source: Korea Corporate Governance Service

Signatories to the code vote against more than non-signatories

KCGS has also measured the impact of signing the Stewardship Code on an investor's willingness to vote against. Looking at both voting on Kospi and Kosdaq companies, it found that, in aggregate, signatories tripled their rate of voting against - from 2.42% in March 2017 to 7.61% in March 2018. Over the same period, non-signatories increased their rate of voting against only marginally - from 1.99% to 2.23%. Similar differences were apparent for subsequent periods from 2018-19 and 2019-20.

NPS published stewardship guidelines in early 2019

Company engagement

In January 2019, the NPS issued guidelines for meeting its Stewardship Code commitments, articulating it would exercise its shareholder rights where it held a 5% or more stake in a company and outlining four key areas for engagement:

- A clear and reasonable dividend policy;
- Suitable compensation limits;
- Impairment of corporate value, for instance through violation of laws; and
- Failure to show improvement despite NPS encouragement.

Disclosure of engagement activities is growing

In our review of five major Korean asset owners, we found that NPS was the only pension fund to demonstrate it had undertaken individual engagement with investee companies. Yet seven of the 10 asset managers provided evidence of individual company engagement, including both open letters and the more common informal communication with companies. Five of these investors also report on their engagement activity in annual stewardship reports, most with some narrative explanation.

The nature of domestic asset manager engagement is changing

In May 2020, KCGS published the results of a review of institutional investor engagement over 2018-19 and 2019-20 (both years from April to March). Contrary to its expectations of an increase during this period, the number of engagement activities actually decreased slightly - from 178 items in the former fiscal year to 165 items in the latter. More interestingly, the range of engagement themes changed. Whereas "shareholder return and financial structure improvement" had dominated in 2018-19, accounting for 58% of themes discussed, this had dropped to 35% the following year. Meanwhile "ESG" jumped from 38% to 58%. The KCGS findings also show that private letters and dialogue make up the vast majority of engagement activities, with open shareholder letters relatively few in number. This broadly accords with our findings.

ACGA surveyed its members in Q3 2020 on voting and engagement in Asia-Pacific

The foreign dimension

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific public equity markets we cover. Almost half of our investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As expected, the responses showed that Korea is an important market for foreign institutional investors:

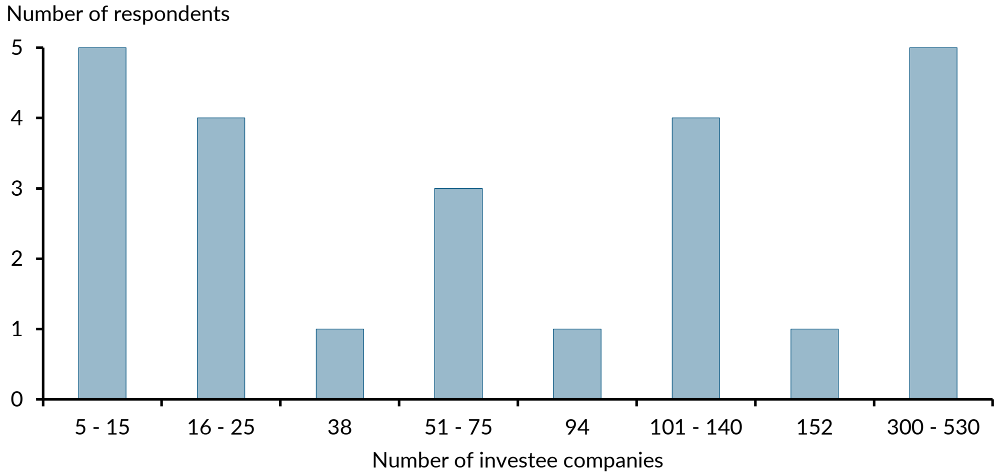
- Some 87% or 39 respondents invest in Korea - this puts the market slightly below China, Hong Kong, India and Taiwan; broadly on par with Indonesia; and above other markets.
- Only 24 respondents provided data on the exact number of Korean publicly listed companies they invested in. Of this group, the average number of investee companies per respondent was 128, with a median of 70 and range from five to 530.

Another way to show the extent of investment in Korea is to group portfolios by size. As Figure 19 shows, most respondents are at either the lower end of the chart (25 companies or less) or at the upper end (100 companies or more). Five respondents own between 300 to 530 companies each. The remainder of the group are mostly in the middle, holding 51 to 75 companies each. This chart is one of the more unusual in our survey: in most markets the proportion of investors holding large numbers of companies drops off quite noticeably in a typical bell curve distribution.

The distribution of foreign-investor portfolios by size is unusual

Figure 19

Foreign investors in Korea: By size of portfolio, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Investor Member Survey, September 2020

Most respondents vote in 100% of AGMs and vote against in 34% of meetings

- As expected, respondents take voting seriously in Korea and voted against management resolutions in a third of the AGMs in which they participated in 2020:
- The vast majority of foreign institutional investors vote in 100% of AGMs each year, but two vote in 90-95%, one in 36%, one in 17%, and one does not vote in any.

On average, they voted against at least one management resolution in 74 meetings in 2020. The median figure was 19 meetings, with a range from zero to 395. The median average puts Korea below China, Hong Kong and Japan for votes against, but well above most other markets.

As a proportion of their holdings, respondents voted against at least one management resolution in 27% of meetings.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Foreign company engagement

Korea ranks 5th for individual company engagement

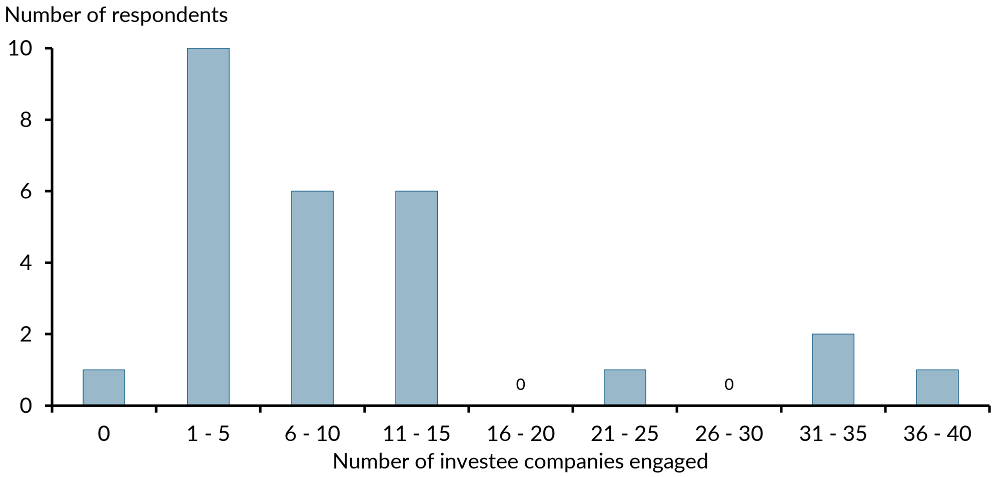
In aggregate terms, Korea is the fifth largest market in Asia-Pacific for foreign-investor engagement after Japan, China, Australia and Hong Kong. The total number of individual company engagements in Korea among respondents was 285 companies over 2019 and 2020, with an average of 11 per respondent.

Again, a more representative way of illustrating this is to show it as a distribution. Of the 39 respondents who indicated that they invest in Korea, 27 answered our question on company engagement. As Figure 20 shows, most of the respondents who answered the question engaged individually with 10 or fewer firms over the two years. Six respondents engaged with 11 to 15 companies and a few more with 20 or above.

Most respondents engaged with 10 or fewer firms over 2019 to 2020

Figure 20

Foreign investor engagement prevalence in Korea, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Top engagement issues for our members

What do foreign investors engage on? We received input from our Korea Working Group, a sub-group of ACGA investor members comprising foreign institutions and working with us on regulatory advocacy in Korea. They highlighted topics such as the following:

- Board composition, diversity, and independence;
- ESG and sustainability risk management;
- Coal financing; and
- Capital management: dividends, use of spare cash, investment allocation.

Next steps

Stewardship reports in English

More disclosure in English of Korean asset owner and manager stewardship reports (or report summaries) would be welcome.

A domestic-foreign investor dialogue?

There is limited dialogue at present between domestic and foreign institutional investors on CG and ESG issues in Korea. A healthy exchange of views could benefit both groups.

Opportunities for collaboration

Collective investor engagement is rare. With the backing of the Stewardship Code and relaxation of the 5% rule, opportunities for collaboration should increase.

6. Auditors & audit regulators

Korea ranks 8th on a score of 70%

Korea's score increased marginally by one percentage point to 70% and its ranking remained at 8th. Our more stringent scoring methodology led to slight falls in score for auditing standards, the independence of external auditors, the powers of the audit regulator and disclosure by the latter of its enforcement action. Scores increased however in four areas: disclosure of audit and non-audit fees; preparedness of large listed companies and mid-cap issuers for their audits; and disclosure by the audit regulator of its annual inspection programme.

Korean accounting standards are fully aligned with IFRS and well communicated

Standards

Listed companies in Korea are required to use Korean International Financial Reporting Standards (K-IFRS), which are fully converged with IFRS standards. There are no carve-outs or modifications. Standards are set by the Korea Accounting Standards Board (KASB), which closely tracks international developments and actively participates in IASB consultations on new standards. A handy list comparing K-IFRS standards with IFRS can be found on the KASB English website and is quite comprehensive, though does not appear to be fully up to date. A more updated list is on the Board's Korean website.

The process for updating Korean auditing standards is less transparent

The state of play for Korean auditing standards is somewhat less clear. Standards are set by the Korean Auditing and Assurance Standards Board, formed by the Korean Institute of Certified Public Accountants (KICPA) under delegation from the FSC. However, there is only limited information in English on the process for updating Korean Standards on Auditing (KSAs) with their counterpart International Standards on Auditing (ISAs). The KICPA membership action plan for the International Federation of Accountants (IFAC) states, "All exposure drafts issued by IAASB are requested for comments to KICPA's members, regulatory body, academy and industries. The final standards are posted on KICPA's web-site to increase the public's awareness." KICPA's Korean website contains a page called "Audit News" that requests comment on new standards, but overall we found this site to be less informative than we had expected.

There is no handy list comparing KSAs with ISAs

Another challenge was that, in contrast to the list of accounting standards on the KASB website, we were unable to find a similar list of KSAs on the KICPA site to determine whether they were fully converged with ISAs. The KICPA English site has an outdated statement dating back to 2014, while IFAC said in April 2020 that, "KICPA reports the standards are developed in line with the 2015 International Standards on Auditing, issued by the International Auditing and Assurance Standards Board, which include the new auditor's report." Given the apparent slower pace of adoption of ISAs into Korean auditing standards, and the research challenges in finding an answer to what should be a straightforward question, we deducted a point for our question (Q6.2) about local auditing standards.

The FSS is Korea's regulator for listed company audits

The audit regulator

Like other markets in the region, Korea has an independent audit regulator and is a member of the International Forum of Independent Audit Regulators (IFIAR), the global club for audit oversight boards. The Securities and Futures Commission (SFC) under the FSC has responsibility for audit oversight, but in practice this function is carried out by the FSS for listed company audits. The FSS has similar powers to other audit regulators, including inspection (of listed-company and financial-institution audit reports), investigation, and disciplinary action. But it does not set standards, nor does it do registration, both of which are handled by KICPA. Meanwhile, KICPA also reviews the audit reports of entities not covered by the FSS. including non-listed entities.

FSS and KICPA share responsibility for firm-level quality control reviews

There is also a sharing of responsibilities over firm-level quality control reviews. As KICPA notes: "The FSC is responsible for reviewing quality control of accounting firms to ensure that they maintain high-quality audit services, and delegates the FSS to provide oversight on quality control of large-sized accounting firms, while the KICPA is delegated with providing oversight on small-and-medium-sized accounting firms."

Korea provides much less information on audit regulation than other markets in the region . . .

Regulatory disclosure

There is much less information available in Korea on the work of the audit regulator than in most markets we cover in Asia-Pacific. Whereas it is standard practice around the region for the audit regulator to produce a standalone report on its inspection, investigation and disciplinary activity during the year, in Korea this information comes as a small subset of the FSS annual report or is contained in ad hoc announcements on the FSS website. This situation has remained unchanged for the past decade or more, hence our ongoing recommendation for a dedicated report on audit regulation.

. . . but the FSS 2019 annual report is more informative

Having said that, there is evidence that the FSS is making an effort to disclose more in its annual report. Its 2018 report contained just five pages on "Accounting and Audit Supervision", whereas the volume doubled in its 2019 report. This is largely because there is more to report. For example:

- It is doing more reviews of auditor reports - 126 in 2018 and 159 in 2019 - and finding more deficiencies - 82 in 2018 and 98 in 2019.
- In contrast, it did fewer inspections of large, medium and small audit firms in 2019 (seven in total) compared to 2018 (11 in total).
- Its new system for regularly designating auditors for listed companies, which came into effect in 2019 following an amendment to the Act on External Audit of Stock Companies in November 2018, is clearly keeping it busy. This system is unique to Korea and is a response to large-scale accounting frauds that occurred in the mid-2010s. It means that listed companies may appoint their own auditor for the first six years of any nine-year period, after which the FSS will appoint an auditor for the final three years. Note that this system is in addition to a pre-existing system whereby the FSS could appoint auditors for companies where there has been fraud, have a high debt ratio, are on a regulatory watchlist, or are about to list. The total number of such designated auditors has risen from 546 in 2017 to 699 in 2018 and to 1,224 in 2019.

Next steps

KICPA could enhance disclosure on standards

We recommend KICPA provide clearer information on the progress in updating KSAs in line with ISAs, including a complete list of current KSAs in English as well as Korean.

FSS could produce a standalone report on its audit regulatory work

A standalone report from the FSS on its audit regulatory work, including information on auditing industry capacity, would be very welcome. Such a report should cover inspection, investigation and disciplinary action. It could also contain case studies on auditing irregularities and how the regulator has dealt with them, as well as remedial action required of audit firms.

7. Civil society & media

Korea ranks equal 10th on a score of 36%

Korea's score improved by five percentage points to 36% in 2020 and its ranking moved up from 11th to equal 10th with the Philippines. The gains were attributable to higher scores for the research and advocacy work of non-profit groups and academic institutions, as well as the arrival of a new forum for institutional investors. However, the score dropped in the media section on the depth of reporting on CG developments - although most media companies report diligently on the latest developments in policy, regulation, and corporate scandals (sometimes with an ideological slant depending on their ownership), we have rarely seen detailed investigations or analyses of issues.

Training

Korea is behind the curve on director training

Korea's score suffered most in questions regarding training of directors and company secretaries, receiving zero for both and the only market in our survey to perform so poorly. Although there are basic requirements for large companies to disclose the level of training they organise for their directors, there is no director association and no formal director training standards (eg, x number of hours per year of mandated training per director), leaving Korea behind the curve. In addition, the role of the corporate secretary does not exist in Korea, hence there is no association or training requirement.

Professional associations and business chambers

Most professional associations are only indirectly involved in CG

Professional associations such as KICPA, the Institute of Internal Auditors Korea, and the Korea Institute of Finance offer some CG-related materials on their websites, but overall do not place particular emphasis on CG or ESG in their activities or reports. Of more interest is the Korea Capital Market Institute (KCMI), a think tank founded in 1992 by the Korea Securities Dealers Association (KSDA). It was originally called the Korea Securities & Economic Research Institute, then became KCMI in 2009. While most of its work is focussed on general capital market issues rather than CG or ESG, if one types "corporate governance" into its search engine a number of interesting papers come up. For example, one on how audit fees rose in response to the changes in the Act on External Audit of Stock Companies.

Business associations are evenly balanced between pro- and anti-CG

As for business associations, the Korean Listed Companies Association and the Korean Financial Investment Association (KOFIA) have done some ESG-relevant research. KOFIA has also held webinars on ESG issues and shared research on ESG trends, in addition to promoting investor education. However, these efforts were cancelled out in our survey by negative scores for the largely CG-unfriendly stance and behaviour of the country's other leading business chambers.

Non-profit research and advocacy

The non-profit research and advocacy ecosystem is becoming more fertile by the year

On a more positive note, Korea earned full marks for its increasingly rich and diverse ecosystem of non-profit organisations and advocacy groups working on CG and ESG. Solidarity for Economic Reform (SER) regularly comments and writes on key CG policy, regulatory and corporate developments, as highlighted already in this chapter. SER's affiliate, the Economic Reform Research Institute (ERRI), is an excellent source of data and insights. The Korea Corporate Governance Service (KCGS) plays a range of roles, from research organisation to proxy advisor to steward of the Stewardship Code. Its English website has improved by leaps and bounds over the past two years and contains informative reports on previews and reviews of the AGM season, analyses of voting and engagement by Korean and foreign institutional investors, and a summary of its own voting recommendations. Meanwhile, the newest group on the block is the Korea Corporate Governance Forum, an investor-led group formed in December 2019 to discuss and provide opinions on major company and regulatory issues.

Next steps

Time for a director institute . . .

It would seem time to review the structure of director training in Korea and establish a central entity that coordinates, leads and professionalises this process.

. . . or a bigger role for professional groups

Professional associations could play a bigger role in promoting an understanding of CG and ESG among their members.

Media investigations?

Media investigations into CG or ESG issues in Korea would be welcome.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- Enactment of the company law amendment on dual-class shares (DCS) and any widening of its scope to existing listed companies or the KOSPI index
- Any backtracking in the fight against civil service or private-sector corruption
- No improvement in the disclosure of regulatory funding or enforcement actions and outcomes
- No attempt to address long-standing weaknesses in shareholder rights (eg, the lack of a mandatory bid rule)
- Lack of progress by companies in improving capital management, board diversity, and CG/ESG reporting
- Another eruption of accounting fraud
- A change of president in March 2022 that leads to a backtracking in policy priorities and reform efforts

What to fix

Quick fix list

Issues to address as soon as possible:

- Develop a national "CG Roadmap" for the next three years. This job could be given to the FSC to try to depoliticise the process, given that President Moon's five-year term ends in March 2022
- Bring forward the starting date for mandatory ESG reporting from 2025 to no later than 2023. Many large Korean companies already produce detailed sustainability reports
- FSS to publish its annual report within six months of its financial year-end
- FSS to publish an annual enforcement report and improve the presentation of statistics, both in its annual report and website
- FSS to publish a standalone report on audit regulation
- Make the public consultation process (for written submissions) as robust as the public hearing process
- KICPA to improve transparency on the adoption of new auditing standards

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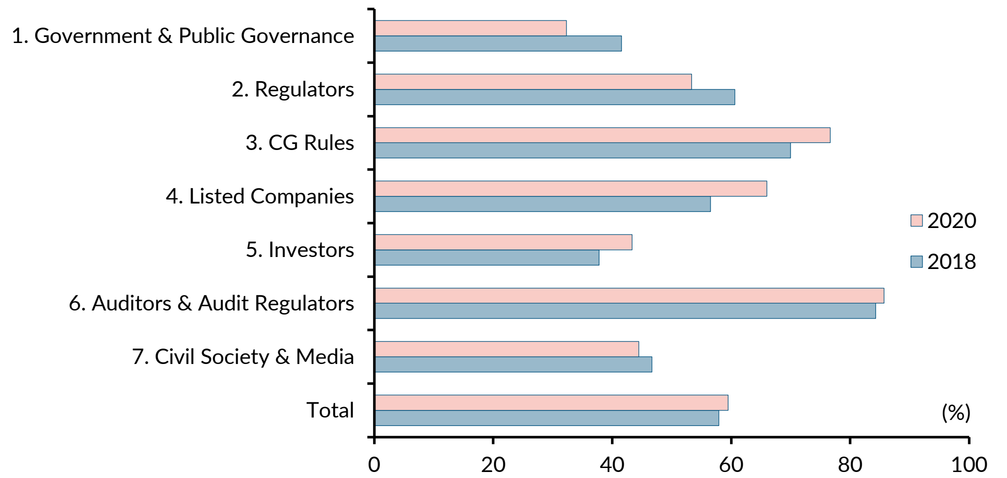
Malaysia – Dashed hopes

- Political turmoil weighs on corporate governance
- Progress made on the most important corruption cases
- Steady improvements in corporate disclosure following from previous upgrade to Malaysian Corporate Governance Code
- Effective monitoring of corporate disclosure through the securities regulator's CG Monitor report
- A separate enforcement entity has been announced to address conflicts of interest at Bursa
- Climate change received attention from Bank Negara Malaysia
- Continued delays to accounting reform
- Press freedom curtailed

Figure 1

Malaysia CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Malaysia falls to 5th place behind Taiwan with a score of 59.5%

Malaysia's score improved from 58% in 2018 to 59.5% in 2020 which was below the average 3% increase across all markets and its rank fell by one place to 5th. It now sits behind Taiwan, which experienced a much larger increase in score from 56.4% to 62.2%.

Public governance holds back progress

There were sharply divergent moves in different categories in Malaysia. We scored markets using a more granular methodology this year, which helped increase scores in the categories of CG Rules, Listed Companies, and Auditors & Audit regulators. The score in the Investors category also increased thanks to a continued emphasis on stewardship. However, Malaysia's scores in the Government & Public Governance, Regulators and Civil Society & Media categories declined, largely due to rapid political change which has halted reform and an eroded press freedom.

Hopes of genuine reform in 2018 . . .

In May 2018, when we visited Malaysia shortly after the fourteenth general election, there was a buoyant atmosphere. The previous administration led by Prime Minister Najib Razak had been dismissed at the ballot on 9 May following corruption scandals and there was real hope that the new Pakatan Harapan coalition government would make good on its promises to clean up politics and set the country on a new course. Indeed, Pakatan Harapan means "alliance of hope". But we also sounded some notes of caution. The ruling coalition was fragile and the old guard would clearly take steps to protect itself. While Malaysia's score increased on the back of post-election reforms, we questioned in 2018 whether this would last. Specifically we asked whether the government would revert to the autocratic style usually favoured by the country's leaders, especially in reaction to political or economic crises.

. . . come crashing down with a March 2020 regime change

Our question was answered when a state of emergency was declared in Malaysia on 12 January 2021. The official reason was to curb the Covid outbreak. This resolves for a while at least an ongoing power struggle stemming from a change in government in March 2020, when the king appointed Muhyiddin Yassin as prime minister following the resignation of Mahathir Mohamad. This led to a completely new ruling coalition with a very slim majority and a complete change in cabinet without a general election. By declaring a state of emergency, Muhyiddin can hold on to power by suspending parliament and delaying any bids to hold a general election.

Political upheaval leads to setbacks

Political influence is particularly important for the CG ecosystem in Malaysia as the government has significant control over the economy through means including a high level of ownership of leading companies listed on the country's stock exchange, Bursa Malaysia. The change in government led to a reversal of the previous direction, with new heads of agencies, new heads of government-linked companies and government-linked investment companies, delays to the legislative agenda, reversals in corruption cases and a decline in press freedom.

There are still checks and balances in the Malaysian market ecosystem

Nevertheless, there have also been positive development since the previous CG Watch in 2018. From a stock market perspective, higher retail trading volumes following the pandemic have added vibrancy to the market. From a CG perspective, the regulatory framework remains strong. Some of the key corruption cases have resulted in important convictions and tough sentences. New corporate liability provisions under Malaysia's anti-corruption legislation which makes companies criminally liable for graft conducted by directors, employees and associates, came into effect according to the initial timeline. Listed companies generally produce useful financial reports and audits, and audit regulations for issuers are still considered relatively sound. Investors are also stepping up their role on stewardship. While the hopes of 2018 have been dashed, there are still checks and balances in the Malaysian market ecosystem that support minority shareholders and allow some measure of accountability.

Recapping CG Watch 2018

The National Anti-Corruption Plan aims to make the country corruption-free by 2023

There have been some steps taken in line with the quick fixes recommended in the CG Watch 2018, though overall the pace of reform has slowed since then. Aside from the quick fixes referenced in the table below, we provided a list of cautionary areas. These included that regulatory reform could fail in the accounting profession - we are still waiting for an overhaul of the relevant law. A second concern was that corruption cases could fail to deliver tangible results. Some corruption cases were dropped following the March 2020 change in government, but the July 2020 conviction of former Prime Minister Najib Razak for his part in the plunder of state fund 1MDB is critical. Najib was sentenced to 12 years in jail and fined RM210m, while other key figures considered to be cronies were put on trial and some of them have already been found guilty. It is still too early to judge the effect of reforms brought by the National Anti-Corruption Plan (NACP), a government roadmap launched in January 2019 aiming to make the country corruption-free by 2023.

Hits and misses since 2018

Figure 2

Malaysia: Recap of 2018

	Recommendations	Outcomes
1.	Stronger participation from professional associations and civil society in regulatory consultations	Neutral. There is still little information provided following consultations
2.	Strengthen the definition of independent director with longer cooling-off period	Positive. The cooling-off period was increased to three years. We prefer five years
3.	Enhance remuneration strategy disclosure to make clear the links to strategy	Limited progress. There has been a focus on remuneration quantum, but not on links to strategy
4.	Introduce electronic voting ahead of the AGM and extend mandatory notice to 28 days	Positive. There are now virtual meetings due to Covid. 28 days' notice is only mandatory for selected resolutions, but 92% of companies have adopted 28 days' notice for their AGMs
5.	Continue to press companies to address material sustainability issues	Neutral. There have been some steps made such as a focus to climate change, but the improvements do not reflect the scale of the challenge

Source: ACGA

1. Government & public governance

Malaysia drops to 9th place with a score of 32%

Malaysia's score in this category fell by 10 percentage points to 32% and its ranking slipped from 8th to 9th. Public governance and political circumstances play a particularly important role for CG in Malaysia as the state has a high level of involvement in the economy and significant ownership of many Bursa-listed companies.

Two political reversals stymie the pace of CG reform

We are politically neutral and only comment where an administration has taken steps that favour or hold back CG standards. However, two instances of complete reversals in political direction and the changing composition of government in the last three years, have held back progress. This particularly matters for Malaysian capital markets due to the high number of government-linked listed companies.

Covid and political upheaval distract lawmakers

The first change happened in May 2018 when the Pakatan Harapan coalition swept to power following a general election which made Mahathir Mohamad the prime minister. This was the first time since independence that a government had been formed outside of the ruling Barisan Nasional (National Front) coalition. In February 2020, Mahathir abruptly resigned as his coalition imploded, paving the way for Muhyiddin Yassin to be appointed prime minister by the king the following month. Muhyiddin formed a new coalition of 12 parties, including the United Malays National Organisation (UMNO) which was voted out of power in 2018, with a very slim majority. There have been ongoing political tussles which were however put on hold in January 2021 when the king declared a state of emergency.

Major leadership changed twice at GLCs and GLICs in three years

Fast-changing appointments

It is a major challenge for any organisation to develop and implement long-term strategies when its leadership is rotated frequently. But many government-linked companies (GLCs) listed on the Bursa have had two major leadership changes in three years. This happened following the wholesale leadership changes at government-linked investment companies (GLICs), which controls the GLCs, first after the May 2018 election, and again when Muhyiddin came to power in March 2020.

A policy which prevents the appointment of sitting politicians to GLC boards was reversed

The Muhyiddin administration also rolled back a policy, which prevents the appointment of sitting politicians to GLC boards, stated by the previous administration. From a capital markets perspective, it is particularly important for listed companies to maintain political independence and for the GLICs to exercise stewardship over them.

Political in-fighting and Covid have slowed down legislation

A legislative agenda falters

A further challenge has been changes to the legislative agenda. This agenda was derailed following Muhyiddin's appointment as prime minister and the appointment of a completely new cabinet. Since then, political manoeuvrings, the pandemic and parliament closures have slowed the legislative programme. Parliament did not sit for much of 2020. For example, on 18 May 2020 it opened only long enough for the king to give the formal opening speech before the sitting ended.

State of emergency removes parliamentary scrutiny

The official explanation for such closures has been safety concerns during the pandemic. But the opposition has said that the new prime minister does not want to face a potential no-confidence vote with a razor thin majority. Following the declaration of the state of emergency on 12 January 2021 the cabinet can now introduce laws. While this may allow more legislation to pass, it will be without parliamentary scrutiny and will fail to follow democratic norms. The emergency will end on 1 August 2021 unless the king ends it sooner on the advice of an independent special committee certifying that the pandemic has subsided.

The new Accountants Act is still waiting to be tabled

One important reform that has been stuck is an overhaul of the Accountants Act, which is still under consideration. But there have been some positive steps since CG Watch 2018, including the introduction of corporate liability provisions in the new section 17A to the Malaysian Anti-Corruption Commission Act 2009, which came into force on schedule on 1 June 2020. Companies and their directors and senior officers are now criminally liable for corruption.

Key enforcers resign

Corruption cases: Progress of sorts

The resignations of Attorney General Tommy Thomas and Malaysian Anti-Corruption Commission (MACC) Chief Commissioner Latheefa Koya came immediately after the March 2020 change in the prime ministership. This sparked concerns that there would be less effort to pursue corruption cases involving former Prime Minister Najib Razak and other high-ranking officials and their cronies. A mixed picture has emerged.

- ❑ The cases against Najib in relation to corruption at state fund 1MDB have moved forward. The High Court found him guilty in July 2020 and sentenced him to 12 years in prison with RM210m in fines on seven charges regarding the misappropriation of funds from SRC International, a former subsidiary of 1MDB. At the time of writing, Najib was free on bail pending an appeal due to be heard in April 2021. He is facing other trials for a combined 42 counts of corruption and money laundering. The US authorities alleged more than US$4.5 billion was embezzled from 1MDB.

- On 18 February 2021, Najib's wife, Rosmah Mansor, was also charged on three counts of soliciting and receiving bribes worth RM194m to help the company Jepak Holdings secure a solar power project in Sarawak.
- Rosmah's son, Riza Aziz, fared better, receiving a "discharge not amounting to an acquittal", a technical term for the dismissal of the charges, in May 2020 from the Sessions Court of Kuala Lumpur following a deal agreed with prosecutors to repay assets worth more than RM457m to the government. This is half the sum he is alleged to have misappropriated. Riza is Najib's stepson and the producer of the film The Wolf of Wall Street.
- Musa Aman, a former chief minister of Sabah, and another senior figure in Najib's UMNO party also received a discharge not amounting to an acquittal. On 9 June 2020, government prosecutors withdrew 46 money laundering and graft charges involving RM403m due to lack of evidence, resulting in the judge ending the proceedings.
- There have been many delays to the trial for former Deputy Prime Minister Ahmad Zahid Hamidi, who is the current president of UMNO, one of the parties forming the current government. Zahid faces 47 charges with 12 counts of criminal breach of trust in relation to the charitable foundation Yayasan Akalbudi, 27 counts of money laundering and eight counts of bribery.
- UMNO party treasurer Tengku Adnan Tengku Mansor was found guilty of corruption in December 2020 for accepting RM2m from a local businessman in 2016 when he was the federal territories minister. He received a year in jail and a fine of RM2m, but has lodged an appeal against both. He had previously received a discharge not amounting to an acquittal in another corruption case.
- On 3 February 2021, the High Court found the former chairman of the Federal Land Development Authority (FELDA), Mohd Isa Abdul Samad, guilty of nine corruption charges involving RM3m. He was sentenced, pending appeal, to six years in jail and fined RM15.45m.

Corruption perceptions are worsening

There are significant concerns that corruption in Malaysia will increase. In March 2020, the annual Perceptions of Corruption in Asia survey from the Political & Economic Risk Consultancy (PERC) showed a material decline in Malaysia. The score improved from 6.78 in 2018 to 6.23 in 2019, and worsened to 7.38 in 2020. The PERC rating is based on scores out of 10 and higher scores reflect a perception of worsening corruption. The figure below shows that Malaysia has received its worst score in a decade.

TI corruption index also raises concerns about Malaysia

Transparency International (TI) also raised concerns about the prosecution's unjustified withdrawal of charges in some cases and predicted Malaysia will receive a worse score in the global Corruption Perceptions Index (CPI) 2021. Malaysia ranked 57th on TI's global corruption index for 2020, down from 51st the previous year. Its score of 51/100 (where zero is highly corrupt and 100 is squeaky clean) declined from its score of 53 in 2019. Among the possible reasons given by TI for Malaysia's deteriorated position:

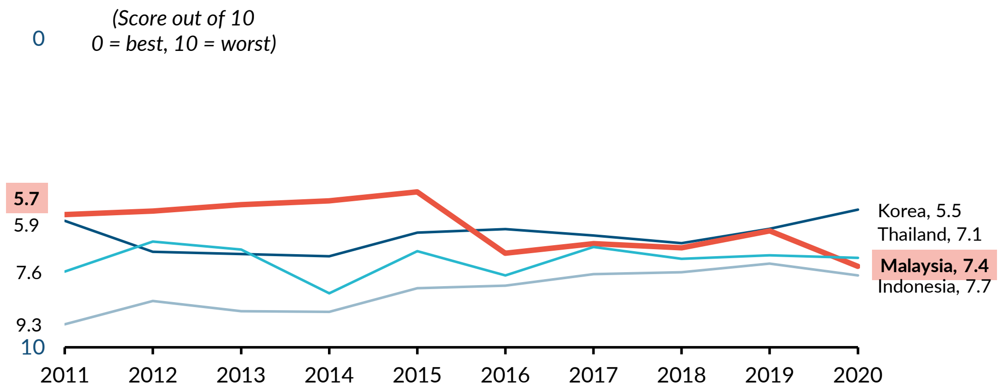
- Institutional reforms have stalled, such as the Political Funding Bill, which would scrutinise donations and other funding given to political parties. This was to be tabled in parliament by the last two governments but has yet to happen.

- A bill to establish independent oversight of the police, the Independent Police Complaints of Misconduct Commission (IPCMC) Bill, was watered down significantly rendering it largely ineffective. And the separation of powers between the Attorney General and Public Prosecutor has yet to be initiated by government.
- The government has yet to table the Public Procurement Bill to improve transparency and accountability in the procurement process.
- The use of a discharge not amounting to acquittal for some high-profile cases has created a negative perception about the legal process.
- Cases of abuse of power and corruption by public officials despite a crackdown by the MACC.
- Continued reports from the Auditor General on wrongdoing and poor governance by government officials in managing projects, programmes and activities.

Malaysia's score in the PERC survey has slipped since 2011

Figure 3

Worsening: How perceptions of corruption in Malaysia have changed, 2011-2020



Source: Political & Economic Risk Consultancy

Airbus pays record fine to avoid bribery prosecution

AirAsia executives allegedly received US$50m in bribes

The alleged bribes were in the form of sports team sponsorship

'I want my money and I want compensation . . . pay up.'

In January 2020 aircraft manufacturer Airbus SE cut a record US$4 billion deal with Britain's Serious Fraud Office (SFO) to avoid prosecution for failing to prevent bribery in five overseas markets. Malaysia was one of them.

Airbus was alleged to have paid a bribe of US$50m to win plane orders from Malaysian budget airline, AirAsia Group, and its long-haul arm, AirAsia X, between October 2013 and January 2015. Airbus employees were also accused of offering a further US$55m to AirAsia executives, but the offer was not finalised and no payment was made.

The alleged US$50m bribe was in the form of sponsorship for a sports team jointly owned by two unidentified AirAsia executives. AirAsia subsequently identified them as CEO Tony Fernandes and Chairman Kamarudin Meranun in a company announcement. The pair were alleged to have received the bribe on behalf of the sports team in exchange for an order of 180 Airbus aircraft. 'The payments to the sports team were intended to secure or reward improper favour by them in respect of that business,' said the SFO. According to the SFO, there was no legal relationship between AirAsia and the sports team, although the association between them was used to generate publicity.

The money was demanded in heated email exchanges

The SFO published an agreed statement of facts in relation to the deferred prosecution of Airbus. It contained email discussions between senior Airbus employees and the two AirAsia executives, including a heated exchange in 2009 over a US$16m payment for sponsorship of the sports team. Replying to an Airbus employee, AirAsia Executive 1 emailed [sic]: "Honestly...I'm fed up. You owe me 4 million already and I'm owed 16 million in total. This shd have been pauid ages ago when I bought thre first 60 aircraft. I want my money and I want compensation . . . pay up. I want my whole 16 million now."

AirAsia denies the allegations

AirAsia denied the SFO allegations and in February 2020 appointed BDO Governance Advisory as an independent expert to conduct an internal review. In March 2020, AirAsia announced that AirAsia's sponsorship of the sports team was approved in compliance with its procedures. The board knew of and approved the sponsorship and that Fernandes and Meranun, had properly disclosed their interests to the board and abstained from discussions or decisions relating to the sponsorship.

MACC was investigating, but offered no update

The Malaysian Anti-Corruption Commission said in February 2020 that it was investigating the SFO allegations but there was no update as of April 2021.

Next steps

Less churn would help

One critical area that needs to improve in public governance is the wholesale change of key leadership when there is a new administration. From a corporate governance perspective, this is particularly important if the positions are for economic institutions such as pension funds, GLCs and GLICs, because the decisions those leaders make should be based on strategic and financial grounds instead of political reasons.

Improved whistleblower protection is key

An area that needs stronger focus in Malaysia is whistleblower protection. A 2019 study in the South East Asia Journal of Contemporary Business, Economics, and Law reviewed the Whistleblower Protection Act 2010. The study includes figures showing both a decline in the number of individuals seeking whistleblower protection in the period 2015 to 2017 and the extremely low proportion of applicants receiving protection. According to the authors of the study, a challenge under the act is that whistleblowers can only report to enforcement agencies, which limits the disclosure options. A second concern is that the disclosure of information itself must not breach any other law. This safeguard is put in place to prevent informants from receiving protection having committed wrongdoing themselves. However, the effect of the prohibition is that it may inadvertently restrict the applicability of whistleblower protection. There are other specific pieces of legislation, such as the duty of auditors to report fraud, which come with no such restriction. The authors recommend legislators to amend the act to address both concerns.

2. Regulators

Malaysia falls from 2nd to equal 6th place with a score of 53%

Malaysia's overall score in the Regulators category declined by eight percentage points to 53% in 2020, placing it equal 6th with India and Korea - down from 2nd previously. These scores are an average of two sub-categories: Funding, Capacity Building and Regulatory Reform; and Enforcement. Malaysia performed worse overall in each category, though not in all questions. The biggest sapper on Malaysia's score in this section has been the stalling of CG reform.

Regulatory roles are split

Malaysia's financial system is regulated by Bank Negara Malaysia (BNM), the central bank, and the Securities Commission (SC) which oversees the capital markets. BNM is responsible for the development of the financial sector and its overall stability. It regulates and supervises financial institutions, particularly banks. The SC, as a self-funded statutory body, reports to the Minister of Finance and its annual accounts are tabled in parliament. Bursa Malaysia (Bursa) is a for-profit company which operates the stock exchange that it itself is listed on. It also has the role of a frontline gatekeeper of the listing rules.

There has been rapid leadership change at the Bursa

In 2018, Regulators was Malaysia's best-performing category but we deduct points where there is slowing momentum or no improvement from our previous survey. As with the political sphere, the regulatory space has at times been turbulent. Over at Bursa for example, its chair Shireen Muhiudeen was ejected in April 2020 by the Ministry of Finance, which the SC stated was due to governance issues but did not elaborate. She had barely been in the post for a year. Her replacement, Abdul Wahid, is a seasoned corporate figure, having served as president of Maybank and chairman of Permodalan Nasional Berhad, a large GLC, as well as having served as a senator and minister in the Prime Minister's Department in charge of economic planning between June 2013 and June 2016.

Conflict of interest concerns prompt a rethink of frontline role

Prior to Muhiudeen's departure, Bursa together with the SC had mooted a Singapore-style hiving off of the exchange's regulatory function into an independent subsidiary to mitigate concerns of potential conflict of interest at the for-profit bourse. According to media reports, there had been friction between the SC and the Bursa over the frontline regulator role. A joint announcement in March 2020 by Bursa and the SC described the proposed entity, Bursa RegSub (RegSub), as having its own board of directors, the majority of them independent of Bursa and its chairman appointed from among the independents. The SC would in the meantime continue to regulate Bursa as a listed company and market operator and maintain oversight of the regulatory functions performed by RegSub. The entity was expected to be up and running by the end of 2020. According to Bursa's 2020 annual report, a regulation subsidiary, Bursa Malaysia Regulation (Bursa Regulation) was incorporated in August 2020. The subsidiary will assume Bursa's regulatory function upon the issuance of the Capital Markets and Services (Regulatory Subsidiary) Regulations 2020. These regulations are still pending as of the time of writing, and the market is still waiting to hear more about RegSub.

2.1 Funding, capacity building, regulatory reform

Malaysia drops from 1st to 6th place with a score of 53%

The score in this sub-category declined by nine percentage points, from 62% in 2018 to 53% in 2020. This places Malaysia 6th in the region - down from 1st previously. In part this reflects our tougher methodology, but where Malaysia gained credit in 2018 for its consistency of efforts in regulatory reform, in 2020 a floundering CG agenda saw it eclipsed by Hong Kong, arch-rival Singapore, and even Japan.

Regulators seem to be well-funded . . .

A major objective of this category is to assess whether the level of resources available to securities commissions and stock exchanges is sufficient for their regulatory role. This is a challenging question to answer and the starting point is to review the level of data provided. On the face of it, funding is not an issue. Bursa has been consistently profitable from 2016-2019. Indeed, its profits more than doubled from 2019's RM185m to RM377m in 2020, making it Bursa's best year since it was listed in 2005. The SC has significant reserves, which rose from 2018's RM857m to RM867m in 2019, and turned in a surplus of RM10m in 2019 having seen deficit in the previous three years. Together, these would appear to indicate that the organisations have sufficient funding in the medium term.

. . . but there is a lack of disclosure on the resources applied to key CG-related functions

But where Malaysia loses points is in the quality of its data disclosure which made it hard to assess the extent to which both organisations are investing in oversight of the market. The SC provides its headcount in the annual reports for 2016, 2017, and 2019. At the end of 2016, it had 753 employees, which dipped to 742 by the end of 2017. The figure was 739 for 2019. No headcount was given in the 2018 annual report. The 2019 annual report shows the proportion of staff by age and years of service. It also shows the proportion of men and women at different levels of seniorities: Overall, 54% of the workforce was female, and half of those at senior management level were women. At the lower end of the scale, a vast majority of support staff, ie, 72%, is male. However, there is no functional breakdown for staff or for the budget. Consequently, it is not possible to understand the way in which resources are allocated to critical corporate governance-related functions, such as regulations, enforcement, and market and corporate surveillance. Similarly, Bursa does not provide these breakdowns. We only know that its total headcount in 2019 was 600, compared to 589 in 2018. This is a salient point, given that one of the drivers for separating Bursa's regulatory function into RegSub was to ensure consistent investment in regulatory activities.

CG Monitor uses AI to collate and analyse issuers' data

In terms of technology, the SC's annual publication, Corporate Governance Monitor, which had its inaugural report in 2019, provides a useful overview of corporate governance standards across the market. The SC uses an internal web-based system to collate and analyse CG data of listed issuers. Bursa introduced the SMARTS surveillance system in December 2018, which is also used by Nasdaq, to detect market offences in real-time and post-trade activities in the equities and derivatives markets, but provides few details aside from how the surveillance framework operates in broad brush terms. Among other tech initiatives in 2020 was the enhancement of the Bursa Anywhere mobile app and the launch of Bursa Academy, an e-learning platform. Technology upgrades appear to be more focussed on the market than regulation.

The regulatory agenda stalls

Momentum in regulatory reform is lost

In terms of regulatory reform, there was much to write about in CG Watch 2018: a new Companies Act came into force in January 2017, which codified directors' duties and responsibilities, and enhanced shareholder rights in calling general meetings and limiting the use of proxies. The Malaysian Code on Corporate Governance (MCCG) also received a major upgrade in April 2017. Smaller reforms included an upgrade to disclosure of directors' fees and the standardisation of corporate governance reporting through a requirement to use a template.

Implementation of regulatory agendas lacks continuity

Since then, reforms have proceeded at a much slower pace and in terms of our scoring this has cost Malaysia dearly. Changes in the ruling coalition in 2018 and again in 2020 have led to a lack of continuity in the implementation of regulatory agendas. There were also long breaks in the sitting of Parliament in 2020 and much time was spent addressing the pandemic. Overall, this has resulted in relatively few governance-related acts since CG Watch 2018.

Corporate liability for corruption

The MACC holds both companies and senior executives accountable for failing to prevent bribery

There were technical adjustments in the Companies Act amendment bill 2019 passed in July 2019, which removed some ambiguities. But the most notable development in governance terms has been the introduction of corporate liability under the Malaysian Anti-Corruption Act (MACC), which came into effect in June 2020. It makes companies subject to legal proceedings should one of their officers commit corruption offences. The new section 17A of the Act goes even further than the UK's Bribery Act 2010 in holding both companies and senior executives accountable for failing to prevent bribery offences.

The NAFCC mandates the setting up of a national anti-financial crime centre

Meanwhile, the National Anti-Financial Crime Centre Act (NAFCC) came into force in January 2020, mandating the establishment of a national anti-financial crime centre to coordinate and advice on the efforts of enforcement agencies in tackling financial crime. It will also maintain a centralised data system on financial crime. Another positive was the repeal of the much-criticised Anti-Fake News Act 2018 in December 2020. However, other important matters such as the proposed new Accountants Act, which would give the Malaysian Institute of Accountants (MIA) greater investigative powers and introduce stronger sanctions, have faced delays.

SC to take on enforcement of directors' duties

The SC in July 2020 issued guidelines on the conduct of directors in line with its new powers to enforce directors' fiduciary duties. The SC also updated the Equity Guidelines in December 2020 to introduce the requirement for advisors to consult with the SC prior to initial public offerings or proposals marking a significant change in direction for a main market-listed company. Bursa strengthened the definition of independent directors, enhanced disclosure requirements in relation to raising finance, and strengthened guidance documents for sustainability and corporate governance among other changes.

Consulting the market

Regulators are consulting but not concluding

We introduced a new question in CG Watch 2020 on the transparency and professionalism of regulatory consultations. Generally Malaysian regulators have medium-length consultation periods, although this varies. The SC issued one consultation in 2020 on amendments to guidelines on unit trusts, and two in 2019, one for a proposed regulatory framework for initial coin offerings and another for property crowdfunding. During the 2020 consultation, participants were given two months to comment but for the two 2019 papers, just 23 days. Bursa issued two consultations in 2020 and four in 2019, on topics including technical amendments to trading rules and the imposition of anti-corruption and whistleblowing measures. Three of the consultations gave stakeholders one month to respond, two allowed respondents two months, while the remaining one reserved just 14 days to receive comments.

Longer consultation periods are needed to broaden stakeholder participation

We welcomed the three-month response period for the Bank Negara Malaysia (BNM) consultation on climate change issued in December 2019. We believe long, ie, at least three month, consultation periods are important to support broader stakeholder participation, including by international investors. We believe the regulators in Malaysia could also strengthen consultation processes by producing conclusion papers, which are currently only released on an ad hoc basis, and publishing submissions, which is not done at all.

Addressing climate change

Regulators are starting to address climate change through JC3

Malaysian regulators are taking a more focussed approach to prepare financial institutions to address climate change-related challenges. The primary efforts are under the Joint Committee on Climate Change (JC3), which was launched on 27 September 2019. JC3 is co-chaired by senior representatives from BNM and the SC. Its members comprise senior officials from Bursa and 19 other industry players, which were not named. The objectives of JC3 are to build capacity, identify issues and challenges faced by the financial sector, and facilitate collaboration towards providing solutions.

JC3 focusses on practical steps to develop green finance and support disclosure

JC3 held its fourth meeting on 24 February 2021. The meeting covered a review of the consultation and pilot implementation of BNM's Climate Change and Principles Based Taxonomy, a review of current financial institution disclosure in Malaysia, and a gap analysis of the green finance landscape. In 2021 the committee will develop guidance on risk management and scenario analysis; support disclosure by the industry; conduct stakeholder engagement to strengthen enabling conditions for green financial products and solutions; and further develop technical capacity around disclosure.

2.2 Enforcement

Malaysia slides to 10th place with a score of 54%

The enforcement score for Malaysia fell by five percentage points to 54% in 2020, taking its ranking from equal 6th with Singapore to 10th place. The change in rank is partly due to progress in other markets, notably Singapore, Japan, and Korea. Malaysia also lost points for its limits in enforcement disclosure which have not been addressed, namely the lack of narrative on what its statistics actually mean. In addition, a low conviction rate on the criminal front continues to be an issue.

The Securities Commission has a broad range of powers

We reviewed the methodology for the questions relating to regulatory powers, taking a more granular approach. As a result, the score for the Securities Commission (SC) increased. It has investigatory powers, civil sanctions, the ability to seek restitution and criminal sanctions in appropriate areas. There are still inevitable difficulties for cases that span multiple territorial jurisdictions.

A data paradox

Regulators are sound on statistics but short on analysis

There is detailed statistical information about enforcement from both the SC and Bursa. However, there is limited narrative about the reasons and significance of changes in the patterns of cases. Also, discussion on the specifics of cases is brief even after they are closed.

Illicit trades dominate enforcement

The SC receives referrals of possible securities offences from its surveillance and supervisory divisions, as well as from other local authorities and complaints. In 2019 there were 26 such referrals, while in 2018 it was 17. The number of active investigations meanwhile in 2019 was 48, up slightly from 43 in 2018, suggesting a moderate uptick in caseload. Insider dealing continues to keep the regulator busy: of all investigations in 2019, illicit trades accounted for 44%, although this figure has dropped slightly from 50% in 2018. Securities fraud investigations are meanwhile on the up, accounting for 25% of all investigations in 2019 compared to just 14% in 2018. Disappointingly, no narrative is offered as to why there has been an apparent shift in market misbehaviour in either the SC's annual report or its yearly publication, The Reporter, which outlines its work on market integrity.

There was only one criminal prosecution in 2019

It would appear that 2019 was a good year for wrongdoers. There was just one criminal prosecution initiated in 2019: In October, Cheah Yew Keat was charged with insider trading in the shares of DIS Tech. Granted, there were only eight individuals charged for criminal securities breaches in 2018 - five for insider trading, two for allowing unauthorised individuals to trade in their accounts, and one for securities fraud - but a sole prosecution is a disappointing result and hardly serves as a deterrent to capital market offences.

One day in jail for insider dealing

Insider traders stay outside

Securing convictions remains a sore point for Malaysia. In CG Watch 2018 we noted the difficulties the SC has in securing convictions for insider trading and there is little sign of improvement. In fact, the predicament appears to have taken on a new twist.

Charges are often withdrawn with no reason

The problem as we saw it in our previous report was that cases resulted in acquittals, or charges were withdrawn at the eleventh hour by the Attorney General with no reason. This continues: Out of 24 criminal trials and appeals relating to capital market offences which were resolved in 2019, a dozen concluded with charges being withdrawn and a settlement reached, or a consent judgment being agreed between the parties.

Convictions can result in only one day in confinement

The latest sting in the tail is that where the SC secures convictions for capital market offences, the punishment is often a token one-day in jail and a financial penalty. Out of 15 convictions secured in 2019, in six cases the punishment was a token one day in prison together with a fine ranging from RM200,000 for furnishing false statements to Bursa, to RM1m for insider trading. Besides these six prison day-trippers, in only one case could we find an individual who went to jail (seven months imprisonment for furnishing a false statement to Bursa) in 2019, the remaining cases either are currently on appeal, or resulted in acquittals or fines.

Some white-collar criminals may yet be jailed

In fairness, 2018 had been slightly better and the SC took a few scalps. In February 2018, Ismail Basir was jailed for a year after pleading guilty to securities fraud and fined RM1m. In March 2018, Alan Rajendram was unsuccessful in appealing a one-year jail term for furnishing false statements to Bursa and ordered to serve his sentence with immediate effect. And one of the stiffest sentences meted out in recent years may yet be served: A case currently on appeal is that of insider trading in the shares of Malaysian Merchant Marine by Ramesh Rajaratnam. The charges date back to April 2015 and in September 2019 Ramesh was found guilty and sentenced to five years imprisonment and a fine of RM3m. Likewise, the appeal of Norhamzah Nordin will be watched with interest. He faces a two-year jail term and a RM1.45m fine after being convicted for an abetting role in furnishing false statements for 2006 and 2007 financial results to Bursa. He was charged in 2011.

More action on the civil front

Sanctions are on the up at the SC

The SC imposed 99 administrative sanctions for misconduct in 2019, up from 80 in 2018. Typical breaches include false or misleading statements to the securities regulator, breaches of licensing conditions and late submission of documents. The sanctions vary from reprimands to revocation of licences, financial penalties and public statements. Penalties of RM6.39m were imposed in 2018; in 2019 the figure dropped to RM5.38m. The SC also issues infringement notices where it feels breaches of securities laws do not warrant a formal enforcement or administrative action. These include warning and cease and desist letters. In 2019, the SC issued 99 infringement notices, compared to 66 in 2018.

Over at Bursa . . .

The exchange is less active

Bursa took enforcement action against 12 issuers, one advisor and 30 directors in 2020, including public and private reprimands and cumulative fines of RM3m. In 2018, 17 issuers faced action, along with 25 directors and the fines imposed were much higher at RM8.6m. There were only six public reprimands in 2020 (five issuers and one director), down from nine the previous year (six issuers and three directors). Bursa offers little analysis of its enforcement action beyond the figures, although in 2020 it noted that key enforcement actions were for manipulative or false trading activities, misapplication of client money, and failure to comply with margin calls and account opening requirements. It does issue a press release where the enforcement action includes a public reprimand.

A national financial crime agency is set up

Complex crime, multiple agencies
One challenging area in Malaysia is the question of which domestic agency has jurisdiction for different crimes. Sometimes this is clear, but on other occasions either the crime covers multiple activities or the evidence gathering requires cooperation from multiple agencies. The government established the National Financial Crime Centre (NFCC) under a new act as part of its National Anti-Corruption Plan 2019-2023. NFCC brings multiple agencies including the SC together to coordinate where necessary.

RegSub announced, but not yet implemented

As we mentioned earlier, on 25 February 2020, the SC and Bursa jointly announced that they would set up a subsidiary, RegSub, to assume the regulatory functions currently undertaken by Bursa. RegSub is to be a wholly-owned subsidiary of Bursa but have its own board of independent directors with the chairman selected from these directors. The subsidiary would have financial and human resources from the stock exchange. The SC will continue to regulate the market, covering Bursa directly as a listed company and maintaining oversight of the regulatory functions performed by RegSub. The Commission referenced market developments in Singapore, Japan, and Brazil as precedents for the proposed structure in Malaysia. The purpose of the move is to address the perception of the conflict of interest between the stock exchange's commercial and regulatory activities.

Next steps

Identify patterns and trends

We suggest the authority could strengthen reporting on enforcement to include a stronger narrative on the reasons for changes in the statistics and to include specifics from cases when they are concluded.

Get moving on RegSub

Regulators could also finalise the arrangement of RegSub.

Improve consultations

It will also be helpful to allow longer consultations, replete with published submissions and conclusions.

Give better disclosure of regulatory capacity

Regulators could provide more information about the financial, human and technical capacity they invest in and how these safeguard markets.

Continue to address climate change with urgency

They should also continue to take urgent action to address the strategic implications of climate change for financial institutions, companies and the economy.

3. CG rules

Malaysia beats Hong Kong to rank 2nd with a score of 77%

Malaysia's score increased by seven percentage points in this category to 77% in 2020. Hong Kong's score was relatively flat and consequently Malaysia overtook it to rank 2nd behind Australia for CG rules, up from 3rd place in 2018. Overall, scores in this category increased by an average of five percentage points across the 12 markets covered. The primary reason was changes to the methodology, which involved a more granular assessment than used in previous surveys.

A few tweaks to the rules

Fine-tuning gets underway

Malaysia has not seen major reforms since CG Watch 2018, when we feted the introduction of the new Companies Act in 2017, and a significant update to the corporate governance code. Nevertheless, regulators have introduced several smaller positive changes aside from the measures required to handle the turmoil of Covid. The changes included:

Bursa extended cooling-off periods for directors from two years to three years

- **Independent director definition:** Bursa updated the listing rule definition of independent director in an amendment dated 1 October 2020. This extended the cooling-off periods for directors who are former officers or former advisors from two years to three years before these individuals can be designated as independent. We welcome these changes, though we only give full marks for markets that have five-year cooling-off periods. We also view positively Malaysia's use of a two-tier voting system that gives minorities a stronger say in the designation of independence for directors with a tenure of more than nine years.

Issuers are now required to give details of equity fundraising in the past 12 months and how the proceeds will be used

- **Enhanced disclosure in raising finance:** Bursa introduced extra requirements to the listing rules in August 2020 in relation to the quality of announcements and circulars. To enhance disclosure, issuers are now required to give details of equity fundraising in the past 12 months, including particulars of corporate placees and how the proceeds will be utilised for investment and working capital. Further, issuers should seek shareholder approval if there was to be a material (>25%) change in the utilisation of proceeds of a securities offering that had required specific shareholder approval. Bursa also enhanced requirements on debt finance. Where a listed issuer announces a material loan or borrowing and the debt has a condition or restriction relating to the controlling shareholder, this condition should be disclosed to the market. This helps investors better understand the dynamics of company borrowing for a controlling shareholder. We believe that more could be done where the controlling shareholder pledges stock independently for a personal debt, rather than on behalf of the company.

Listing rules require companies to have policies and procedures on anti-corruption, whistleblowing

- **Anti-corruption measures:** Bursa also updated the listing rules in December 2019 to align with amendments to the Malaysian Anti-Corruption Act 2009. These now require companies to ensure that there are policies and procedures in place on anti-corruption and whistleblowing, with disclosure on the company's website. The procedures should be reviewed at least once every three years and corruption risk should be covered in the company's annual risk assessment.

SC can now enforce breaches of directors' fiduciary duties

- **Director conduct:** With the approval of the Special Cabinet Committee on Anti-Corruption, the SC has been empowered to enforce breaches of fiduciary duties of directors for listed companies. Previously such breaches were under the purview of the Companies Commission of Malaysia. The SC issued the Guidelines on Conduct of Directors of Listed Corporations and their Subsidiaries on 30 June 2020. This has three short chapters on director conduct, record keeping, and group governance arrangements. The group governance arrangements stipulate the requirement for subsidiaries to provide information to the board of the listed parent entity.

Where Malaysia lost points

Five areas of concern emerge

While Malaysia gained in multiple areas, the market also lost points in five areas. They are as follows, with the reasons why included:

The market will be informed between 5 and 7 calendar days from the trading date

- **Substantial ownership:** We looked at how soon an investor must inform the market when becoming a substantial shareholder, or changes in ownership thereafter. In making this assessment, we viewed the total time from the moment of trading. In the Malaysian context, settlement is now on a T+2 basis, the Companies Act 2018 requiring the investor to give notice to the company within three days from the change in ownership, and the listing rules require a company to immediately disclose changes in substantial shareholding to the market. This means the market will generally be informed between five and seven calendar days from the trading date, whereas we gave full marks where disclosure is required three calendar days from the date of the trade.

- **Price-sensitive information:** Bursa listing requirements under Chapter 9 on continuing disclosure sets out the rules for the handling of material information. While we believe the rules are appropriate and there is a wide range of examples of types of material information, there are limited examples of the appropriate procedures, mechanisms, and control systems for handling inside information. We only gave full marks for markets where such procedures are provided.

- **AGM minutes:** We looked at voting by poll across markets. When we first introduced this question many years ago, most Asian markets voted on most resolutions by a show of hands or by acclamation. Voting by poll became mandatory in Malaysia on 1 July 2016 and the listing rules require immediate disclosure of the detailed results of general meetings, including the total number of votes cast and the proportion in favour of the resolution. As most markets have now improved, our scoring has become more specific and addresses whether companies must also provide detailed minutes of the meeting. This allows investors who were not present at a meeting to understand the substance of the discussions that took place. Many companies in Malaysia already provide detailed minutes. Out of the 15 large companies that we reviewed, 11 provided minutes that included detailed questions from the floor and the company responses, while a further two provided the questions that the Minority Shareholder Watchdog Group (MSWG) had asked, together with the company response. As this is an increasingly common practice, we believe it is something that could be introduced to the rules.

There is no requirement to disclose voting activity

- **Stewardship code:** The Malaysian Code for Institutional Investors was launched by the SC and MSWG on 27 June 2014 and was the second such code promulgated in the region, following the launch of Japan's stewardship code in April 2014. The Malaysian Code has not been revised since. One gap that we note is that there is no requirement to disclose voting activity. This is an increasing requirement in markets across the region including for India, Thailand and Korea. We believe this would be a useful addition to the landscape in Malaysia.

MCCG is not mandatory, leaving gaps for senior management pay disclosure where the individuals are not on the board

- **Remuneration disclosure:** Shareholders need to know whether pay and incentives for directors and top company management are aligned with or diverge from investor interests. There are two considerations, the amount of pay and the structure of the package including how it links to the performance and strategy of the company. The listing rules cover pay and other types of compensation and require this to be broken out by the amount and type of reward (director fees, salaries, benefits etc). The disclosure of remuneration for the top five senior management is addressed in the Malaysian Code of Corporate Governance (MCCG) where disclosure is stipulated for all companies in bands of RM50,000. There is a further principle for the largest companies seeking detailed remuneration for all senior management. We reduced the score as the MCCG is not mandatory and therefore leaves gaps for senior management pay disclosure where the individuals are not on the board. Nevertheless, it is possible to undertake quantitative analysis and the SC does so in a thematic review in its report on the market, *CG Monitor 2020*. However, a major gap remains as very few companies provide information on the factors that drive pay awards - in other words the metrics and indicators that are assessed in awarding variable compensation. This means that it is still not possible for investors to understand how pay is incentivising management behaviour and performance.

Next steps

Current 21-day notice period for AGMs could be extended to 28 days

Malaysia has solid rules in most areas, however, there are multiple points that could be tightened further. For instance, the current 21-day notice period and detailed information circulars for AGMs could be extended in the listing rules to 28 days. It is currently 28 days in the MCCG and most companies adopt this practice. The annual report could be released in three months in line with most markets, instead of the current four months.

ESG reporting should be more strategic

Sustainability reporting requirements could also be enhanced. While there have been improvements across the market, there are relatively few targets, and the discussions are rarely strategic. Useful enhancements would include sector specific reporting requirements, the introduction of mandatory reporting for some KPIs, and more emphasis on the strategic implications of climate change.

Malaysia's response to Covid: Orders

Layers of lockdown orders introduced in March 2020

The first imported case of Covid-19 in Malaysia was reported on 25 January 2020 and an initial wave of infections gathered pace by the end of February. The first of several lockdowns of varying severity was introduced on 16 March 2020, by way of a Movement Control Order (MCO). These orders have been used as needed, both nationwide and within individual states, when cases spike. Likewise a stricter lockdown, the Enhanced MCO (EMCO) has been used on occasion from April 2020, as well as a Semi Enhanced MCO (SEMCO) where soldiers and police erect barbed wire fences to keep people in place.

The government has tightened and eased movement control orders

The government has also used orders to relax lockdowns and reopen the economy. The Conditional Movement Order (CMCO) was first introduced in May 2020 to relax lockdown measures although it did not have broad popularity, many fearing it could lead to a Covid resurgence. The order was been used on and off during the course of 2020: recently it was used in January 2021 in Kuala Lumpur and Selangor for two weeks. On the heels of the CMCO came the Recovery Movement Control Order (RMCO). This was first introduced in June 2020 and relaxed restrictions even further than the CMCO.

Regulators made the rules more flexible

Against this backdrop, regulators have supported listed companies with extensions of reporting deadlines, delays for meetings, guidance on virtual AGMs and other initiatives. Perhaps not surprisingly companies largely switched to virtual AGMs for 2020 (see the box Electronic AGMs: A new virtual reality in the Listed Companies section). Malaysia also allowed a temporary increase in the general mandate from 10% to 20% to allow companies to raise capital. Certain conditions had to be met, including shareholder approval at a general meeting for an increase in mandate. The measure lasted until 31 December 2020.

Reporting extensions have been permitted

Financial reporting and AGM extensions
With the first MCO issued on 16 March 2020 and extended three times until 12 May 2020, the Companies Commission of Malaysia (Suruhanjaya Syarikat Malaysia, or SSM) gave companies a moratorium on submitting statutory filings. Once the MCO was lifted, Issuers had a 30-day extension to submit any outstanding documents with SSM. Companies were also allowed 90 days to circulate financial reports and lodge financial statements and reports. Likewise, in April 2020 the SSM gave a 90-day extension to companies to hold their AGM, the clock starting from the last day their annual meeting was due to be held. Extensions have been issued as needed according to the severity of lockdown in place.

Issuers were urged to stick to their original deadlines

The SC and Bursa Malaysia (Bursa) took a fairly supportive line, allowing flexibility in the filing of quarterly and annual reports and the timing of AGMs. Bursa nevertheless urged issuers to stick to their original deadlines if possible.

Bursa also reminded them about continuous disclosure

Continuous disclosure
Bursa in mid-March 2020 reminded companies of their continuous disclosure obligations under the listing rules, including the need to make an immediate announcement should there be any material information to report.

Our company survey is a collaboration with ARE

4. Listed companies

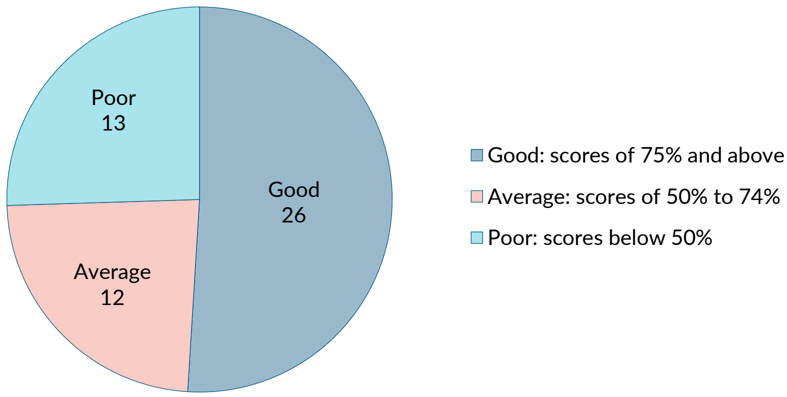
Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

Malaysia jumps from 4th to 2nd place with a score of 66%

Malaysia's score for this category increased significantly by nine percentage points to 66% in 2020. Overall, this resulted in Malaysia increasing its ranking to 2nd overall behind Australia in 2020, compared to 5th in 2018. Malaysia partly benefited from a change in methodology, which used a more automated approach to scoring to assess the chosen 15 large cap companies and 10 mid-cap companies. But the core reason its score increased was because of incremental improvements in disclosure by Malaysian listed companies. Stronger disclosure requirements mandated by 2017 revisions to the corporate governance code seem to have had an effect. Likewise, a requirement for companies to provide corporate governance information in a template provided by Bursa makes it much easier to find relevant information. It also helps the SC to assess compliance with the code, which it reports on through its publication, *CG Monitor*. Our aggregate results showed that large caps performed well in 26 out of 51 questions, averagely in 12 and poorly in 13 (see Figure 4).

Figure 4

Malaysia: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where Malaysia does well

Disclosure is generally good and timely

According to our analysis, companies in Malaysia generally provide a wide range of information to investors in a timely manner. In general, Bursa listed companies make their annual reports and company announcements readily available on both stock exchange and company websites. General meeting notices and circulars have relevant information to enable investors to make decisions on voting. Malaysia has also improved disclosure of internal control and risk management, which helped increase its score. Issuers are also disclosing policies for mitigating corruption, pursuant to new rules brought in as part of a new regime on corporate liability for graft which took effect from June 2020.

AGM notice is improving

The overall provision and timeliness of information from mid-sized companies has also improved. We understand from the SC's *CG Monitor* that of 868 companies assessed on their 2019 disclosure, 802 companies provided notice of the AGM 28 days ahead of the meeting.

Beneficial ownership disclosure is a positive

One strong aspect of disclosure in Malaysia involves beneficial ownership. Most markets and companies provide aggregated holdings for substantial shareholders. For many markets there are also longer lists of the larger shareholders, the problem being that these often show aggregate positions for nominee shareholders which are often custodian banks, rather than the underlying investors. Malaysia's disclosure goes one step further and most companies present a beneficial owner underlying the nominee account, often giving the legal name of the fund or fund manager with discretion over buying, selling, or voting the shares. This allows investors to have a better understanding of larger peer shareholders. A further innovation would be to present a consolidated position where some fund managers have holdings in shares across multiple funds. For example, Permodalan Nasional Berhad may hold shares directly or through one of the funds issued by its wholly owned subsidiary, Amanah Saham Nasional Berhad. It would be helpful to see the holdings under this entity grouped together and similarly for other asset management organisations that include a range of different legal owners.

Where Malaysia performs averagely

Even large companies do not all provide named IR contacts

Malaysian companies performed averagely in multiple areas. For investor communications, while 10 of the 15 companies we assessed provided named IR contacts, four only provided a general contact and one did not provide any contact details for investors to use. There were different formats for communicating with investors. While 12 of the companies provided presentations or financial briefings, only one of these made a webcast of the results available. Three of the companies did not provide presentation materials. We believe it is important to strengthen disclosure here given the challenges of holding in-person meetings. It is notable that companies generally provide few details of shareholder engagement overall.

Nomination committee disclosure is basic

For nomination committee reporting, Malaysia excels in providing information on training. But other nomination committee reporting is basic. There is sparse information about decisions taken throughout the year. Board evaluations are undertaken, but almost no tangible outcomes are shared with investors. None of the companies provided a board skills matrix. This latter point is particularly important as boards need to consider where and how to strengthen their understanding of climate change and other sustainability issues.

Sustainability reporting is not strategic

All 15 companies provided lists of priority or material sustainability issues. However, only four of them provided detailed disclosure. Furthermore, there is almost never a link between the issues identified as material in sustainability reporting and the issues identified as important on risk registers. We believe the only way to address this lack of joined up thinking is to ensure that there are specific board members accountable for overseeing the integration of sustainability into business strategy, which could be through establishing a board sustainability committee. There are very few companies that have done this.

Where Malaysia does poorly

There is limited detail on changes in costs

There are multiple areas where Malaysian corporates do poorly. While there are informative notes to balance sheets, there is generally less information accompanying profit and loss statements and in particular limited details on costs and movements in costs.

Remuneration disclosure is lacking

Remuneration is another area where disclosure remains weak. To be clear, Malaysian companies routinely provide information about board director fees and broader remuneration for executive directors who sit on the board. Further, independent directors are not paid with distorting incentives, such as stock options. However, there are significant gaps regarding the pay for the most senior management, generally the top five executives, where the individuals are not on the board. The primary gap is that there is no discussion to help investors understand the link between remuneration and strategy or performance. The usual expectation is to understand which factors are used to judge performance of these senior executives. Investors seek to understand management incentives to see if there is good alignment between management and investors.

Corruption information is still limited, despite improving

There has also been a steady improvement in disclosure on policies in relation to corruption. Corporate disclosure typically includes rules on gift giving and 13 of the companies provided detailed whistleblowing policies, with the remaining two providing policy that was less detailed. We believe the improvements were likely due to companies anticipating liability for graft under the Malaysian Anti-Corruption Act that came into force in June 2020. The SC shared a similar view in its *CG Monitor*. However, there is still limited information beyond the basic gift policy. For instance, companies should make their detailed codes of conduct publicly available, and these should generally provide illustrative examples to guide employees.

ESG and climate are not part of business strategy

Malaysian companies are still poor at addressing sustainability or ESG concerns. The Bursa requirement for a sustainability statement has had a positive effect over the years. Sustainability reports have typically moved beyond a narrow focus on philanthropy or community investment to cover operating metrics. All 15 of the large-cap companies reviewed referred to communication with stakeholders, but there was typically little information about the changes in priorities or the nature of communications over the year. Companies list material issues with little discussion of how they have identified them. Also, the companies frequently fail to provide disclosure about how they are addressing the material issues they have identified. While there are metrics these often fail to be comprehensive or adequately address the identified issue. There are very few targets in relation to improving ESG or climate-related matters. Most companies provided no discussion of the physical impacts of climate change.

A cursory approach to sustainability

Leading Malaysian companies, such as Sime Darby Plantations, Felda Global Ventures and Top Glove, are now facing export challenges due to concerns about labour violations. Whether or not the trade restrictions are fair, the boards of Malaysian companies need to work harder to understand the strategic implications of issues such as labour rights. It does not make sense to identify the issues as material in the sustainability report and then ignore them when reviewing the business strategy or even in risk related processes. One enabling step that boards can take to address sustainability is to appoint a board committee with a specific remit and terms of reference.

Figure 5

Helicopter view: Rating Malaysia's CG disclosure and governance, 2020

Good	Average	Poor
❑ Annual reports and company announcements are readily available ❑ Most companies provide relevant information in general meeting circulars ❑ There is good disclosure on beneficial ownership ❑ Balance sheet items generally have detailed explanations ❑ CG and audit committee reports often refer to substantive items for the reporting year ❑ There is specific disclosure relating to director training ❑ Audit and risk management reporting is often informative	❑ Some companies do not provide IR contact information ❑ Not all companies provide financial information in a range of formats, eg recordings of webinars ❑ There is predominantly basic reporting from nominations committees ❑ Board evaluations are typically undertaken, but reporting is uninformative ❑ Few independent chairs, but there are lead independent directors ❑ There is good audit/ non-audit fee disclosure, but somewhat high levels of non-audit fees ❑ Most companies have materiality matrices	❑ There is limited discussion of costs ❑ There is little disclosure of shareholder engagement activity ❑ We did not see any companies that provide a board skills matrix ❑ Remuneration committee disclosure is weak, with few companies providing the amount or structure for the top five senior management pay ❑ The basis for NED fees is typically not provided ❑ Companies typically have rules on gift giving, but many do not publish a detailed code of conduct ❑ Few companies provide targets for addressing material ESG issues ❑ Few companies recognise the physical risks posed by climate change

Source: ACGA, ARE

Next steps

Key advocacy points flowing on from the above discussion include:

Quick wins

- ❑ Provide IR contacts and disclose stakeholder and shareholder engagement
- ❑ Provide recordings of webinars and analyst briefings on websites
- ❑ Publish detailed codes of conduct including case studies
- ❑ Provide further information about the results of board evaluations such as the resulting action points
- ❑ Companies should disclose more detail on costs in footnotes to the accounts

Medium to long-term challenges

- ❑ Remuneration disclosure should cover the structure of incentive packages for senior management
- ❑ Nomination committees should strengthen assessments of board skills and experience requirements and include climate change and sustainability as part of the required mix
- ❑ Boards should establish sustainability committees with public terms of reference to oversee changes in strategy required to address the risks and opportunities of climate change
- ❑ Companies should provide a strategic approach to ESG, particularly climate change, with appropriate plans and targets
- ❑ Boards should continue to strengthen independence, seeking an independent chairman or ensuring that lead independent directors have no formal or informal relationships with management
- ❑ Companies should continue to strengthen committee reporting to cover substantive discussions that occurred during the year, rather than repeating standing items

Climate change creates transition and physical risks and opportunities

Blowing hot and cold

The February 2021 CLSA Blue Book titled Green Stepping Stones, written by CG Watch Malaysia chapter author Benjamin McCarron and his team at ARE, provides an in-depth review of the challenges and opportunities that climate change presents for Malaysia and its industries. There are broadly two types of risks and opportunities to consider: transition risks as economies move to low carbon and introduce new regulations, and physical risks such as floods, storms, rising sea levels and droughts.

As a signatory to the Paris agreement, Malaysia has committed to reduce carbon emissions per unit of GDP by 45% by 2030 from its 2005 levels, but its trajectory so far means it will need to step up its efforts to meet the target. While the government was quiet on climate change in 2020, there were significant developments within the industry. In October 2020, Petronas became the first company in Asia to announce a 2050 carbon neutral target. Tenaga Nasional Berhad unveiled far higher renewable capacity targets. CIMB announced it would stop financing new coal power or mining and would phase out coal exposure entirely by 2040.

Assessments found Malaysian companies only just started to address climate change implications

Despite these positives, the assessments of Malaysian companies found they are only just starting to address the strategic implications of climate change. The study gave average climate-related financial disclosure scores of only 38% to eight large listed companies that were reviewed from four high exposure sectors: banks, power, transport infrastructure and consumer. It will be important for the larger players in Malaysian industry to take stronger steps, or local companies may struggle to compete against international firms that have used carbon reduction to drive efficiency through their operations and enter new industrial and consumer markets.

Key recommendations for companies include:

For all sectors:

- Establish a board level sustainability committee with public terms of reference and ensure that the board has relevant climate change or sustainability experience;
- Conduct climate scenario analysis. Stress tests on physical risk should be based on scenarios at the upper end of potential impacts. There should be a transition risk scenario where mitigation limits temperature rise to the Paris objectives, ie, less than 1.5°C to 2°C; and
- Align business strategies to Paris Agreement objectives.

Banks should also:

- Disclose balance sheet exposures to high-risk sectors and publish policies with minimum standards for these sectors. For palm oil, this should include methane capture. For energy this should include a commitment to stop new coal capacity regardless of technology used or the geography; phase out all financing for coal power by 2030 in OECD markets and 2040 in non-OECD markets; and cease financing for oil and gas exploration; and
- Assess climate-related opportunities and size up necessary financing requirements to capture the market share in growth areas.

Power companies should also:

- Commit to a complete halt of coal capacity addition; provide timelines to phase out coal entirely by 2030 in OECD markets and 2040 for non-OECD markets and establish a decarbonisation roadmap with interim timelines.

Transport infrastructure companies should also:

- Set out business plans that include service provision for low carbon vehicles, whether ships, planes, trains or automobiles.

Consumer companies should also:

- Introduce low carbon and sustainable product offerings to support changing consumer preferences, such as the switch to plant-based foods; and
- Address risk in the supply chain including physical risks and greenhouse gas emissions-related challenges such as deforestation.

Electronic AGMs: A new virtual reality

Virtual AGMs arrive

Company law in Malaysia allows companies to hold virtual AGMs unless their articles expressly state otherwise. The chairman must be present in the country: if he is not in Malaysia, the role must be delegated to someone who is. With social distancing restrictions in place to varying degrees at any given juncture, a pattern emerged in the type of meeting held: hybrid and/or physical meetings during the less restrictive periods, or virtual ones when strict lockdowns were in place. On 16 March 2020, the Companies Commission (SSM) issued instructions on how companies in Malaysia could apply to delay their AGMs until after the expiry of the Movement Control Order (MCO), a restriction on mass gatherings and travel. Public companies in Malaysia are required to hold an AGM within six months of their year-end and not more than 15 months after their previous AGM.

SC issues new guidance for holding AGMs under the pandemic

On 18 April 2020 the SC issued new guidance on general meetings and stated that listed companies 'shall only conduct fully virtual general meetings" during the MCO period. However, the SC allowed a maximum of eight people to be physically present to manage the meeting, including the chairman, CEO, CFO, company secretary, auditor and those providing technical support. The SC also encouraged issuers to "continue leveraging technology, even beyond the MCO period'. Hybrid meetings were not allowed during the MCO period.

Physical AGMs only possible when movement controls are removed

As new control orders were introduced in Malaysia, either tightening or loosening restrictions, the guidance on meetings was revised. For example, with the introduction of the Conditional Movement Control Order (CMCO) in May, only virtual meetings were allowed. During the Recovery Movement Control Order (RMCO) issued in June, companies could choose to hold fully virtual, hybrid or physical-only meetings. During an Enhanced Movement Control Order (EMCO), issuers were prohibited from conducting a meeting at a locality under the order: if such an order was in place, issuers were recommended to delay the AGM. The various orders in place during 2020 and 2021 were as follows (these were issued both nationwide and across individual states as needed):

- **Movement Control Order (MCO)**: no mass gatherings and a general prohibition on movement, sports, social and cultural activities. Closure of all government and private premises with the exception of essential stores and services. Closure of schools and universities and a ban on travel both nationwide and outside Malaysia.
- **Enhanced Movement Control Order (EMCO)**: residents are confined to their homes, businesses remain closed, food supplies are supplied by authorities to residents and all roads into the area are blocked.
- **Conditional Movement Control Order (CMCO)**: travel permitted for work purposes, and for those providing healthcare and medical services. Funeral attendance permitted with a 20-person limit.
- **Recovery Movement Control Order (RMCO)**: travel permitted for work purposes, house gatherings allowed for celebrations. Public transport at half capacity.

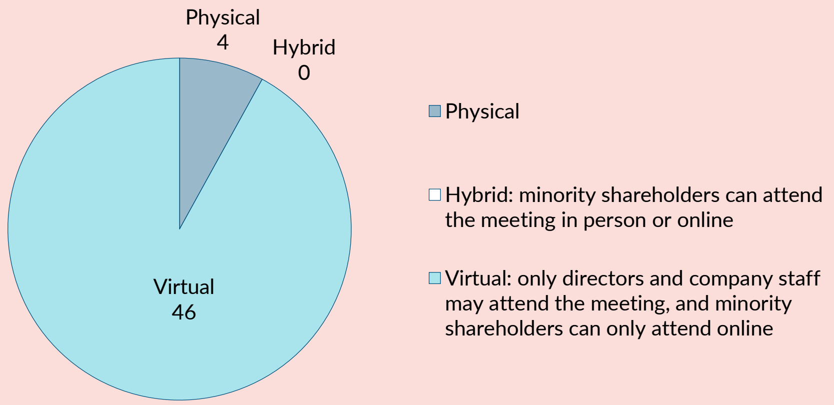
Virtual is the new reality

Meanwhile, ACGA found that out of the top 50 issuers by market cap, only four held physical meetings in 2020. These took place early and before the spread of Covid.

Almost all top 50 issuers held virtual meetings in 2020

Figure 6

AGM modes in Malaysia: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

5. Investors

Malaysia ranks 5th with a score of 43%

Malaysia's score here improved here by five percentage points to 43% in 2020, but it slipped two places to rank 5th. The better score reflects both genuine improvements in investor practices and adjustments due to changes in our research and scoring methodology. The downgrade in rank is due to significant improvements in Korea and India that resulted in both markets narrowly beating Malaysia.

No uniformity

Patchy approaches to stewardship prevail

Stewardship behaviour varies across the institutional investor base. While all the major domestic asset owners we reviewed discuss their approach to responsible investment or stewardship, the main asset managers serving the Malaysian market are far behind. Foreign institutions typically take their voting responsibilities seriously, but many do not have on the ground presence in Malaysia, so there is limited engagement. The score for the retail investor category is boosted by the presence of the Minority Shareholder Watchdog Group (MSWG) which continues in its role of reviewing corporate governance in relation to Bursa listed companies.

The IIC fosters senior level engagement

A further strong aspect of the Malaysian stewardship ecosystem is the Institutional Investors Council Malaysia (IIC), which was formed in July 2015 following the launch of the Malaysian Code for Institutional Investors. The membership comprises many of the key financial institutions in Malaysia. The IIC has a distinctive engagement model in which senior leadership of the signatory institutions meet with board members and senior management at investee companies. Company engagements in 2020 included with FGV Holdings and Bursa Malaysia, while engagements in 2019 included IOI Corporation, Tenaga Nasional Berhad, IHH Healthcare, Malaysia Airports Holdings and Telekom Malaysia. In each case, the engagement topics covered a range of issues alongside ones that are particularly pertinent to each company.

Engagement by domestic players

Asset owners take steps . . .

We reviewed the disclosure and practices of many of the leading asset owners in Malaysia including Employees Provident Fund (EPF), Kumpulan Wang Persaraan (KWAP), Khazanah Nasional, Permodalan Nasional Berhad (PNB), and the Social Security Organisation (SOCSO). They have all taken steps to strengthen their approach to responsible investment and stewardship. All of them have signed the local stewardship code and joined the IIC, which coordinates collaborative engagements in the local market. They all have policies on corporate governance or ESG, although we could not locate the documents for SOCSO. The related disclosures indicated that each of the asset owners engaged with holding companies. However, none of them published information regarding voting or engagement.

. . . while asset managers fall behind

We also assessed 10 domestic asset managers and found that they were far behind the asset owners. Only four of the 10 asset managers had signed the local stewardship code. Only two clearly stated that they had a policy on corporate governance or ESG, which in both cases covered engagement, but the documents were not publicly available. There was no other indication that the asset managers voted in an informed manner or attended AGMs.

The foreign dimension

Foreign investors often engaging over bad news

There is a different landscape for foreign institutional asset managers. The major global institutions typically have voting policies, and these extend to their holdings in Malaysia. Those with a footprint in Malaysia also engage directly and sometimes attend AGMs. The foreign investors that are not based in Malaysia typically have a lower emphasis on engagement. Where there are attempts to engage, these often relate to public allegations of grievances, such as environmental and labour violations in palm oil supply or glove manufacture.

What our members say

As part of the research for CG Watch 2020, we conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As the responses showed, most respondents invest in Malaysia but as expected for a smaller market, the number of investments held is considerably fewer than in larger markets:

- Some 35 or 80% of foreign investor respondents invest in Malaysia - slightly above the Philippines, slightly below Singapore, and lower than other markets that range from 84% to 93%.
- Only 21 respondents answered the question on the exact size of portfolios. The average number of investee companies per respondent was 48, with a range from one to 168. The average figure is notably higher than the Philippines, broadly in line with Indonesia, Singapore and Thailand, well below the 100 to 130 in Hong Kong, Korea and Taiwan and far below China and Japan.

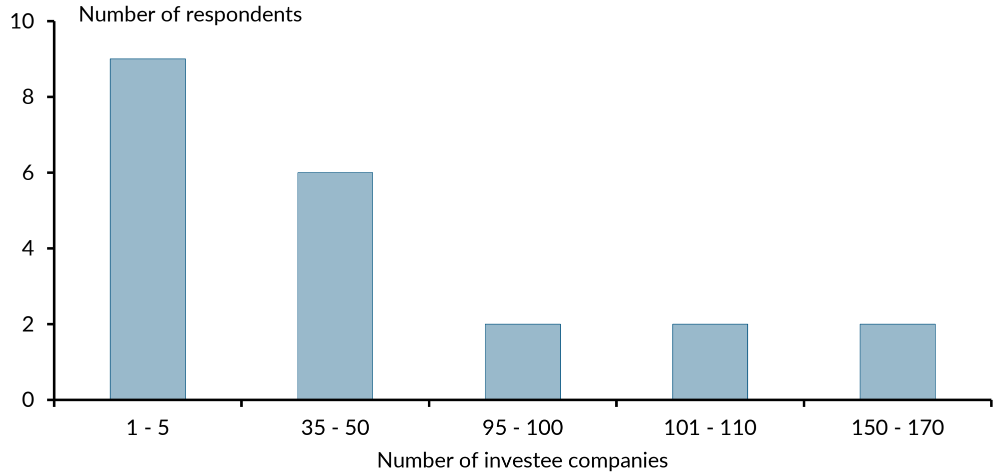
(Note: All figures quoted in this section exclude any Malaysian members who responded to our survey.)

Most respondents have portfolios of 50 or less

Another way to show the extent of investment in Malaysia is to group portfolios by size. As the following figure shows, while a few ACGA members invest in close to or more than 100 companies each, most have portfolios of 50 companies or less.

Figure 7

Foreign investors in Malaysia: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Global investors vote against in 10%-20% of meetings

Although Malaysia is a relatively small market from the perspective of global institutional investors, respondents still take voting seriously. They also vote against a reasonable number of management resolutions:

- Nearly all respondents with holdings in Malaysia vote in 100% of their investee-company AGMs. One votes in 50%, two in only 20% to 30%, and one votes in zero.
- On average, they voted against at least one management resolution in 11 meetings in 2020. The median figure, which is arguably more representative, was seven meetings. This means that these investors are voting against a resolution at 10% to 20% of their investee-company AGMs in Malaysia.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director and executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Company engagement

A mixed picture emerges

The level of global investor engagement with companies in Malaysia is limited in absolute terms. Japan absorbs the largest part of foreign-investor engagement energy and budget, followed by China, Australia, Hong Kong, Korea and India. Southeast Asian markets uniformly attract much less attention in terms of the number of engagements.

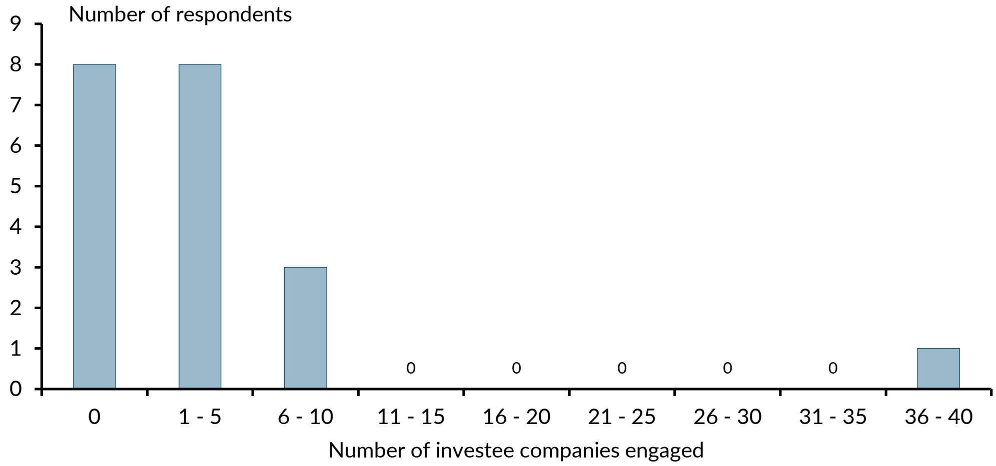
Not a whole lot of engagement going on

Of the 35 respondents who indicated they invest in Malaysia, 20 answered our question on company engagement. Of these, eight said they undertook no engagement at all over 2019 and 2020. Of the remaining 12, one engages with a relatively large number of issuers while the remainder engage with 10 or fewer, as the following figure shows.

Most respondents have low engagement

Figure 8

Foreign investor engagement prevalence in Malaysia, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Average engagement is lower than most markets

In terms of the relative level of engagement in Malaysia, ie, as a percentage of companies invested in, our survey provides some tentative answers. The figure for most of those who answered is 10% or less but rises to 20% to 30% for two institutions, including the one engaging with 40 listed companies a year. It is important to emphasise that these results do not include foreign-owned asset managers in Malaysia such as Aberdeen Standard Islamic Management. Other respondents are predominantly foreign institutions based outside Malaysia.

The retail scene

A growing number of retail investors capable of asking specific and challenging questions

Retail investors are a mixed bunch. Many are still clearly happy to attend AGMs hoping for a decent meal and some goodies - hopes that were dashed in 2020 as Covid and Malaysia's Movement Control Order shifted practices to virtual AGMs. There is also a growing number of well-informed retail investors capable of asking specific and challenging questions of management. The SC along with MSWG and IIC are seeking to facilitate a more actively involved retail base, including through launching the Annual General Meeting Corporate Governance Checklist for shareholders. This checklist includes a range of questions across eight categories helping shareholders think through whether they are satisfied with information provided and conduct of AGMs.

Minority investor watchdog ups the ante

MSWG's continuing role is particularly notable. The organisation provides questions in advance of AGMs and companies frequently include these and responses as an addendum to the company presentation at the start of the Q&A section of the meeting. The consistent assessments have improved the quality and professionalism of AGMs over time in Malaysia.

Next steps

Domestic asset managers need to step up

Domestic asset managers should take much stronger action across the board. This includes signing the stewardship code, developing meaningful policies on corporate governance and ESG, and voting in an informed manner. Asset managers should also report publicly on these activities so that clients and the market can understand that expectations of company behaviour have increased.

Local asset owners should disclose voting records

Asset owners can go further in making their policies public, disclosing voting records, working with foreign institutions, and reporting on engagement case studies.

Investors should strengthen approach to addressing climate change

Institutions should significantly strengthen their approach to managing the strategic implications of climate change. This includes strengthening the research base to understand the implications to investee companies and broadening responsible investment activities to multiple asset classes. Climate change considerations - both transition and physical risks and opportunities - should factor into fixed income decisions, real estate and infrastructure investment processes in addition to equity.

6. Auditors & audit regulators

Malaysia is still joint 1st with a score of 86%

Malaysia held on to joint 1st place in this category with a slightly higher score of 86%, up two percentage points from 2018. It continues to share this ranking with Australia, where the score increased by the same amount.

Key legislation stalls

We had hoped after CG Watch 2018 to see the introduction of reforms in the accounting profession. While there has been some progress with competency frameworks, the long-hoped for new Accountants Act has stalled, delaying reforms that are necessary to strengthen enforcement. We also proposed longer cooling-off periods for former audit partners before they can audit committees at companies where their former firm is the auditor. There has been a small improvement here: the definition of independent director has increased cooling-off periods to three years, from two previously.

Audit oversight and standards

The picture on enforcement is too vague

Here Malaysia's score dropped in two places:

- **Audit industry oversight:** While we still take a positive view of the Audit Oversight Board (AOB), we tightened our assessment of audit industry oversight. This was in part due to limited reporting on enforcement. The AOB section on the SC website provides enforcement reporting, with a list of cases outlining the parties involved, a brief description of misconduct, and information on actions taken together with the status of cases where there are further court proceedings. The description of cases only refers in vague terms to the regulation that has been breached, while the description of the cases is very brief. It is helpful where cases have more specific descriptions, setting out the precise action or omission with reference to the relevant section of the regulation or standard that has been breached.
- **Independent audit standard setting:** The reason for the decline is that we have taken a tighter view of the independence of the Auditing and Assurance Standards Board (AASB). This body sits under the Malaysian Institute of Accountants (MIA) and sets standards for the audit industry. The AASB states that it "comprises members representing various sectors such as professional accounting firms, academia and the public. Members are appointed by the Institute's Council based on recommendations from the Institute's Nominating Committee". AASB calls itself an independent standard-setting body, however most of the board comprises representatives from the profession.

Ethics, mid caps and capacity

Ethical rules have been quickly adopted

Scores increased in three areas:

- **External auditor independence:** We reviewed the way that we assessed rules relating to the independence of external auditors, which led to this question. The International Ethics Standard Board for Accountants released a new Code of Ethics, which was adopted into the MIA by-laws. Malaysia has aligned itself to international standards on auditor rotation. In general, there is weak whistleblower legislation in Malaysia, however, there are specific protections for auditors, including a positive duty to report. Overall, we viewed these different aspects as positive.
- **Mid-cap company preparation:** This score increased one point, largely for methodological reasons. The focus of our question was tightened to look only at mid caps, not small and medium-sized enterprises (SMEs) as in the past, and since the mid-cap universe contains some quite large and professionally run companies an uptick in score was warranted.
- **Strengthening of audit firms:** The question reviews the extent to which the audit regulator promotes the capacity, quality, and governance at audit firms. The AOB has long taken actions to support stronger firms in the market for public interest entity audits. This has included encouraging consolidation of smaller firms. This is important for several reasons, including that small firms with few partners often find it hard to appropriately plan for succession. We also note the new requirements for larger firms to publish transparency reports that will allow a better understanding of audit firm governance.

Annual Transparency Reporting

Greater clarity on audit firms is coming

The AOB issued its transparency reporting requirements in August 2019. These are mandatory for AOB registered firms that for two years in a row have more than 50 public interest entity audit clients with combined market capitalisation of above RM10 billion. Other audit firms are encouraged to provide transparency reports.

Transparency reports to help audit committees select on quality, not just on price

The contents of the reports cover a wide range of topics including: the audit firm's legal and governance structure; the measures taken to uphold audit quality and manage risks; and a full suite of audit quality indicators. There is a mix of qualitative and quantitative information and the audit firms are expected to provide information to enable the reader to understand relevant indicators. The audit quality indicators are grouped under the following headings:

- Audit partner workload;
- Auditor independence;
- Capacity and competence of audit practice;
- Audit engagement supervision;
- Audit firm's investment to uphold quality; and
- Internal and external monitoring reviews.

Covid resulted in delays to the timeline for transparency reports

Under the initial AOB timeline, audit firms had to provide their first transparency reports in respect of the year ended 31 December 2019. But due to the Covid pandemic, in April 2020 the AOB granted an extra grace period and allowed for the first transparency report to be in respect of the year ended 31 December 2020.

Delays to the Accountancy Act are disappointing

Still waiting for a new Accountants Act
Reforms in Malaysia can take a long time. The first Companies Act was in 1965 and the first Accountants Act followed two years after in 1967. While there was a new Companies Act in 2016, the accountants are still waiting. This matters as the accounting industry needs to be better able to discipline itself and the wider business community needs a better understanding of the capabilities of accountants.

A bill is with the Ministry of Finance

The passage of legislation has been delayed due to the change in government and the time spent addressing the Covid crisis. However, the Ministry of Finance secretariat has been preparing a new Accountants Bill along with supporting cabinet papers to get a green light from ministers. The new bill proposes a range of measures for the MIA's governance, competency frameworks, and enforcement related powers.

MIA needs to have stronger enforcement powers

The MIA currently has multiple challenges in respect of enforcement. While the MIA has the responsibility of regulating the profession, the power of investigation resides with the police, which makes it much harder for the MIA to discharge its enforcement responsibilities. The new proposals strengthen the disciplinary processes for members adding laypeople to the disciplinary committee and increasing sanctions for breaches to create further deterrence. The reforms will also provide criminal enforcement powers to allow the MIA to act against non-members that are inappropriately providing accounting or related services.

New membership tiers are on the cards

Another major reform is to define three types of MIA membership: chartered accountant, accountant, and accounting technician. The required competencies and certifications will be calibrated against international education frameworks. This will help the market employ people of the right capability with the right qualifications for the right roles.

Next steps

Legal change is needed

As before, the main concern is the introduction of the new Accounting Act to support reform across the profession.

Better disclosure would help

The AOB could also provide more information in respect of cases to better inform the broader community of where audit related transgressions receive sanctions.

7. Civil society & media

Malaysia ranks 8th with a score of 43%

Overall, there has been a modest decline in Malaysia's score, which was down by four percentage points to 43% in 2020, although it remains in 8th place. After initial improvements in press freedom following our 2018 report there was a steep decline. Elsewhere the landscape for director training has improved as the Institute for Corporate Directors Malaysia (ICDM) has become better established, having been launched shortly before the publication of the previous survey.

Civil society is not so focussed on CG

There remains relatively little academic work in relation to corporate governance or ESG more broadly. There are many civil society organisations operating in the country. However, there are relatively few that focus on corporate governance. The Institute for Democracy and Economic Affairs (IDEAS) is a notable exception and has produced multiple relevant studies since CG Watch 2018.

Press freedom

The media has faced a squeeze . . .

The media has come under significant pressure in Malaysia. Good corporate governance relies on appropriate access to reliable information. When the media comes under significant pressure this can reduce accountability for key decision-makers in various contexts across capital markets.

. . . with freedom reversed

There were significant gains for the free press under the Mahathir administration, which we noted in CG Watch 2018. The Reporters Without Borders 2020 World Press Freedom Index also tracks the changes and shows an improvement in Malaysia's ranking from 145 in 2018 to 123 in 2019, and 101 in 2020. However, there has been a marked deterioration following the change in leadership in early 2020, with multiple cases where authorities have clamped down on dissenting views.

Independent Malaysiakini receives hefty fines . . .

In a case that has received worldwide attention, online news portal Malaysiakini was found guilty on 19 February 2021 of contempt of court and issued a fine of RM500,000. There have been widespread concerns that this judgment will have a chilling effect on online discussion.

. . . over reader comments

The judgment revolved around five comments submitted by readers that were made in response to an article on the site about the reopening of courts following Covid-related restrictions. According to Malaysia's Attorney General, the comments implied that the judiciary had committed wrongdoing, was corrupt, and lacked integrity. Although Malaysiakini staff had not written the comments, the portal was deemed to have published and promulgated them, according to a 6-1 majority judgment by the Court of Appeal. The prosecutor had asked for a fine of RM200,000 but the court ruled that a higher amount was justified. The court did not find the editor, Stephen Gan, guilty of the same offence. The dissenting judge noted that prosecutors had not shown a deliberate intent by Malaysiakini to publish the comments, that it had apologised for them unreservedly and had taken them down within 12 minutes of a police notification of the matter. The case was brought under the Communications and Multimedia Act 1998 and the Penal Code.

Al Jazeera also faced a heavy handed investigation

Another example was a police investigation into Al Jazeera following the documentary Locked up in Malaysia's Lockdown aired on 3 July 2020. The programme covered Malaysia's treatment of undocumented workers, with rights groups criticising mass arrests of undocumented foreigners including children and authorities claiming the arrests were necessary to contain the spread of Covid. The official justification for the probe into Al Jazeera was that the programme was inaccurate and misleading and was allegedly seditious, defamatory, and in breach of a communications law. Actions taken by authorities included raiding the news network's offices; seizing two computers; questioning seven journalists; not renewing work visas for two journalists; and arresting and deporting Mohammad Rayhan Kabir, one of the people interviewed in the programme. The country's Inspector General of Police Abdul Hamid Bador also urged that international media be responsible and should not 'write something...that is inaccurate'.

Director training provision continues

Directors' institute continues to establish itself

We have raised the score for the provision of director training in Malaysia. The ICDM has continued to make progress since its launch on 1 October 2018. It has established a full programme for directors with regular training across a broad range of topics. The ICDM also hosts Climate Governance Malaysia, an initiative of the World Economic Forum that targets non-executive directors and seeks to raise their knowledge and understanding of climate change. Climate Governance Malaysia was launched in May 2019 and has hosted a wide variety of events since then.

Iclif forms new entity with Asia School of Business

The Iclif Leadership and Governance Centre also has a leading role in director training in Malaysia, particularly for financial firms. It was originally developed jointly by Bank Negara Malaysia (BNM) and the Malaysia Deposit Insurance Corporation. In November 2019, Iclif merged with the Asia School of Business, which is a venture between BNM and the MIT Sloan School of Management. The new organisation is known as The Iclif Executive Education Center at Asia School of Business.

Next steps

Allow a free media

Regulators should reduce the barriers to a free flow of information by strengthening the independent media. It will be important to reform laws to reduce concerns over arbitrary investigations and fines.

Encourage civil society participation in consultations

It will be helpful to encourage stronger inputs from civil society organisations. Longer consultation periods would help, such as the three-month window BNM provided to respond to its paper on climate change. Consultations would benefit from greater transparency, such as providing a conclusion paper that reviews the substantive points, providing the names of responding organisations, and publishing the responses.

Business associations could ramp up standards

Business associations have typically had a limited role supporting positive corporate governance reforms in Malaysia. However, they are often able to support tougher level playing fields or address issues such as corruption or combating climate change. There would be benefits for corporate governance and sustainable development if business associations took on a more forward-thinking role.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- ❑ Momentum must continue for regulatory efforts to address climate change
- ❑ Continued political changes and interference at government-linked companies and investment companies
- ❑ A rollback on corruption-related reforms or failures to convict offenders
- ❑ Regulatory reform fails for the accounting profession
- ❑ Continued suppression of the media, which reduces the flow of information necessary for corporate accountability

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ Protect listed government-linked companies from political interference in appointments
- ❑ Strengthen remuneration disclosure to include the factors used to assess performance for variable pay awards
- ❑ Finalise Bursa RegSub arrangements
- ❑ Improve narrative reporting for capital market enforcement strategy and statistics and provide specifics from cases
- ❑ Require voting disclosure from institutional investors

Philippines – Signs of life

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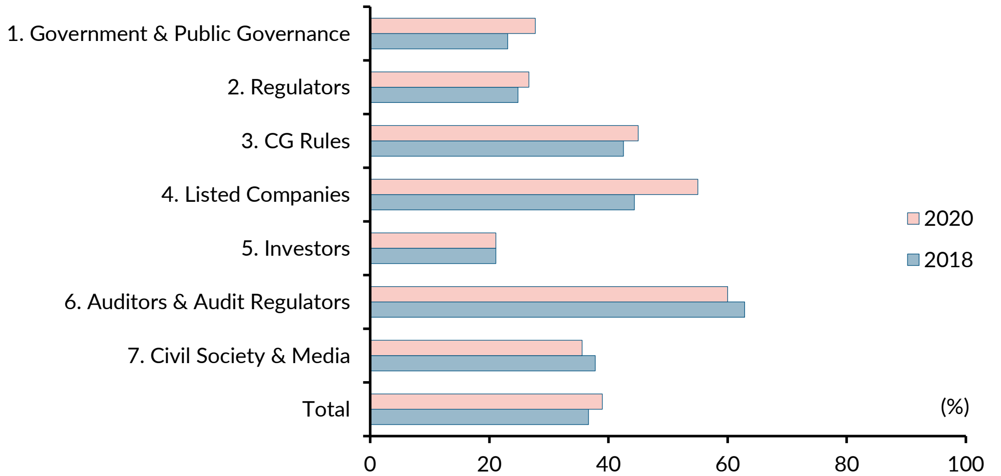
- The Philippines inched away from last place to outscore Indonesia again
- A surprising but welcome burst of regulatory zeal, mainly from the SEC
- Do the signs of life from a perennial CG laggard presage a new direction to CG in the country or merely herald a false dawn? Hard to say
- Scores increased for Government & Public Governance, Regulators, CG Rules and Listed Companies . . .
- . . . but dropped for Investors, Auditors & Audit Regulators and Civil Society & Media
- There are few signs of CG advocacy among local and foreign investors
- Chronic underfunding and other resource constraints at regulators remain major roadblocks to further progress on CG reform, as do recalcitrant company management and thuggish politics
- President Duterte's authoritarian and prescriptive approach has wrought progress on CG rules, but continues to threaten social freedoms and the media

The Philippines ranks 11th again with a score of 39%

Figure 1

Philippines CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Is CG in the Philippines about to take off?

After years bumping along the bottom of our CG Watch table of scores hand-in-hand with Indonesia, the Philippines finally lifted itself off the foot of the table and put a few useful percentage points between itself and its perennial rival for last place. The reason for the improved overall score is largely attributable to a notable improvement in governance at the Securities and Exchange Commission (SEC) that coincided with a new Chair, Emilio B. Aquino, appointed by President Rodrigo Duterte in June 2018.

SEC deserves credit for leading the key reforms

Aquino has certainly improved the professionalism as well as momentum at the SEC which introduced a number of important CG initiatives, details of which are provided in the Regulators section of this narrative. Along with a revitalised SEC, the Philippine Stock Exchange (PSE) also rediscovered its regulatory teeth and introduced some welcome improvements in regulations to narrow the still significant gap between local and international standards of listing regulations.

Recapping CG Watch 2018

Lack of external engagement

It would be tempting (and self-flattering) to presume that the improvement in the Philippines' overall CG Watch score was a result of extensive engagement with ACGA and paying close heed to our past CG Watch commentary. Alas, that is not the case. Indeed, engagement with local regulators remains difficult and political, especially with the current administration. Duterte's government is fiercely nationalistic and not one to take outside criticism (or advice) easily. Rather, the improvements that have come (mainly) from the SEC, have been internally generated, perhaps in part, in response to regional peer pressure.

Duterte's administration is competent yet controversial

In truth, the increase in the Philippines' improved CG Watch score is more a result of the technocratic Duterte regime. Love him or hate him, the president has arguably achieved more practical and material results in terms of economic progress in his six years than has been the case in the last two generations. He remains hugely popular domestically. Duterte has, in large part, smartly surrounded himself with capable technocrats who have been held accountable by the most powerful president since Ferdinand Marcos. While by no means perfect, the results are tangible; and begrudgingly warrant recognition. His prescriptive and direct approach has come with serious costs and consequences-notably the loss of life amid the putative war on drugs and the alarming suppression of personal liberties from the emasculation of the free press, more of which is covered in our section on Civil Society & Media. But Duterte's approach to the economy has, to a large degree, worked.

Improved rules and practices drove some scores higher

The Philippines scored higher in four out of our seven categories: Government & Public Governance; Regulators; CG Rules; and Listed Companies. It fell in three categories: Auditors & Audit Regulators; Civil Society & Media; and Investors. In most cases, the higher scores were a direct result of improved rules and practices. In the case of the drop in scores, the country's score in Auditors & Audit Regulators suffered in the main due to a change in our scoring methodology, while investor ennui, particularly institutional, accounted for the drop in the Investors score. The fall in score for Civil Society & Media should come as no surprise nor need much explanation.

The Philippines remains a CG underperformer

Despite the improved scores, a little perspective is warranted. Based on our analysis, with an overall score of 39%, the Philippines ranks 11th of the 12 countries analysed, still four full percentage points below our score for China and light years from the top market, Australia at almost 75%. Still, we should be grateful for small mercies and hope that the small but marked improvement in overall score presages the start of material progress for CG in the country and not merely an aberration.

The Philippines: it is where it was . . .

Figure 2

Philippines: Recap of 2018

	Recommendations	Outcomes
1.	PSE to include more than two years of company data on its EDGE website - easy!	No progress
2.	SEC and PSE to include detailed enforcement data on websites - easier!	No progress: data remains extremely limited
3.	Mandate key CG issues: term limits, poll voting, audit committee independence, directors' remuneration	No progress: all of these issues remain recommended best practice under a "comply or explain" regime
4.	Tighten definition of independence for INEDs, lengthen cooling-off periods and mandate split of Chair and CEO - and then police it!	As above
5.	Introduce a Takeovers Code - even a basic one!	No progress

Source: ACGA

1. Government & public governance

The Philippines scores 28% and ranks 12th

Our scores for Government & Public Governance rose five percentage points to 28% in 2020, but the Philippines ranked 12th, behind China and Indonesia. While the current government still lacks a clear and credible long-term strategy for promoting corporate governance reform, the Duterte administration has capable personnel in Finance, Treasury, its central bank and the SEC, with some positive impacts on CG. The government has never formalised a CG roadmap or other strategic blueprint. All such CG initiatives, policies and frameworks have come from the SEC, with scant evidence of political support from government.

The SEC and BSP lead the regulator rankings

Other than the SEC, the Bangko Sentral ng Pilipinas (BSP), the country's central bank, continues to provide effective oversight of local lenders. The Manual on the Regulation of Banks, last issued in 2018, includes sections on CG requirements and reporting, risk management, compliance, internal control and audit.

The BSP pushes bank governance

The BSP has also issued CG guidelines for non-banking financial institutions in 2017 and for banks in 2019. While these guidelines could be better, they have helped improve governance over local financial institutions. The BSP issued an exposure draft for regulations regarding the management of reputation risk in banks in March 2020 and a basic sustainable finance framework for all banks in April.

SEC lacks independence and resources

The SEC, while competent, remains a de facto arm of government and is far from independent. All of its commissioners are appointed by the president and it is subject to politicisation risk. The SEC is an agency of the Department of Finance and remains chronically underfunded: long-mooted plans to move into a purpose-built new facility have stalled and the commission is now semi-permanently housed in an ageing exhibitions centre in a run-down part of old Manila. Rather than being funded independently of government, the SEC remains a net contributor to the government via the remittance of fees and fines levied from the corporate registration operations it manages, a function that really should be hived off into a separate agency. The SEC also receives a grant from government.

New SEC chair has wrought meaningful changes

That said, the SEC has surprised us over the last two years, with CG reforms and initiatives that suggest it is more independent in thinking than previously. Its reform efforts do not however appear to come from government impetus as part of an overall strategy, more from reaction to external pressures, such as other regulatory reform. We ascribe the more professional, freer thinking of the SEC to the leadership of Chair Emilio B. Aquino, appointed in June 2018.

Regulatory regime lacks cohesion

The Philippines' capital markets regulatory system remains somewhat disjointed. The SEC assumes much of the key regulatory role, with the PSE, a for-profit exchange very much playing second fiddle. The PSE has done better in the last two years properly enforcing some of its rules and there is some cooperation with the SEC, with the latter very much in the ascendancy. The relationship seems a testy one at times and there is a lot of scope for more consistent cooperation on CG reforms.

Disappointing anti-corruption efforts

Graft remains a scourge

There is still no independent anti-corruption commission in the Philippines - and precious little chance of one being established, it seems. President Duterte did launch the Presidential Anti-Corruption Commission (PACC) in October 2017 in an effort to reduce endemic corruption in government departments. So that is a start and, in fairness, the PACC has claimed a few high-profile scalps, including at the Bureau of Customs and the Bureau of Immigration. Duterte talks a lot about fighting corruption, but the tender for the third telco licence was fudged and a known Duterte crony was awarded the contract alongside China Telecom after two other bidders were disqualified on questionable grounds.

Some improvements in GOCC governance . . .

The administration has also made a strong push to improve woeful financial performance at the 120 Government-Owned and Controlled Corporations (GOCCs) overseen by the Governance Commission for GOCCs (GCG). Indeed, the GCG published a strategy roadmap to 2022 with the key objective of improving governance. Previously agreed bonus incentive limits were suspended to reduce what Duterte regarded as excessive payments to management at certain GOCCs. The GCG abolished 30 zombie entities, approved the disposal of three GOCCs and declared a further 23 inactive.

. . . and then the PhilHealth scandal hits

Much was made of the 33% increase in 2018 dividends remitted to the Treasury from revamped GOCCs as evidence of the new governance broom. However, a more sobering assessment of the scale of the task facing the GCG was provided by the PhilHealth debacle (see box below), which saw taxpayer funds plundered by a coterie of corrupt management. The Philippines is not a signatory to the OECD Anti Bribery Convention. Its Transparency International score in 2019 was 34 points, down two points from 2018, and it ranked 113th, a fall of 13 places from 2018.

There have been signs of political interference in the judiciary

The Philippine judiciary, creaky, cumbersome but on the whole competent, is generally regarded as independent from government in commercial cases, unless the matter in hand becomes overtly political. The blatantly politicised attack via the courts on media giant ABS-CBN during 2019 and 2020 is a clear example. Officer of the Solicitor General, Jose Calida, pursued ABS-CBN on highly questionable legal grounds, in what was widely regarded as a Duterte-directed vendetta for lack of political support. Calida was appointed by Duterte soon after he was elected in July 2016. And 11 of the 15 supreme court justices have been appointed under the Duterte administration, including the Chief Justice.

Next steps

A CG roadmap is badly needed . . .

The Philippines needs to produce a comprehensive CG roadmap that encompasses all of the necessary stakeholders: SEC, BSP, PSE, GCG and other interest groups. Real commitment to executing that CG strategy on a consistent, logical and comprehensive basis will pay rich dividends. SEC-led initiatives by enlightened chairs will only get the country so far.

. . . as is an independent anti-corruption commission

The country should capitalise on the progress made by the Duterte administration to tackle endemic corruption within government by establishing urgently an independent anti-corruption commission, adequately and independently funded and with non-political commissioners.

An epic graft scandal emerges at the state health insurer

PhilHealth Plundered

In July 2020, departing anti-fraud officer, Thorrsson Montes Keith, blew the whistle on rampant corruption at state health insurer, Philippine Health Insurance Corporation (PhilHealth), claiming more than P15 billion (US$312m) had been pilfered with the collusion of senior management through years of mismanagement and malfeasance.

The schemes included fake medical claims on an epic scale, suspicious misallocation of funding meant for hospitals fighting the Covid-19 pandemic to hospitals and clinics unconnected with the effort, and bloated procurement processes for unnecessary IT equipment.

A full investigation by both houses of Congress was launched, which unearthed what lawmakers termed a "mafia" operating at the top of PhilHealth. President and CEO, Ricardo Morales, resigned and is facing administrative charges along with other senior executives and managers.

2. Regulators

The Philippines scores 27% and ranks 11th

Our score for local regulators in the Philippines increased by two percentage points from our last survey in 2018 to 27% in 2020. This puts it in 11th place. The increase was principally due to two higher scores: for the SEC in pushing through a decades' overdue revision in antiquated securities laws; and an improvement in PSE listing regulations aimed at tightening protections for minority investors.

Enforcement is the biggest problem

Despite the improvement in scores in certain areas, there were reduced scores- notably in the areas of disclosure of enforcement and other activities. And a final score of 27% is nothing to shout about: second last, just ahead of Indonesia. So, there is still a huge amount of work to be done by local regulators to bring local laws and rules anywhere near best practice.

2.1 Funding, capacity building, regulatory reform

The Philippines is in 12th place with a score of 27%

The Philippines scored 27% in this category, up three percentage points from 2018 but nevertheless it still came in 12th place. The SEC always scores poorly when we look at funding sources and capacity and this year was no exception. The main regulator used to be housed in a single dilapidated office building unfit for purpose. A putative plan to build a larger, purpose-built facility in Fort Bonifacio has still not been realised some six years or more since it was first promised. The SEC is still split across two separate facilities in Manila.

The DoF treats the SEC as a piggy bank

Part of the funding problem lies in the way the SEC is treated by the Department of Finance (DoF), the government department that oversees it. The SEC is a net revenue earner for the DoF, via the fees it levies on all of the corporate incorporation and monitoring activities it undertakes. The DoF provides an annual budget to the SEC which is clearly inadequate to provide the necessary staffing and technology investment to adequately support the SEC's statutory activities.

Adequate disclosure, sometimes any disclosure, remains a big problem

At the time of writing, the latest annual report available on the SEC website is dated 2016, which is frankly, woeful. Disclosure even in that report is sparse and far below other regional regulators, making it difficult to assess the actual status of funding, human resources and regulatory activity, save for what hits the media and is announced by the SEC itself. The same applies to assessing the regulator's investments in surveillance, investigation and enforcement capacity.

Most SEC enforcement focusses on scams and Ponzi schemes

Indeed, much of the SEC's activity relates to warnings to the public in respect of the plethora of investment scams and Ponzi schemes that proliferate in the archipelago nation. Its Enforcement and Investor Protection Department is effective at shutting down these scams quite quickly, only for a new scheme to emerge (see box in Enforcement section). This leaves little to no resources for the prosecution of insider trading or listed company misbehaviour.

Stock exchange no role model

Disclosure is a bit better at the PSE, partly because it is self-funded

The situation is a little different at the PSE, which is a self-funded self-regulatory organisation. Disclosure of its activities is a little better, which is not saying a great deal. And the PSE still operates the Capital Markets Integrity Corporation (CMIC), which does undertake surveillance on market manipulation and other trading irregularities. Its disclosure, however, while better than the SEC, remains weak: at the time of writing the latest data available in the PSE annual report was for 2017. And we found limited information from the PSE annual report in respect of its enforcement of its listing rules.

Little evidence of increased investment in surveillance or enforcement

We found no evidence of material increased investment in surveillance, investigation and enforcement capacity and related technology. And we have not seen any material improvement in activity or funding since CMIC was incorporated more than six years ago. This for a market that has grown by more than 300% in the last decade.

Major securities law reform a feather in the SEC's cap

The regulatory picture is far better for activity relating to securities law reform and regulations related to corporate governance. Again, much of the credit for this reformist zeal should go to the SEC itself.

Company law and CG code revamp

New Corporation Code replaces 40-year-old law

Undoubtedly the most significant achievement was the successful introduction of the Revised Corporation Code 2019, which replaced the existing code passed in 1980, which has helped improve and modernise the Philippines' arcane corporation laws significantly and was long overdue.

Impressive SEC regulations rollout

In addition, the SEC passed a number of other important regulations, including a revised CG Code (2019), increased the minimum notice required for AGMs from 14 days to 21 days, passed a regulation granting shareholders the right to put items on a company agenda, introduced a rule requiring shareholders' approval of the sale of material company assets, tightened up rules for related-party transactions as well as audit committees, and even found time to issue sustainability reporting guidelines.

Regulatory moves that will make a difference

Figure 3

Key regulatory moves by the Philippines, 2019-2020

Law/Regulation	Assessment
Revised Corporation Code 2019	Comprehensive overhaul of 40-year-old company law. Significant, including introduction of perpetual corporation
Revised CG Code 2019	Applied to all listed companies, the 2019 code adopted a "comply or explain" regime that covers detailed recommendations for board structure, procedures and committees
Requirement for minimum notice of 21 days for AGM	Rule change from SEC brings local notice requirements closer to best practice of 28 days clear notice
Shareholders' right to put items on the Agenda for Regular/ Special Stockholders' meetings (holder(s) of 5% or more of a company's shares)	Recognition by SEC of importance of shareholder democracy and may shift the balance of power somewhat from management to shareholders
2/3 shareholders' approval on sale of 51% of corporate assets	Important rule change that, while far from best practice, narrows the scope for insider self-dealing and other questionable corporate practices
Rules on Material Related Party Transactions for Publicly-Listed Companies - MC No. 10 s.2019	Material RPTs (10%+) to require 2/3 approval by board and majority of INEDs. Disclosure requirements tightened. But shareholders still do not get a vote and rules are still way behind best practice. A (small) move in the right direction
Sustainability Reporting Guidelines for Publicly-Listed Companies	An aspirational memorandum requiring basic disclosures by PLCs of objectives, policies and targets for ESG. Includes detailed reporting templates. "Comply or explain" approach
Shareholders' Approval on Any Change/s in the Company's External Auditor; Audit Committee composed entirely of board members	Important step to improve shareholder oversight of audit changes and improved audit committee structure

Source: ACGA

SEC deserves credit for regulatory achievements

While much of what was introduced would not really pass as radical in leading capital markets, for the Philippines the regulations represented a significant move in the right direction in terms of tightening corporate governance and especially for protections for minority investors. As such the rules are very welcome and the SEC is to be applauded.

New PSE rules helped minority investors

The PSE for its part amended its listing rules in September 2018 to expand the amounts to be made available in IPOs and other public offerings for public investors and issued new rules in February 2020 on involuntary delistings requiring exit offers.

SEC is driving the country's CG agenda

That said, it is clear that the SEC remains in the driving seat on regulatory reform and in many cases the PSE's rule changes reflected new regulations first passed by the SEC. The PSE, like so many stock exchanges in Asia, remains a for-profit commercial enterprise first and a reluctant regulator second.

Keeping the market informed, reluctantly

Regulators do not consult often or well enough

Despite the impressive regulatory reforms over the past two years, neither regulator scores very well when it comes to adequate market and public consultation. While both the SEC and PSE do issue market consultation papers for major rule changes, the time allowed-usually not much more than a week-is woefully inadequate. Perhaps this is deliberate to minimise troublesome and unwelcome feedback?

Woeful websites and a lack of data

Another area where local regulators fall behind their regional peers (with the exception of Indonesia) is in their websites. The SEC website, although recently updated (which is a material improvement on its predecessor) is still clunky and slow, but most infuriatingly, is still quite difficult to navigate. Most significantly, data included is often out of date, missing or incomplete.

PSE needs to upgrade its database of announcements

The PSE website is beginning to look tired and has not been overhauled in some years. But it works better than the SEC's website, although it is also tricky to navigate at times. The PSE's separate EDGE website (for corporate announcements and disclosures) is much better, but lacks the required depth of data. Our standards call for 15 years of archived company data and announcements: the PSE provides just two years, and on a rolling basis. Like its sister website, EDGE can be a bit difficult to navigate and there are no IPO prospectuses available.

Virtual AGMs but no live votes, please

SEC acted quickly on Covid measures for remote voting but could have done more

In response to Covid-19, the SEC mandated the ability for shareholders to attend AGMs virtually and to vote remotely. However, unlike Indonesia, where a fully functional e-voting platform was rapidly rolled out, the Philippines' solution offered no official e-voting platform. Shareholders are permitted to vote remotely only if a majority of the board of directors agrees and only for a specific meeting and according to existing company internal procedures. As with many issues relating to corporate governance, in the Philippines the power is very often wielded by the board of a company rather than its shareholders.

No material CG preparation for IPOs

As with many exchanges in the region, significant effort is expended to attract new listings to the market. Corporate governance in the Philippines tends to be an issue mandated by the SEC once you become a listed company rather than before or at the time of listing. Other than meeting the existing listing regulations, there is very little meaningful governance preparation undertaken with listing candidates. Listing sponsors and other advisors are not required to provide explicit assistance or advice with respect to governance preparation for a new company prior to listing.

Next steps

SEC needs to be made independent of government, and independently funded

The funding problems around the SEC, including completion of its dedicated headquarters as soon as possible, are pressing. The government needs to act quickly. An independent SEC (and an adequately funded one) will be far more effective. The government should pass legislation to enable the SEC to source funding from the market itself by way of fees, as with most commissions. A market-funded solution saves the government significant money and makes the SEC more accountable to the market.

Regulatory websites need an overhaul and more disclosure

Please improve your websites (SEC and PSE)! There really is no excuse for sub-standard websites, especially among frontline regulators. And please improve disclosure of your activities: a 2016 Annual Report is of little practical use to any website user trying to assess nature, amount and increase in regulatory activity and enforcement.

A proactive approach

The Philippines response to Covid: Thorough

The Philippines' regulatory response to the pandemic was thorough and focused. Notably, it did not shy away from reminding companies of their continuous disclosure obligations. The use of new webcasting technology in AGMs was widespread and better than many higher ranked markets in our survey (see box "Virtual AGMs: Going for it" in the Listed Companies section).

Decent extensions for filing reports

Financial reporting extensions

The SEC issued a series of Memorandum Circulars (MC) over March, April and May 2020 to help companies deal with the challenges posed by Covid-19. On 12 March, the SEC issued MC No.5 2020, which allowed extensions of filing for 2019 annual reports, 2019 audited financial statements (AFS) and 2020 quarterly reports for listed companies with a December 2019 year-end and whose operations, either domestic or foreign, had been affected by the pandemic.

Purely domestic plays receive shorter reporting limits

Companies with domestic operations only could request an extension for the filing of their 2019 AFS and annual reports to 30 June 2020 (ie, 1.5 months), while those with both domestic and foreign operations were permitted an extension either to 30 June 2020 or 60 days from the lifting of travel restrictions by the relevant government authorities, whichever came later. Companies that were successful in getting such approval from the SEC were allowed the same extensions for their 2020 first quarter reports.

Timely disclosure is reinforced

Notably, the SEC reminded companies to continue disclosing price-sensitive information on a timely basis and it emphasised, in bold lettering, that companies not affected by Covid-19 must still file within the normal deadlines.

Sustainability reporting is pushed back . . .

On 21 April, the regulator released MC No.13 2020 that addressed the publication of sustainability reports. This allowed companies an extension to 30 June or later, as per the timeframe above for companies with foreign operations, for the submission of these reports. The following day, the SEC published a brief notice giving listed companies an extension also for the filing of their Integrated Annual Corporate Governance Reports (I-ACGR). These are due each year on 30 May, but in 2020 the new deadline was set at 30 July (later extended to 1 September).

. . . as are financial reports

On 7 May, it issued MC No.17 2020 that extended the deadlines for annual reports, AFS and quarterly reports of companies with fiscal years ending between 31 January 2020 and 31 April 2020.

Issuers are expected to keep the market informed

While all these extensions were automatic, companies wanting to take advantage of them would need to inform the market by filing a "special disclosure form". Once again, the SEC reminded issuers to "continuously observe" their disclosure obligations under relevant securities laws and listing rules, and to disclose all material information on a timely basis. "Where the company's operations are materially affected by the Covid-19 outbreak, disclosure on the financial impact or any other material aspects should be made immediately," it stated.

Companies are given more time to issue CG reports

CG report extension

To harmonise the corporate governance requirements of the SEC and PSE, the commission requires publicly listed companies to submit an I-ACGR every 30 May for each year that the company remains listed on the PSE. However, due to Covid-19, on 22 April 2020, the SEC issued a notice extending the deadline for the filing of the I-ACGR until 30 July 2020.

The Philippines is in 11th place with a score of 26%

2.2 Enforcement

The Philippines scored 26% here, no change from 2018, and sits in 11th place ahead of Indonesia. Like many markets in the bottom half of the CG Watch rankings, enforcement remains a serious issue for the Philippines. A function of inadequate budgets, a lack of political will and entrenched and intransigent company promoters, depressingly, there seems little prospect of a material change in approach.

Regulators seem to be selective in who they pursue

There were no major enforcement cases by regulators against violators of the country's securities laws and regulations, unless of course you count the politically motivated witch hunt of ABS-CBN and the presidential tirades against Manila Water (Ayala) and Maynilad (Metropacific) over claims of water supply services concession violations. The last serious enforcement case by the SEC and PSE of note against a listed company was the 2017 Calata delisting, which entailed an egregious insider market manipulation scheme that forced the regulators to act.

SEC has the powers but lacks political will and funding

It could all be very different. Under its constitution, the SEC has strong powers of surveillance, investigation and sanction. It just does not use them properly, likely due to chronic under-funding, although political considerations certainly play a role from time to time. There has never been a single prosecution for insider trading despite plenty of evidence that it remains a significant problem in local markets.

There is almost no SEC action against insider trading . . .

The latest available SEC annual report (from 2016!) states that it acted on one case of insider trading. It is unclear what (if anything) happened to that (or what, if anything, has happened since). The law requires an insider trading case to be prosecuted by the Attorney General's Office, guaranteed to slow due process to a crawl in the Philippines.

Selective policing

. . . but the SEC clamps down on Ponzi and investment scams

One caveat to the criticism of SEC enforcement: the regulator clearly goes to great lengths, and applies material resource, to shut down a plethora of unlicensed investment scams that plague the country. In a market where stock market investment is still regarded as the privilege of wealthy locals and foreigners, perhaps the SEC has decided that it is more important to play Ponzi scheme whack-a-mole with unscrupulous criminals (see box below) than to chase after slippery and politically influential market manipulators through the country's tortuously slow legal process? In many ways, it is difficult to argue with that. Absent a material increase in budget, human and technical resources, coupled with the clear direction from prevailing political forces, the SEC clearly has to pick its fights and little is going to change.

SEC provides very little enforcement data. And what is provided is out of date

Enforcement disclosure, absent the investment scam warnings and some violations by securities firms, remains a serious weak point. The SEC does not provide multi-year enforcement data against which its activities can be assessed, either on an individual or even a consolidated basis.

Enforcement disclosure is also weak at the PSE

Matters are little better over at the PSE, where disclosure remains sparse. The 2018 PSE annual report discloses that the Capital Markets Integrity Corporation (CMIC), the exchange's market surveillance arm, "endorsed" 24 cases of securities violations in 2018 to the SEC and referred 19 violations of PSE listing rules to the exchange. No further (or more recent) information is provided.

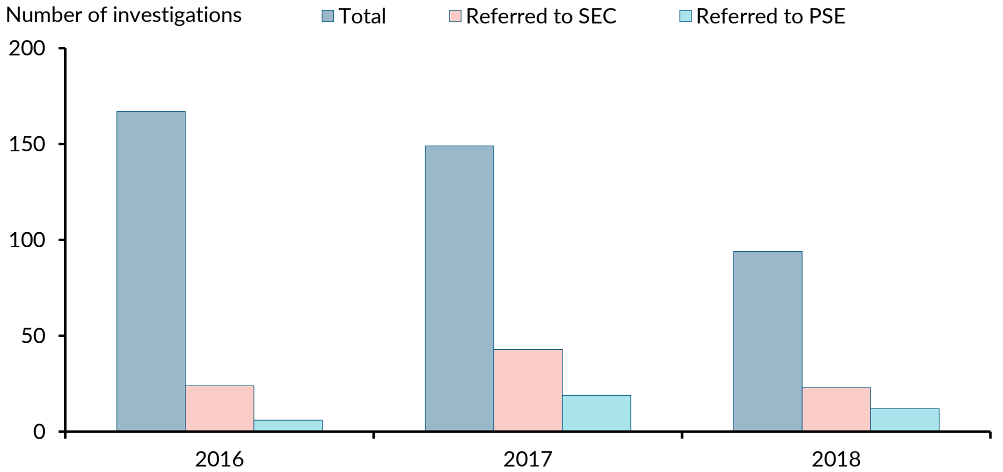
The PSE's surveillance arm lacks punch and authority

The existence (and survival) of the CMIC, does help the PSE somewhat to separate commercial from regulatory activities in respect of market manipulation. But the CMIC lacks punch and follow-up on referrals from both the PSE and the SEC is slow to non-existent. Make no mistake: the PSE, like so many Asian exchanges, is a commercial animal first and foremost.

Enforcement appears to be on the decline

Figure 4

Market enforcement in the Philippines, 2016-2018: In reverse?



Source: PSE Annual Reports

Next steps

Funding first: regulatory enforcement cannot improve without it

It is difficult to discuss next steps in enforcement until the government decides to take the first step by funding and empowering the SEC properly. This should include statutory powers to prosecute egregious market manipulation and insider trading cases without the necessity to refer cases to the Attorney General's Office (AGO).

PSE needs to beef up its surveillance arm too, and has the funds to do it

The PSE should provide additional funding to the CMIC and empower it to name and shame repeat market offenders, including powers of fines, licence suspension and revocation of securities firms, through which much of the market manipulation activity is channelled.

Disclosure *has* to improve

Efforts should be made to provide detailed disclosure of enforcement activities by both the SEC and PSE to provide evidence that the government remains serious about improving its poor enforcement track record.

Regulatory whack-a-mole

SEC acts as the Philippine Ponzi Police

Under-resourced and under-manned, the SEC expends huge efforts to keep criminals from scamming mainly lower-middle class and poor citizens.

EIPD protects the public from themselves

The Enforcement and Investor Protection Department (EIPD) of the SEC acts as the frontline regulator in the fight to protect the public from themselves. The two biggest scams are companies illegally selling "shares" to "investors" offering guaranteed returns; and the traditional Ponzi schemes, usually dressed up as multi-level marketing product sales operators. The global frenzy over cryptocurrencies has recently provided a new "front" to get punters to part with their cash.

Pyramid schemes are the hardest to detect early

Scammers operating pyramid schemes are especially difficult to catch early on as they can rack up large sums from their victims before the scams inevitably become widely known. The SEC cannot award damages from scams: that power rests with the Department of Justice and an inefficient court system. So the EIPD has resorted to public information campaigns to warn people instead. It has significantly ramped up its efforts: the EIPD issued 127 separate advisory notices in 2020, a 160% increase over 2018.

3. CG rules

The Philippines in 11th place with a score of 45%

The Philippines' score under this category increased by two percentage points to 45%, putting it in 11th place, although in net terms this reflects a combination of different scoring methodology for CG Watch 2020 as well as some positive moves on CG rules from the regulators in the country, notably the SEC.

But still a long way to go to catch up to peers

Despite the improvement, the total is still the second lowest in the region, again beating Indonesia. The next two lowest markets - Japan and Korea - are respectively 13 and 11 percentage points higher, so considerable daylight exists between the Philippines and the remainder of the market.

Decent financial reports, shame about CG disclosure

Good financial reporting standards . . .

Financial reporting standards in the Philippines for listed companies are generally of a good standard: they tend to follow international standards and all of the larger listed companies use Big Four local affiliates.

. . . but disclosures need to be more timely

Financial reports could be more timely, but some larger companies exceed minimum requirements which are within 45 calendar days of the quarterly reporting period and an unusually long 105 calendar days for their audited financial statements and annual reports (most Asian jurisdictions set a deadline of 90 days for the annual audited accounts). And the statements could often also be a little more detailed, hence a small drop in our score due to a stricter assessment methodology.

SEC played catch up with the region on CG reporting

CG reporting standards are less impressive, explained in the main by the approach the regulators-the SEC in this case-have taken with the CG arms race unleashed some years back by the ASEAN CG Scorecard. Shocked by its low relative scores upon joining the scheme, the SEC decided to address the serous shortfalls by introducing the Annual Corporate Governance Report (ACGR). A one-size-fits-all report required to be filed with the SEC by all listed companies, the ACGR includes disclosure and other CG requirements that tracked closely the ASEAN scorecard, thus helping the scores of Philippine companies the next time they were assessed.

ACGR is all comply-or-explain . . .

The problem is that the ACGR, borne of expediency, is based on a "comply or explain" basis, providing many listed companies with an exit from full (or even partial) compliance and leaving companies the easy option of cherry-picking their compliance and exempting themselves from the rest. The result is the feeling of a missed opportunity. Our score here dropped as a result.

. . . and so is the CG Guide

The SEC also issued a CG Code of Corporate Governance for Public Companies and Registered Issuers in 2019 which was a welcome intervention. The Guide sets out key principles, or statements of good CG, which the code identifies as, in part, aspirational. It then provides detailed recommendations under each principle and offers explanations to justify its stance. A brief summary of the key principles and salient recommendations is set out below:

Figure 5

CG Code 2019: Key principles and recommendations

Principle	Key recommendations	Comments
Clear roles on Board of Directors (BOD)	❑ Policies on setting strategy, succession planning, remuneration, nomination, disqualification and temporary suspension ❑ Policies on RPTs, assessment of CEO performance; internal controls	❑ Remuneration to be aligned with long term interests of the company ❑ Code provides a long list of circumstances that would bar a director from holding office ❑ Temporary disqualification for lack of attendance and for NEDs with 2%+ ownership ❑ Material RPTs (>10%) require 2/3 vote of BOD and majority of INEDs
Board Committees	❑ Comprise BOD members only ❑ Audit Committee (AC); CG Committee; Board Risk Oversight Committee	❑ AC must comprise only NEDs; at least three, majority independent (including the Chair), who cannot chair or sit on any other Board committees; CG Committee
Fostering commitment	❑ All BOD members must play an active role in company matters	❑ Limits on directorships: 10; or five if at least three directorships are in listed companies
Reinforcing Board independence	❑ Boards should comprise a majority of NEDs ❑ Term limits for NEDs ❑ Chair/CEO should be separate roles ❑ NEDs expected to meet separately with key risk management functions	❑ Minimum of two INEDs or 1/3 of BOD, whichever is the greater ❑ Nine-year consecutive limit for INEDs. May continue thereafter but not as INED ❑ A lead independent director should be appointed if the Chair is not independent ❑ Includes external auditor, internal audit function. Compliance and risk officer. No executive directors to be present
Enhancing company disclosure, policies and procedures	❑ Policies expected to ensure complete, accurate, reliable and timely reports are sent to shareholders	❑ Directors/officers must report dealings in company shares within five business days ❑ Company must have a manual on CG and an annual CG report, which should be posted on the company website and submitted to the SEC
Strengthening external auditors' independence and improving audit quality	❑ AC controls all aspects of interactions with external auditors	❑ AC must have a robust process for appointing the external auditor, assessing their performance and ensuring their independence ❑ Company must disclose the nature of non-audit fees paid to the external auditor and manage potential conflicts of interest
Promoting shareholder rights	❑ Company must have policies to protect fundamental rights of shareholders to:	❑ Approve material corporate acts ❑ Propose holding of meetings and propose agenda items ❑ Nominate candidates to the BOD ❑ Retain pre-emptive rights ❑ Receive dividends ❑ Receive adequate notice of shareholder meetings (21 days) ❑ Receive detailed minutes and voting results within five business days
Enhancing Employees' Participation	❑ ABC policies ❑ Code of Ethics	❑ Policies should include whistleblowing framework, including safe harbours and confidentiality

Source: SEC CG Code of Corporate Governance for Public Companies and Registered Issuers, 2019

New CG code is thoughtful but still shy of best practice

The new CG Code is a thoughtful document, albeit some distance from best practice in several areas. However, the policy is still framed on a "comply or explain" basis. That provides recalcitrant companies with a way out of compliance or an opportunity to cherry-pick, and while some companies certainly will take that opportunity, others will not, and the code will hopefully help raise local standards gradually. A more robust, mandatory document would be preferable but the code is a step in the right direction.

SEC faces pressure from government and the market

In defence of the SEC, it has the unenviable task of negotiating between government pressure to raise local scores on the one hand and material recalcitrance from many local listed companies on the other. With the market having performed so strongly in the last few years, the listed company lobby often wins the day.

Local ESG reporting standards are in their infancy

ESG: rudimentary reporting

In February 2019, the SEC issued its Sustainability Reporting Guidelines for listed companies (MC 4/2019). The document is aspirational and represents a start on the Philippines' ESG reporting journey. The guidelines follow four key reporting standards: GRI, IR, SASB and TCFD and require companies to report to the SEC and shareholders using a detailed reporting template based on seven key assessment criteria: materiality, stakeholder inclusiveness, balance, completeness, reliability, accuracy, and consistency and comparability.

SEC encourages disclosure on economic, environmental and social issues, as well as SDGs

Figure 6

Sustainability Reporting Guidelines for listed companies

Key disclosure topics	Breakdown	
1. Economic	❑ Performance ❑ Practices ❑ Anti-corruption	
2. Environment	❑ Resource management ❑ Ecosystem and biodiversity ❑ Environmental impact & compliance	
3. Social	❑ Employee management ❑ Workplace conditions ❑ Labour standards ❑ Supply chain management	❑ Community relations ❑ Customer management ❑ Data security
4. UN Sustainable Development Goals (SDGs)	❑ Company contribution to SDGs through products and services	

Source: SEC Sustainability Reporting Guidelines for listed companies, 2019

Will local companies take the new sustainability guidelines seriously?

While the Sustainability Reporting Guidelines are a positive move, the guidelines, like their CG counterpart, are issued on a "comply or explain" basis and it remains to be seen how seriously local companies take the new obligations. ESG sustainability for many listed companies, seems to equate to CSR ribbon-cutting on new schools and charity handouts. Reporting in annual reports is generally rudimentary and perfunctory. There are some material exceptions: a few companies, or more accurately groups of companies, that really understand the issues at stake and embrace the reporting and disclosure around them.

Financial reporting standards are solid

Good news on quarterly reporting . . .

On a more positive note, quarterly reporting is mandatory in the Philippines and disclosure is of a good standard. Financial reporting standards require full financial statements (profit & loss, balance sheet, cash flow, movements in equity) as well as accompanying notes. In the main, quarterly financial statements (called 17-Q reports by the SEC) are released with business updates and commentaries that are of a good standard, although we think they could be more comprehensive.

Substantial ownership rules are good but random

Rules regarding the disclosure of substantial ownership are not bad, with "substantial" starting at a respectable 5% (purchase or sale) and a requirement to disclose within five business days (although curiously, notification of a sale back below 5% is required within three business days). From there the rules become curiouser and sketchier: a material increase, set at what we consider to be a relatively high threshold of 5% and above must be disclosed within three business days. A shareholding threshold of 10% and above must be disclosed within 10 calendar days, for reasons that escape us. None of the above applies for banks, which are additionally regulated by the BSP and which sets disclosure thresholds at a more reasonable 2%.

. . . but not on insider dealing and share pledges

Insider dealing disclosures are weak

Local rules require directors' dealings in shares to be disclosed within five business days, far behind international standards. The CG Code for listed companies issued in 2016 states that directors' dealings should be disclosed within a more respectable three business days, but the entire code is "comply or explain" so directors and companies can choose to meet that deadline if they wish.

Blackout periods for insider trades could be longer

Trading blackout periods for company insiders, such as directors and key management, are 30 days before each financial period end, which is reasonable for quarterly financial statements. But that rule also applies to the end of the financial year when we would expect to see a longer blackout period, typically of two months' duration. PSE rules also require an immediate ban on dealing by insiders upon obtaining material non-public information and for a period of two days after its disclosure.

Specific rules for disclosure of share pledges are lacking

There are no specific rules requiring controlling shareholders of listed companies to disclose any share pledges. While PSE rules require a change of control in a company to be disclosed immediately, the effect of such an announcement, post facto, is of little practical use to minority shareholders in a listed company.

The 10-minute rule on price-sensitive information

One of the region's strictest PSI regimes on paper

Curiously, while many of the local rules on disclosure are behind best practice, the PSE rule on the announcement of price-sensitive information by listed companies is extremely strict. Under PSE rules, disclosure of "material information", which includes price sensitive information (PSI), is required to be made by a company to the PSE within 10 minutes, with an immediate suspension of trading if the announcement is made within trading hours. A full announcement is then required to be made to the public via the PSE within 24 hours.

Connected transactions don't need shareholder consent

Rules relating to related-party transactions (RPTs) remain weak in the Philippines, despite some tightening by the SEC, principally relating to their disclosure in a company's annual report. There is still no requirement for shareholder approval of a RPT (ratification only), irrespective of nature or materiality, no requirement for a full independent financial advisor opinion, and no specific content requirements for a RPT circular (they must be disclosed post facto in the annual report). RPTs remain one of the weakest areas in Philippine capital markets regulation.

Insider dealers easily circumvent the law

The insider trading regime trails global norms

Local rules prohibiting insider trading are behind best practice. While the critical definition of an insider is sound and legislation clearly makes insider trading a crime, much of the rule focusses on the tipper in terms of its provisions, and less on the person receiving the tip, an area where other leading markets have tightened up of late and where the Philippines' regulations are left wanting.

Civil penalties are inadequate

The civil penalty regime provides inadequate fines. These range from a minimum of P50,000 to a maximum of P5m (around US$1,000 to US$100,000) and while custodial sentences are tough on paper, a two-year statute of limitations renders them toothless given the cumbersome and sloth-like nature of the local legal system. No one has ever been convicted of insider trading in the Philippines.

Poll voting: still a show of hands

Local companies continue to resist voting by poll

Like the country's perennially weak rules on related-party transactions, another *bête noire* of the Filipino corporate establishment is poll voting for shareholder meetings. While very few listed companies adopt this system voluntarily, the vast majority stick stubbornly to the old show-of-hands system of voting. To its credit, the SEC at least tried to encourage poll voting, introducing the recommendation into its 2016 CG Code for issuers, but it remains just that: a recommendation under a "comply or explain" regime.

Shareholder voting result disclosures are fudged

The results of shareholder meetings must be disclosed by the next business day and while there is a requirement to identify all votes cast for resolutions, (for, against and abstentions), that too is fudged: disclosure is required only if "significant" votes against a specific resolution were cast.

A diluted CG Code and stewardship abyss

CG code fails to pack a punch

The SEC's latest CG Code was published in 2019. A reasonably thoughtful and comprehensive document is somewhat diluted by its "comply or explain" regime. It is doubtful, frankly, that further headway will be made in promoting better CG standards among most listed companies without more stringent regulation.

No stewardship code and little chance of one

The Philippines remains without a stewardship code and seems unlikely to adopt one anytime soon. The SEC talked vaguely about drawing one up some years back, but a lack of depth in the domestic institutional investment market (see separate section on Investors) as well as doubtful political will, likely explain the absence of any such initiative to date.

Director independence rules are a bit tighter

Regulators have recently tightened rules and definitions around director independence, which is a welcome move. While the Securities Regulation Code (SRC) Rule 38 states that independent directors must be free of management and substantial shareholders, the CG Code 2019 introduced a clearer definition of independence, noting that an independent director must also be, "free from any business or other relationship which could, or could reasonably be perceived to, materially interfere with the exercise of independent judgment in carrying out his responsibilities as a director". Cooling-off periods, at two years, are too short and lead to independent director appointments of recent advisors and auditors who are anything but independent in practice.

Other disclosure and boardroom shortcomings

Board remuneration disclosure is inadequate

Another sticking point in CG board reform with Filipino corporations relates to the disclosure of individual board remuneration. While the SEC CG Guide states that companies should disclose remuneration on an individual basis, the "comply or explain" escape clause means that almost all companies report remuneration in bands or a simple total.

Audit committees are required but full independence is not

Audit committees are mandatory, but they do not have to be fully independent from executive management, as is best practice. The SEC guidelines recommend audit committees comprise a minimum of three non-executive directors and an independent non-executive director as chairman. Again the "comply or explain" nature of the guidelines provides companies with a convenient out.

CG committees deal with board performance

Similarly, the SEC recommends a CG committee, comprising a majority of INEDs, (including the chairman) be established to deal with nomination and board performance assessment matters rather than a separate nomination committee. The recommendation is on a "comply or explain" basis.

Rules banning offending directors hit the mark

There are regulations banning persons convicted of offences, such as fraud, from acting as directors of listed companies. The Revised CG Code of 2009 bars persons permanently for various acts including fraud and also has temporary bans for non-performance of duties. The 2019 CG Code prohibits persons acting as directors of listed companies, inter alia, if they have been convicted of an imprisonable offence of more than six years or if that person has violated the Securities Regulation Code within the preceding five years of their election or appointment.

It is difficult for minorities to nominate board members

Minority shareholders are able to nominate independent directors to Filipino companies, although in general it is not easy to do given how tightly controlled local companies are and how resistant many companies remain to outside shareholder interference. That said, in 2017 minority investors nominated INEDs to the boards of Globe (Ayala) and Aboitiz Equity Ventures, but both companies have high CG standards and sophisticated outside shareholder engagement track records.

The mockery of rules on pre-emption rights

Pre-emption remains a major CG problem . . .

The issue of pre-emption rights for shareholders remains one of the most problematic areas for CG in the Philippines. Local practices are so far from best practice-such as strict caps on amounts and issue prices of share issues for cash on a non-pre-emptive basis-that the SEC made an attempt to address the yawning discrepancy between local and regional rules in its Revised CG Code 2019. It stipulated that all shareholders of any class of shares have pre-emption rights unless such shares are issued for the purposes of maintaining minimum public ownership or if they are issued in a “good faith” transaction approved by two-thirds of shareholders.

. . . tighter rules offer no practical help

That might sound like a step in the right direction, but the entire provision contains a caveat that companies can still remove pre-emption rights for shareholders in their articles of incorporation. And that is precisely what all listed companies do.

Longer lead time for AGMs still comes up short

AGM notices increase from 14 to 21 days

On a happier note, the SEC mandated a longer notice period for AGMs, up to 21 days from the original 14, an improvement of course, but still below our assessment of best practice, which is 28 days. And in another peculiar quirk of the Filipino market, due to legal requirements, Filipino corporations generally send out very detailed agenda items via a preliminary information sheet (and before the definitive notice) weeks in advance of AGMs. So while the formal notice may only be issued within the now-mandated 21 days, in practice, shareholders receive information well in advance of any meeting.

Takeovers, major acquisitions and delistings are still problematic

Protections for minorities in takeovers, major share acquisitions and delistings remain well short of best practice in the Philippines. There is no Takeovers Code in the Philippines. Securities law requires shareholders of 15% or more that wish to acquire 30% or more of a listed company over a 12-month period to make a tender offer to all shareholders on a pro rata basis. Boards of directors can vote to merge with another listed company but need to obtain two-thirds of shareholders’ approval. The PSE tightened its listing rules in 2019 by requiring a mandatory exit offer, including a fairness opinion, neither of which was previously required.

Collective engagement got easier in 2019

Institutional shareholders’ ability to undertake collective engagement activities in the Philippines without falling foul of concert-party rules improved somewhat due to SEC rules passed in 2019 allowing shareholders of 5% or more to add items to the agenda of a shareholder meeting and holders of 10% to call a meeting.

CG guidelines need to become rules

Next steps

Where to begin? A good place to start would be to overhaul the latest CG Guide and revise it into a set of regulations and some guidelines, removing the enormous loopholes of the "comply or explain" strategy that lets so many listed companies off the hook from many simple and important CG disclosures and requirements. More work needs to be done on ESG if the country is not going to fall further behind peer group markets.

Specific areas of CG that regulators should take a long hard look at include:

- Overhauling the RPT rules: currently woefully inadequate.
- Overhauling the pre-emption rules: again, currently woefully inadequate.
- Realigning substantial shareholder disclosure rules to make them uniform.
- Tightening insider trading rules - and enforcing them!
- Mandating shareholder voting by poll.
- Longer term, introduce a formal Code on Takeovers.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

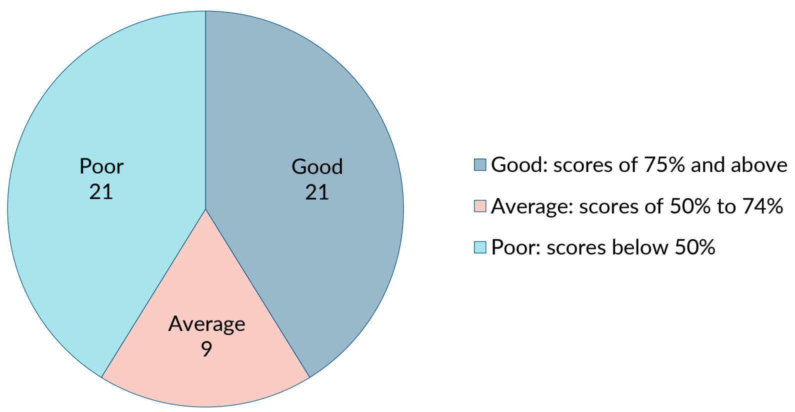
The Philippines ranks 8th with a score of 55%

Our score for the listed companies section for Philippines increased markedly by 11 percentage points, to 55%, placing it 8th overall, comfortably ahead of Indonesia, Japan and Korea and just ahead of China. Our aggregate results showed that large caps performed well in 21 of 51 questions, averagely in nine and poorly in 21 (see Figure 7). The scores flatter the Philippines a little, given changes in the scoring methodology, but the fact is that reporting and information provided for investors is generally of a good standard and this is reflected in the overall score.

Room for improvement

Figure 7

Philippines: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where the Philippines does well

Strong scores for financial reporting

The Philippines earned a high score in the market-level question on the reporting of key financial metrics. In our analysis, issuers in the Philippines provide good notes and management discussion and analyses, including the breakdown of operating expenses, and detailed outlines of trade receivables, payables, and loans. Mid-caps notably improved their scores in our survey, largely driven by the quality of local financial reporting standards, which are driven by Big Four accounting firms and compare favourably with IFRS.

Corporates keep investors well-informed

Both large-caps and mid-caps are adept at providing quick and good access to information to investors, with good investor relations operations generally. Issuers make timely announcements on corporate actions, although a handful of issuers only share corporate announcements with less than five years' history. When it comes to AGM information, companies share agenda and circulars prior to meetings and voting results shortly afterwards. Most companies also share investor Q&A as part of their AGM minutes, and for some, even webcasts. The improvement of investor relations programmes in the Philippines has been noticeable over the last few years as the local market has outperformed regional rivals and piqued foreign investor interest.

There are quality ESG statements on materiality

The quality of ESG and sustainability reports improved for both large- and mid-caps, suggesting that companies are beginning to take the market's increasing emphasis on ESG seriously, especially some of the larger family-owned conglomerates. The improvement is also at least in part due to the SEC's Sustainability Reporting Guidelines (see CG Rules section) issued in February 2019 that mandate ESG disclosures. In terms of sub-questions, the Philippines scored well in identifying material issues and discussing its management and measurements. Specifically, all 15 large-caps we surveyed addressed physical risks of climate change, although SASB only recognised the issue as material for six of the 15, all of which are universal banks. We note that the Philippines' central bank, the BSP, has issued specific ESG requirements for the universal banks under its ambit. There is a long way to go however before ESG achieves mass adoption and further regulatory arm-twisting will be needed. The use of the materiality matrix is widespread but only one of the 15 large-caps had a detailed discussion as to how materiality is determined and relevant to the business.

Where the Philippines performs averagely

Anti-corruption policies are better but enforcement is a weak spot

Listed companies also increased their score for the clear and credible policies for mitigating corruption, scoring well on the quality of whistleblowing policies, and averagely on codes of conduct. These policies are now required as part of the SEC's CG Code 2019 (see CG Rules section). While it is true that larger companies have tightened policies in this area, a policy is one thing but policing and enforcing it is quite another. Several of the largest and most reputable family-controlled conglomerates certainly practice what their anti-corruption policies say. However, many do not. For example, most companies - 14 out of 15 - have a public code of conduct, but three do not mention rules on gifting or entertainment, and only two have extended it to their suppliers.

There is some board training but details are lacking

Issuers in the Philippines disclosed that they provide training to both their executive and non-executive directors, but there is definitely room for improvement in this area. One of the 15 did not mention director training at all, and another four only mentioned ongoing professional development with no mention of induction training at all. In addition, they generally provided limited details on the training with most only giving brief statistics on topics or hours.

Where the Philippines does poorly

Board independence is still an issue

Filipino listed companies improved their scores for the presence of an independent chair or lead independent director, but much remains to be done. Weak independence definitions coupled with short cooling-off periods weaken true independence from controlling shareholders. Only one of the 15 has a chairman that is designated independent, but the chair is also the chair of the parent company, while having served for 12 years on the board. Five of the other 14 also do not have lead independent directors. Board committees remain weak in terms of structure. Audit committees, while mandatory, do not need to comprise fully independent non-executive directors and nomination committees are instead replaced with a so-called CG Committee, which again does not require full independence from the controlling shareholder either.

Disclosure is weak . . . especially on remuneration

Board disclosure could generally be improved in listed companies. For meeting attendance, two of the 15 large caps did not provide any details, while another five only gave partial details, for either board or committee meetings by director. However, the most glaring omission is in disclosure of individual remuneration. Only one of the 15 disclosed remuneration for each director in a table and companies mostly gave aggregate figures for the remuneration of the top five executives. Listed companies make ample use of "comply or explain" caveats to CG rules to avoid disclosing individual remuneration. Well-worn excuses such as providing competitors with a greater ability to poach key executives are peddled as reasons to maintain the status quo.

Boards are not being evaluated

In terms of board governance, while the discussion on training is generally good for board members, board composition and proper evaluations are not. Only five provided a skills matrix, three of which did not provide a clear link to its business, while nine of the 15 did not discuss any plans to improve board diversity (although gender diversity in the Philippines is generally well accepted relative to most regional peers due to cultural factors). As for board evaluations, only five of the 15 mentioned appointing third parties, while three did not mention board evaluations at all, and issuers generally do not provide much detail of such assessments. There is a lot of form over substance on many boards of Filipino companies. The "clubby" nature of many boards, with many INEDs holding multiple board positions, unduly increases the influence of controlling shareholders. This suppresses true independence.

There is not much evidence of stakeholder engagement

Issuers also provided inadequate levels of information on engagement with both shareholders and stakeholders. At most, issuers disclosed the frequency and type of shareholder engagements, but gave no details on the nature of the discussion. As for stakeholder engagement, most issuers discussed different stakeholder groups and shared some description on engagement, but only one of the 15 had a discussion specific to the year.

Filipino corporate scorecard

Figure 8

Helicopter view: Rating the Philippines' CG disclosure and governance, 2020

Good	Average	Poor
❑ Breakdown of operating costs, explanation of "other expenses" ❑ Disclosure of trade receivables and payables ❑ Disclosure of loans ❑ Detailed AGM circulars, voting results and Q&A with shareholders ❑ ESG reporting is improving in the discussion of material issues, including addressing the physical risks of climate change	❑ Policies for mitigating corruption: code of conduct ❑ Director training given to executive and non-executive directors, but with limited information	❑ ESG reporting still lacks discussion of materiality process ❑ Board independence: most chairmen not designated independent, and many audit committees chaired by non-independent directors ❑ Some companies do not provide director attendance statistics, while many only for board meetings ❑ Board remuneration and top 5 senior manager remuneration: mostly aggregated or not provided ❑ Limited use of board skills matrices and many do not disclose plans for improving board diversity ❑ Many companies do not disclose any information on board evaluations, or on involving third-party assessors ❑ Shareholder and stakeholder engagement disclosure vague

Source: ACGA

Where the Philippines could improve

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Extend corporate notices and announcements history beyond five years
- ❑ Detailed disclosure of director training by individual
- ❑ Introduce formal board evaluations, and better disclosure of details
- ❑ Much better transparency on board remuneration
- ❑ Overhaul "comply or explain" reporting regime to mandate more CG disclosure
- ❑ Discussion of board diversity and board skill matrices to ensure an appropriate mix of skills relevant to the business

Medium to long-term challenges

- ❑ ESG/sustainability reports to include substantive discussion of the materiality selection process, and how they set meaningful targets
- ❑ Better policies for mitigating corruption: codes of conduct should have policies on gifts and entertainment and extend to suppliers, and enforcement data should be included
- ❑ Mandate induction training for directors
- ❑ Improve independence via stricter definitions and longer cooling-off periods
- ❑ Tighten rules on board committee structures
- ❑ Proactive shareholder and stakeholder engagement that is well-documented

Virtual AGMs: Going for it

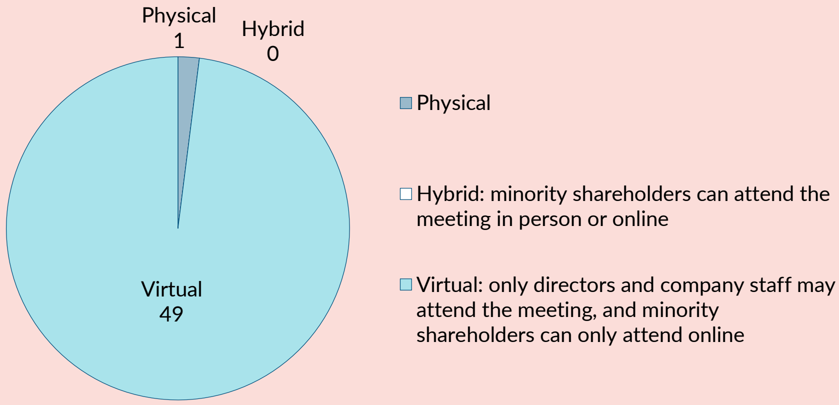
The Philippines was one of only five markets in the region that fully embraced electronic AGMs in 2020-the others were Australia, India, Malaysia and Singapore. As the figure below shows, based on ACGA research of the top-50 listed companies by market cap, only one held a physical meeting while the rest held virtual AGMs.

Most meetings were held, in roughly equal amounts, over April, May, June and July. The notices issued by companies were very clear in illustrating that the meetings were intended to be virtual, though some had small "broadcast venues" from where a few directors and company staff conducted the meeting.

2020: a virtual meeting blitz

Figure 9

AGM modes in the Philippines: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

The Philippines' good performance on electronic AGMs was very much a response to government encouragement. On 12 March 2020, the SEC issued MC No.6 2020 which contained guidelines on the attendance and participation of directors, trustees, stockholders, members, and other persons of corporations, in regular and special meetings through teleconferencing, videoconferencing and other remote or electronic means of communication. The guidelines were taken primarily from the Revised Corporation Code, published on 12 February 2019. Key points were:

- Directors or trustees who cannot physically attend or vote at board meetings are authorised to participate and vote through remote communication;
- Written notices of regular meetings may be sent to shareholders, or members of record, through electronic means;
- Shareholders may vote in person, through a proxy, or remotely through electronic means; and
- The procedures to be followed by shareholders who opt to vote remotely must be included in each notice of meeting.

The guidelines were also intended to operationalise the Electronic Commerce Act, approved on 14 June 2000. This Act helps in facilitating domestic and international dealings through electronic means and to promote the universal use of electronic transactions.

5. Investors

The Philippines ranks 10th with a score of 20%

The Investors category score for the Philippines slipped to 20%, one percentage point lower than our CG Watch 2018 score, putting it in 10th place, just ahead of China and Indonesia. Our scores increased marginally for our analysis of institutional investors, while our scores in the retail investor sub-section fell. This is an interesting reversal of a trend we have seen for several years now of a small number of retail investors and associations pushing the CG story while institutional investors watch from the sidelines. The reversal of this trend, and more specifically the more active participation of the institutional market in CG advocacy, is as welcome as it is overdue.

CG advocacy is still rare

But let us not overstate the case: institutional activity may have awoken but it is still low in the Philippines compared with many of its peer group markets. There remains considerable room for improvement.

The domestic dimension

Insurance giants dominate the domestic plays

The key domestic institutional investors in the Philippines are a mixture of state-controlled pension and insurance schemes - Social Security System (SSS), Government Service Insurance Scheme (GSIS) and Philippine Health Insurance Corporation (PhilHealth) - as well as several privately-owned but successful insurance firms, affiliated with international players. These include Sun Life of Canada Philippines, Manulife, AXA Philippines, Philam Life and First Metro Investment Corporation.

State institutions are not role models

The state-run entities are generally poorly funded and run as civil service type entities and little is promoted by way of CG past internally focussed CG statements and CSR programmes. None has published a comprehensive CG investment philosophy. PhilHealth is beset by a major plunder scandal involving its senior management (see box in Government & Public Governance section).

Privately-owned firms fare better

The picture is slightly better with respect to the privately-owned domestic investors, with internal CG statements and some ESG data, although much of this links directly back to the foreign affiliate's/parent's site. None of these investors has published a Responsible Investment strategy or philosophy and there is no data covering advocacy or company engagement.

Domestic investors do not disclose voting data

Domestic institutional investors typically publish codes of ethics and statements of their fiduciary duties that go at least some way towards assisting with the management of conflicts of interest, but they provide no data on voting activity on a company level. And there are no proxy advisors in the Philippines.

Our survey results suggest engagement is minimal

Of the five leading asset owners in the Philippines we surveyed, and the top 10 asset managers, we did not find much evidence of engagement policies and practices with respect to the companies they invest in. Of the five asset owners, only two appeared to have CG or ESG charters and voting policies. One did provide a narrative on its engagement with the companies it invests in, but none of the asset owners disclose their voting records.

Asset managers are slightly better than asset owners

Among the 10 asset managers, things were slightly more promising. Eight of them make public very detailed CG or ESG charters, as well as voting policies. Five of the asset managers do disclose voting records, with two going so far as to elaborate on this with a description of the actual engagement they had with companies.

AGM attendance is non-existent

Sadly, we were not able to find any evidence among the asset owners and managers of their attendance at AGMs.

ACGA surveyed its members in Q3 2020 on voting and engagement in Asia-Pacific

The foreign dimension

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members in 3Q20 to gather baseline data on their level of voting and engagement in th0065 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time of the survey this group managed in aggregate more than US$26 trillion globally. As the responses showed, many respondents invest in the Philippines, but as expected for a smaller market the number of investments held is considerably fewer than in larger markets:

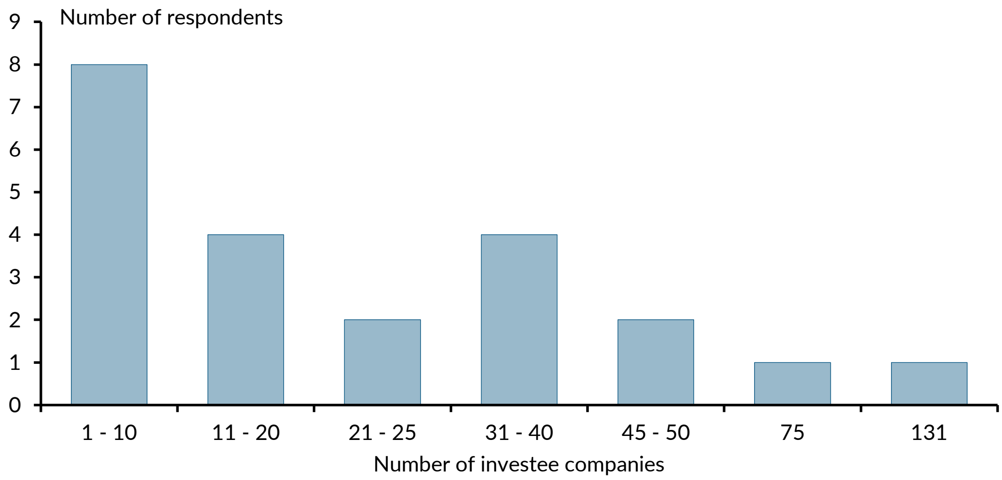
- 35 or 78% of foreign investor respondents indicated that they invest in the Philippines-slightly below Malaysia and Singapore, and lower than other markets that range from 84% to 93%.
- Only 22 respondents answered the question on the exact size of portfolios. The average number of investee companies per respondent was 27, with a range from one to 131. The average figure is the lowest across the markets, well below the 100 to 130 in Hong Kong, Korea and Taiwan and far below China and Japan.

A more representative picture emerges when we look at the size of portfolios across all respondents. As the following figure shows, while two ACGA members invest in 75 and 131 companies each, most have portfolios of 50 companies or less:

. . . and they invest in multiple companies

Figure 10

Foreign investors in the Philippines: By size of portfolios, 2020



Note 1: Not all respondents answered this question; 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points. Source: ACGA Member Survey, September 2020

Foreign investors actively use their voting rights

Although the Philippines is a relatively small market from the perspective of global institutional investors, respondents still take voting seriously. They also vote against a reasonable number of management resolutions:

- Nearly all respondents with holdings in the Philippines vote in 100% of their investee-company AGMs. One votes in 80%, and one votes in 27%.
- On average, they voted against at least one management resolution in 18 meetings in 2020. The median figure was 12 meetings, with a range from one to 70.
- As a proportion of their holdings, respondents voted against at least one management resolution in an average of 60% of meetings. This places the Philippines third among the 12 markets we covered. By respondent, however, the proportion ranged from 2% to 96%.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Company engagement

CG activism is scarce

There are no domestic activist funds seeking to raise governance standards in the Philippines and very few foreign ones, all of which are regional players and not especially active in the Philippines market. Domestic asset owners play no discernible role in promoting responsible investment and we found no evidence of domestic institutional investors engaging on a collective basis with listed companies.

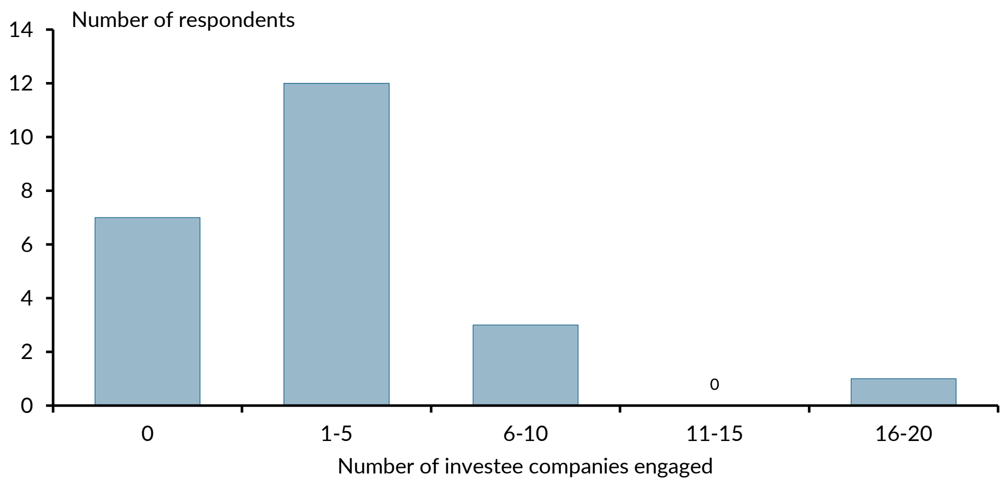
Foreign players vote according to regional policy

The picture is a little different for foreign institutional investors, where regional investment strategies and voting policies tend to drive proxy voting activity in the Philippines and with it some engagement on specific issues. But that engagement is on an individual basis and we found no evidence of collective engagement. Of the 35 respondents who indicated they invest in the Philippines, 23 answered our question on company engagement. As can be seen below, of these, seven said they undertook no engagement at all over 2019 and 2020, and most of the remaining respondents engage with one to five companies on an individual basis.

There is some individual company engagement

Figure 11

Foreign investor engagement prevalence in the Philippines, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Average result is lower than most markets

In terms of the relative level of engagement in the Philippines (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 15% or less but rises to 25% to 50% for three institutions (including the one engaging with 20 listed companies a year).

Foreign investors don't engage with companies . . .

It is interesting to note that few foreign investors are members of the Fund Managers' Association of the Philippines, the principal industry body. The exceptions are AXA, Manulife and Sun Life of Canada. All of these firms have domestic affiliates.

Retail investors are enthusiastic attendees and voters

The retail dimension
The retail investor community in the Philippines is an altogether different affair, with some enthusiastic entities actively attending shareholder meetings and at times, engaging with companies. Chief among these is the Shareholders' Association of the Philippines (SharePHIL), a not-for-profit association established to promote engagement with listed companies and help improve CG and company accountability.

SharePHIL is a rare retail voice

Look past SharePHIL however and there are no other active retail associations. Perhaps the market remains too small for another entity? Retail investor activism remains almost unheard of and it generally takes a corporate scandal of truly epic proportions and a lively media campaign for retail investors to take errant companies and boards to task. Litigation typically remains the chosen modus operandi and while class actions are permitted, these are rare: more typically litigation is actioned by one or two larger disgruntled retail shareholders.

Domestic insurers need to step up

Next steps
It seems unlikely that domestic institutional investors will assume the mantle of shareholder activism and CG advocacy without further external stimulus. The government-controlled institutions have their own internal problems to address, but the larger domestic insurance companies could (and should) corral support for a combined responsible investment policy and use that to start CG advocacy and better company engagement. But that will need investors to challenge powerful family groups that control huge listed groups and vote against resolutions that breach their guidelines.

SharePHIL needs help!

SharePHIL remains the retail shareholder champion and along with a few other NGOs (such as the Institute of Corporate Directors) does a good job in advocating CG reform and remaining relevant and active, but it has limited resources, financial and human, and it seems unlikely that the CG outlook will change materially. SharePHIL needs government (read regulatory) intervention and assistance and a more collaborative approach from the institutional investors and other market practitioners. And that seems a very long way off.

SharePHIL promotes AGM compliance and engagement

Keeping them honest
Since 2013, SharePHIL has undertaken a number of surveys of AGM (ASM in local parlance) procedures by PSE-listed companies, both before, at, and after the meetings. The latest report, the "Annual Shareholders' Meeting Observation Study" released in July 2018, provides an interesting overview of the way companies handle minority investors through the medium of the annual stockholders' meeting.

Volunteers provide eyes and ears at company meetings

The latest survey covers 44 companies in which SharePHIL has invested, equating to some 18% of all PSE-listed companies. Volunteers from SharePHIL scrutinise and assess materials released by companies ahead of the meeting, attend the meetings in person to monitor procedures and compliance with requirements, and finally review post-meeting disclosures.

Its AGM survey is one of a kind in the Philippines

The SharePHIL survey is the only such review of its kind in the Philippines and has no doubt helped improve company compliance with SEC and PSE regulations around the preparation, conduct and post-event disclosure obligations of shareholder meetings. More importantly, the surveys have improved company engagement with retail investors.

6. Auditors & audit regulators

Philippines ranks 9th with a score of 60%

The Philippines punches above its weight in terms of audit quality generally and our scores reflect this. The Philippines ranked 9th with a score of 60% for this category, comfortably ahead of China, India and Indonesia, and not too far behind Korea. The score was a drop of three percentage points from our last survey, in large part due to scoring methodology changes.

Solid standards . . .

Local standards nearly meet the international mark

Philippine Financial Reporting Standards (PFRS) are fully converged with International Financial Reporting Standards (IFRS) except for IFRS15, which concerns the timing of recognition of revenues. Attempts have been made by the Philippine Institute of Certified Professional Accountants (PICPA) to converge fully with this international standard but there has been push back from the accounting industry and progress seems unlikely.

All listed companies must report under IFRS/PFRS

SEC Rule 68 requires all large and publicly accountable entities, which includes all listed companies, to follow IFRS/PFRS. The Philippines Financial Reporting Standards Council has a stated policy of adopting IFRS as PFRS, with some limited modifications.

Local auditing standards also converge with ISAs

Local auditing standards are fully converged with International Standards on Auditing (ISAs). The Auditing and Assurance Standards Council has adopted Philippine Standards on Auditing (PSA) which incorporate the ISAs and pronouncements issued by the International Auditing and Assurance Standards Board (IAASB) and include additional country-specific standards to address issues not covered by IAASB pronouncements.

. . . except for audit independence, fraud reporting and whistleblowing

Auditor independence rules are weaker . . .

On external audit independence, the Philippines scores slightly lower marks. PICPA has already adopted the International Ethics Standards Board for Accountants 2013 Code and has said it will adopt the old 2015 code, so it is behind the curve. The term limit for an audit engagement partner is seven years with a two-year cooling-off period. For public interest entities, which includes listed companies, however, the term limit drops to five years, which is more in line with international standards.

. . . as are rules relating to fraud discovery and whistleblowing

Certain restrictions apply to audit firms undertaking non-assurance work, including the exclusion of audit personnel on such assignments. The adopted code also covers issues for auditors when encountering fraud at audit clients, although curiously it stops at imposing an explicit obligation on auditors to report fraud. The code does not provide whistle blower protections.

Rules on audit and non-audit are only "comply or explain"

The disclosure of audit and non-audit fees paid to external auditors is fudged. The SEC CG Code mandates that audit committees of listed companies should evaluate and determine the non-audit work, if any, of the External Auditor, and periodically review non-audit fees paid. The code states that the Audit Committee should disallow any non-audit work that will conflict with the duties of an External Auditor or that may pose a threat to their independence. Any non-audit work should be disclosed in the annual report. The code does not explicitly state that non-audit fees must be disclosed separately, although many local companies do make these disclosures.

Auditor reports hit the mark

There are some good quality audits, especially at large-caps . . .

Extended auditor reports are required and discussions of key audit matters are common in Philippine financial statements and of a good standard generally. Among large-cap companies, audit standards are generally high and companies are well prepared for audits. The local auditing practice in the Philippines is dominated by local affiliates of the Big Four (see box below) and standards are therefore in line with international best practice, especially for large-cap companies.

. . . but not among mid-caps

Audits of mid-cap companies tend to be more brief in terms of disclosure and detail and are often overseen by smaller auditing firms. Finance and accounting resources at mid-caps are much more restricted and audits generally take longer given information is not as readily available from companies. That said, material issues from audits of mid-caps are generally rare (again, see box below).

Auditor oversight: underfunded, understaffed and no autonomy

Audit oversight is way behind best practice

The Philippines is a laggard in terms of audit oversight. Until 2017, there was no audit oversight body to speak of and attempts to introduce one encountered pushback from the smaller audit practitioners. The SEC stepped in and established the Office of General Audit (OGA) in 2017, which conducts periodic inspections under its SEC Audit Oversight Review (SOAR) programme. But the OGA is very new, far from independent and like much of the SEC, is underfunded. To quote the World Bank in its 2017 Report on the Observance of Standards and Codes (ROSC) in the Philippines: "The legal framework for Audit Quality Assurance does not provide for operational independence, adequacy of staffing and salaries, nor adequacy of funding."

It is also fragmented

The audit regulator's role is also in part duplicated by activities at the BSP (over banks) and by the Insurance Commission. While the OGA is a new entity, early indications are that it is undertaking work to review audit quality. The SEC website discloses some information relating to domestic audit capacity, including a full list of all accredited external auditors and audit firms.

OGA doesn't provide adequate data

However, to date, the OGA has not provided any public data on its enforcement activities and there is no comprehensive separate annual report of its inspection programme or a review of audit capacity and quality.

Nor does it promote capacity or quality issues

Similarly, the OGA does not proactively seek to promote capacity or improve quality or governance issues within audit firms, such as the introduction of audit quality indicators. Restrictions on financial and human resources are largely to blame.

The World Bank views the system as inadequate

To quote the World Bank ROSC again: "A comprehensive, cohesive, and adequate system of audit quality assurance is not in place, with various elements of quality assurance being performed by different agencies."

Next steps

Audit oversight needs an overhaul

Clearly the most pressing issue facing the domestic audit profession is establishing much better oversight. While the SEC SOAR programme is a step in the right direction, it is a small one. If the country is not going to fall behind peer group markets, it urgently needs to ramp up audit inspections, ideally via an independent and well-resourced oversight body.

Auditor and listed company disclosure needs to improve

The other area needing improvement is basic disclosure, both by listed companies around audit fees and non-audit work by auditors and by the audit regulator itself, providing details of inspections, results, sanctions and a credible assessment of capacity issues.

The accounting dog that doesn't bark

Ponzis and plunder, but no pilfering?

In a country rife with investment scams and Ponzi schemes (see box in the Enforcement section), government bribery scandals (the ZTE-National Broadband Network scandal in 2008; PhilHealth (see box in Government & Public Governance) and money laundering issues (the US$181m Bangladesh Central Bank/RCBC heist in 2016; the 2020 US$2.1 billion Wirecard scandal), it seems odd that we do not see more financial and accounting blow-ups among locally listed companies.

Top three ranking markets have corporate scandals, but nothing in the Philippines?

Hong Kong, Singapore, even Australia, the three highest-ranked markets in our survey, all get their fair share of corporate scandals, but not, it seems in the Philippines. Yes, we saw the 2017 2GO Group accounting scandal, which saw net income massively reduced at the ferry firm following a special audit ordered by its new owners, that restated the 2015 and 2016 financial statements. The scandal dragged in the firm's previous auditor, the local affiliate of KPMG and prompted an investigation by the SEC. And then there was the 2012-2017 Calata Corp fiasco, whose financial statements were questioned post listing given the strange provenance of the firm. But that scandal focussed more on market manipulation by insiders, prompting the SEC and PSE eventually to delist Calata in 2017.

Local auditing standards are good, but audit oversight is not so good

While local auditing standards are good, they are certainly not better than Hong Kong, Singapore or Australia, and audit oversight is much worse. It is a conundrum that is difficult to explain, unless such accounting landmines are there and are simply going unnoticed. The 2GO issues only came to light after the company was acquired. Calata's issues were so egregious they were impossible to ignore.

Big Four concentration and minimal oversight may spell trouble ahead

Two factors may explain the absence of financial scandals and offer some food for thought for investors. First, the local auditing market is completely dominated by local affiliates of the Big Four firms, and one in particular, SGV & Co, the local affiliate of Ernst & Young, conducts audits for more than half of all locally listed companies. And many of the other companies are audited by the other Big Four firms.

Statutory auditors lack resources for effective oversight

Second, statutory auditors are stretched, really stretched, which means audit partners cover more and more companies. And regulators (see our analysis in the main narrative to this section) are very short of human and financial resources to carry out effective audit regulation and oversight.

Investors beware of hidden accounting landmines

It may be that Philippines companies are very good at accounting and local auditors are better than their overseas counterparts. But if neither statement is true (which seems likely), it suggests that there are hidden accounting landmines out there. Investors should tread carefully.

7. Civil society & media

The Philippines scores 33%, ranks joint 10th

The Philippines' score dropped in this category by five percentage points to 33%, due in part to some of the more egregious actions taken by the Duterte administration against the media, but also in part due to a lack of obvious enthusiasm and progress among stakeholders for CG and ESG reform. The Philippines ranked joint 10th place with Korea, two percentage points behind Indonesia and ahead only of China, which is not much of an achievement.

The directors' industry body and a shareholder group are leading CG lights

The only score that increased was for the depth and quality of the training provided by the local Institute of Corporate Directors (ICD). ICD continues to be the key leader in CG among Philippine NGOs, alongside the Shareholders' Association of the Philippines (SharePHIL). In addition to comprehensive training programmes for company boards, ICD also offers courses for boards of government-owned companies and NGOs, as well as seminars, CG health checks and publishes a useful "Learning Map" of CG modules.

There is no corporate secretaries institute

While the ICD is alive and well, there is no sign of an institute for corporate secretaries and thus no specific training for what is a key supporting role for the board. And there is precious little else by way of training or CG or ESG promotion among other stakeholders, such as accountants, banks or financial analysts. The Philippine Institute of Certified Public Accountants (PICPA) as the accredited accountancy training body, holds plenty of training courses, but none promotes CG.

Business groups and non-profits give CG the cold shoulder

So many NGOs, but no CG action

There are plenty of NGOs and business associations in the Philippines but many suffer from being too "clubby" and often have the same members. Some are even anti-CG reform. The one exception other than ICD is SharePHIL, which undertakes CG advocacy and some research, although nothing as yet on ESG. SharePHIL and ICD undertake some CG advocacy and lobbying of regulators and government. But they largely operate alone. And there is surprisingly little academic or professional research on CG and ESG among local institutions and other professional associations.

Journalism: a dangerous profession

Most media prefer style over substance

The media are a lively bunch in the Philippines, but there is a shortage of serious financial journalism. The notable exceptions to that are Rappler and The Inquirer, who are prepared to speak truth to power and cover in-depth both political and corporate skulduggery. It is no coincidence that both outlets faced run-ins with the authoritarian President Duterte. In the case of Rappler, that ended with the arrest and indictment of the media outlet's founder and editor-in-chief, Maria Ressa (see box below).

Journalists are often intimidated

Intimidation of the media has been a serious problem in the Philippines for years, but it has gotten worse under Duterte. Journalists are regularly threatened and stories spiked, at times through intimidation, occasionally via payment. Freedom House's "Freedom in the World 2020" survey stated that the Philippines remains one of the most dangerous places in the world for journalists, while a coalition of media groups reported that between June 2016 and April 2019, there were 128 documented attacks and threats against the press, including physical attacks; death and bomb threats; and smearing journalists as conspiring against the government, or so-called "red-tagging". According to the Committee to Protect Journalists, six journalists were killed in the Philippines in connection with their work between 2016 and 2019.

The quality of media coverage of CG is sliding

Perhaps in response to the increasingly hostile operating environment, the quality of media coverage of CG has deteriorated in the past two years. To quote the Freedom House survey: "Private media are vibrant and outspoken, although content often lacks fact-based claims or substantive investigative reporting."

Next steps

More of the same is likely for the media

It is difficult to see too much changing quickly within civil society and media in the Philippines. Indeed, with Duterte extremely popular among the voting public, it seems very likely that the next administration (the Presidential election is due in 2022) will be anointed by the outgoing president and cast in his image. The next president may even be one of his children, or at least one of his cronies. So, the outlook for media and a more open and tolerant society is not encouraging.

Enthusiasm for CG fluctuates

The business elites and intelligentsia in Manila maintain a polite distance from the political noise as much as they can and CG reform tends to wax and wane along with market vicissitudes. It is a crass but often heard statement that CG must be good if the market is strong, and the Philippines market is no different.

Humiliate to stimulate?

Often, necessary reform in the Philippines occurs because of outside stimulus, especially when the government and public feel the country's pride is at stake. A dose of CG shaming might be the best medicine to cure the country's malaise.

The Rappler rap sheet

Media critics become targets

Leading media outlet Rappler and its founder, Maria Ressa, have been consistently targeted by the Duterte administration after crossing swords with the controversial president.

Rappler comes under attack from Duterte, SEC and NPS

In January 2018, after a statement by Duterte in his State of the Nation Address that questioned Rappler's ownership, the SEC announced that Rappler had breached foreign ownership limits for media companies, voided the offending share transaction and revoked its certificate of incorporation. In November of the same year, the National Prosecution Service (NPS) announced that it had found probable cause to indict Rappler and Ressa for violations of the National Internal Revenue Code after a complaint filed by the Bureau of Internal Revenue (BIR). The NPS claimed that Rappler and Ressa had evaded tax by failing to provide accurate information to the BIR as part of the offending share issue.

Rappler founder faces six years in jail for cyber libel

In February 2019, Ressa was arrested for so-called cyber libel in connection with an article that was published in May 2012 even though the charges were based on a law that only passed in September 2012! She was found guilty of the charge in June 2020 and was released on bail pending an appeal: she faces up to six years in jail. Two more charges of cyber libel were subsequently brought against Ressa in January 2021.

Attacks on Rappler are seen as retribution for media exposés

The attacks on Rappler and Ressa are generally acknowledged to be in retaliation for exposing significant foreign interference favourable to Duterte via online media during the Presidential election as well as Rappler's outspoken condemnation of the President's war on drugs.

What to avoid

Downgrade watchlist
Factors that could force the market score to fall in CG Watch 2022:

- ❑ A loss of momentum to CG reform, started by the SEC but which needs to filter rapidly down to the PSE as well as companies and investors
- ❑ Continued failure by regulators to provide adequate and timely disclosure: the SEC and PSE offer very limited data, especially on enforcement: the most recent SEC Annual Report on its website is for 2016!
- ❑ A lack of progress in re-organising the SEC: where are its purpose-built headquarters? When will its incorporation and filings business be hived off? When will it be properly and independently funded?
- ❑ Any roll back of key CG issues, such as RPTs, Board rules, disclosure obligations

What to fix

Quick fix list
Issues to address as soon as possible-depressingly, these are almost identical to our 2018 report:

- ❑ Data disclosure. The SEC and PSE should provide more disclosure (especially on enforcement) and much faster
- ❑ The SEC should simply mandate key CG issues and stop giving companies an escape hatch: Mandatory split of chairman/CEO; clear term limits; mandatory voting by poll; full audit committee independence; mandatory disclosure of individual director remuneration . . . and so on
- ❑ Invest in better enforcement: even if the AGO won't act, at least move against repeat offenders. More resources needed: financial; human; technological
- ❑ Tougher but still important: tackle inadequate rules on RPTs and Takeovers

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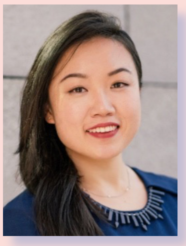

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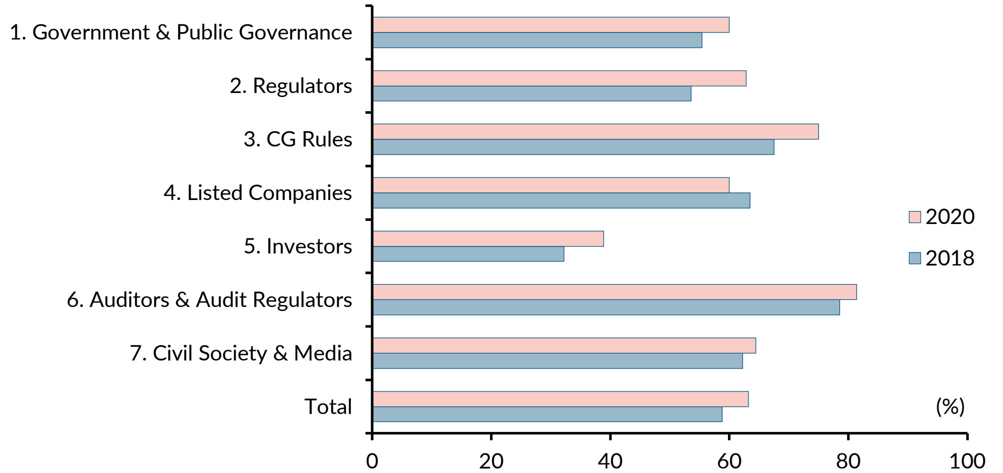
Singapore – Talking tougher

- MAS and SGX up the ante on enforcement
- Pragmatic response to Covid-19, good guidance on continuous disclosure
- SGX strengthens CG rulebook, but tears out pages on quarterly reporting
- No change in the limited transparency on regulatory funding or capacity
- Corporate disclosure on CG and sustainability generally disappoints
- Domestic investor commitment to CG and ESG still behind the regional curve: little disclosure of policies, voting, engagement
- Still waiting for an amendment to the Accountants Act to give ACRA disciplinary powers over audit firms; revision of auditing standards somewhat slow

Figure 1

Singapore CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Singapore regained ground in CG Watch 2020 with an improved score and ranking compared to 2018. Its market score of 63.2% was 4.2 percentage points higher than in our previous survey and it moved from 3rd to equal 2nd with Hong Kong. The biggest area of improvement was the Regulators category, with scores for both the Funding-Capacity Building-Regulatory Reform and Enforcement sub-sections increasing substantially. This was followed by noticeably higher scores for CG Rules and Investors, and a lower but not insignificant boost for Government & Public Governance. More incremental improvements were seen in Auditors & Audit Regulators and Civil Society & Media. The one category where Singapore's score fell was Listed Companies.

Singapore rises to joint 2nd place with a score of 63.2%

In a nutshell, Singapore's improved score over the 2018 survey result has been driven more by government and regulators than by companies, civil society groups and investors. Among investors, a strong contribution by the retail segment, which includes the local retail association, is all that saved this stakeholder category from embarrassment. Although the score for the Investors sub-section increased, it did so from a very low base, leaving Singapore well behind leading markets such as Australia and Japan and even below India and Korea. Like Hong Kong, Singapore has a relatively undeveloped domestic institutional investor community when it comes to stewardship.

Progress is driven more by government than corporates, civil society and investors

From an ecosystem perspective, Singapore has much in common with Hong Kong. Both score 81% on Auditors & Audit Regulators and 75% on CG Rules, yet are underpowered in Listed Companies and Civil Society & Media, where they score around 60% for both categories. Hong Kong does somewhat better on Government & Public Governance, while Singapore beats Hong Kong on Investors (thanks to a more active retail component). The score differences in each of these three areas, however, is not huge.

Gains are made but Singapore still underperforms

A fair question to ask is why are Singapore and Hong Kong, despite coming equal second in our survey, still well below Australia in total score? They are both international financial centres, which Australia is not, and have ostensibly benchmarked themselves against global best practice in corporate governance. After 20 years of reform, one might expect them to be doing much better.

Status quo of family control and reticent regulators stifles structural reform

There are multiple answers to this question. Despite the rhetoric, neither city has followed global CG best practices as closely as outsiders probably think. CG codes of best practice have been updated regularly, yet financial regulators take a fundamentally hands-off approach to influencing boardroom culture among family-controlled companies. Neither has sought to create a strong group of domestic institutional investors capable of holding local companies to account (both have weak stewardship codes), nor do they inherently have a deep base of such investors unlike most of the region. And legal remedies available to minority shareholders in both cities remain slim as reforms such as class-action lawsuits fail to get off the ground.

Singapore and Hong Kong have both traded morals for dual-class shares

Perversely, their position as international financial centres drives them to lower standards at times to compete globally for IPOs: the two markets have led a race to the bottom in recent years over dual-class shares, which has benefitted Hong Kong but not yet Singapore.

Recapping CG Watch 2018

Enforcement disclosure improves but quarterly reporting is scrapped

A number of the recommendations made in our last CG Watch survey seem to have had an effect in Singapore, most notably around more detailed disclosure of enforcement activities by the Monetary Authority of Singapore (MAS), improvements to the Singapore Exchange (SGX) company database, and strengthening various listing rules and investor protections. There have also been areas where Singapore has gone backwards (diluting its quarterly reporting rules) or not progressed (the continued low profile of its domestic institutional investors on CG and stewardship). Further details can be seen in the figure below.

CG hits and misses since 2018

Figure 2

Singapore: Recap of 2018

	Recommendations	Outcomes
1.	MAS to provide systematic analysis of its enforcement outcomes	New Enforcement Report published for the first time in March 2019
2.	MAS to provide details of resources devoted to securities regulation	No change
3.	SGX to improve company reports database	Marked improvement on 2018, though not as extensive as the HKEX archive
4.	SGX to provide systematic analysis of its enforcement statistics	No change
5.	SGX to review interested-person definition	Listing rules amended and improved
6.	SGX to strengthen minority protections in voluntary delistings	Listing rules amended and improved
7.	More meaningful board committee reports	No significant change

Source: ACGA

1. Government & public governance

Singapore in joint 4th place with a score of 60%

Singapore's score improved by five percentage points in this category to reach 60%, placing it equal 4th with Japan and Korea. It held the same ranking in 2018.

Familiar themes undermine its score

While Singapore performs well in many of the questions in this category, including a competent judiciary, strong bank governance, an enhanced capital market regulatory system with the creation of Singapore Exchange Regulation (SGX RegCo), and an independent anti-corruption body, it continues to be held back by the same factors that undermined its score in 2018. Namely, a contradictory strategy on corporate governance generally, a securities commission that is not independent of government, opacity around the funding of MAS's securities regulatory work, and weak legal remedies for minority shareholders.

A mixed CG strategy

Steps are being taken to strengthen enforcement . . .

Singapore's approach to corporate governance continues to be mixed. On the positive side of the ledger, MAS formed a new CG Advisory Committee (CGAC) in February 2019 and launched an enforcement report for the first time the following month. SGX RegCo, formed in late 2017, has upped the ante on enforcement. Then the Exchange launched a consultation in early August 2020 on clarifying and strengthening its enforcement powers, which is still under review. All of these moves arguably reflect a desire to develop its CG ecosystem further.

. . . but there is no tangible CG blueprint

Unlike some markets in the region, notably Taiwan, Singapore lacks any form of coherent CG roadmap. The government is still enamoured with the value proposition of dual-class shares (DCS), despite gaining very little from it to date other than a secondary listing called AMTD in April 2020. MAS chairman Tharman Shanmugaratnam's characterisation of DCS in January 2020 as a measure that will help Singapore become a "listing destination for new high-growth technology companies" seems achingly remote. And in its desire to simplify regulation, SGX scrapped quarterly reporting for a majority of issuers - an issue we look at in more depth under the CG Rules section. On balance, we would argue that Singapore is somewhat more strategic than Hong Kong in CG generally, scoring a 2/5 compared to Hong Kong's 1/5, but it also has a competitively opportunistic streak.

Bank governance rules strengthen

Bank regulator is tightening rules and guidance

MAS has been busy issuing consultations, new rules, and guidance over the past two years. Interestingly, some of these initiatives post-date similar developments in Hong Kong or international policy developments:

- The Banking (Amendment) Act 2020 gazetted in February 2020 aims to enhance MAS's enforcement powers over financial institutions. While largely technical in nature, it does expand the ability of MAS to revoke banking licences.
- Enhancement of anti-money laundering regulation at collective investment schemes, which are called variable capital companies (VCCs) in Singapore, (April 2019 consultation; January 2020 response). VCCs will be required to appoint an eligible financial institution to conduct customer due diligence checks, although the VCC should have its own anti-money laundering policies in place.

- July 2020 consultation on a New Omnibus Act to give MAS greater power to ban individuals at financial institutions who are not fit and proper, regulate virtual asset service providers to curb money laundering and impose new technology risk management requirements. The consultation is still at the review stage.
- Strengthening cyber resilience: MAS made a number of existing risk management guidelines relating to IT security mandatory, effective from August 2020.
- Formation of a "Culture and Conduct Steering Group" in May 2019 to raise conduct and ethical standards among banks in Singapore.

Anti-corruption opacity

Graft agency is not autonomous

One notable aspect of the position of the Corrupt Practices Investigation Bureau (CPIB) within the Singapore government is that it comes under the Prime Minister's Office (PMO) and reports directly to the PM. While the Bureau says that this allows it to operate independently, it raises the obvious question as to what it could do if the PM were ever found to be corrupt. It is also worth noting that, unlike the situation in Hong Kong, the Prevention of Corruption Act in Singapore allows for extra-territorial jurisdiction over acts committed by Singapore citizens.

Corruption figures and analysis offer little insight

The CPIB has long had a programme on corruption prevention and education but scrimps on operational and statistical detail. While the Bureau releases an annual press release summarising its work during the year, it only runs to a few pages and gives a cursory view of the Bureau's enforcement endeavours. Its website likewise offers only limited information on how the Bureau operates, with no disclosure of staffing capacity or how its budget is allocated. Unlike Hong Kong's ICAC, the Bureau does not publish an annual report. We know from the PMO's budget figures that for the 2020 financial year, CPIB had funding of around S$47m (barely a fifth of the HK$1.2 billion that Hong Kong's ICAC received), but there is no indication of how it was allocated. Within the PMO alone this represents just 5.8% of total operating expenditure. In terms of personnel, again there are only broad brush figures: there were 132 corrupt practices investigation staff (at varying ranges of seniority which are not disclosed) and a further 58 investigation assistants, both figures remaining flat compared to 2018 and 2019.

Nine out of 10 graft investigations are in the private sector

The Bureau is more forthcoming on its enforcement work albeit in the form of sporadic press releases, although some are quite detailed. The patterns we reported in CG Watch 2018 do not seem to have changed: the number of corruption reports, which stood at 358 in 2018, fell marginally to 350 in 2019. Of these, 119 were classified as "pursuable investigations", an uptick of 11% on 2018. As before, the private sector continued to dominate, with 107 new cases, representing 90% of investigations (the figure was 88% in 2018). There were just 12 new public-sector investigations in 2019. Meanwhile, the annual number of investigations completed (the so-called "clearance rate") edged up five percentage points to 85%, while the conviction rate remained at an almost-perfect 99% for the third year in a row.

Polls say Singapore is seen as a clean place to do business

Singapore continues to rate well in anti-corruption surveys, suggesting there is a perception that overall its government and business environment is clean. Transparency International gave it a score of 85/100 in 2019, although it dropped one place to 4th. It took 1st place in the Political & Economic Risk Consultancy

(PERC) survey in March 2020 with a score of 1.73, where the lower the score the cleaner the market is perceived to be. This was an improvement on its 2019 (1.85) and 2018 (1.9) scores but a notable deterioration from the 0.37 it received back in 2011. Although some non-OECD countries are signatories to the Anti-Bribery Convention, Singapore is not one of them.

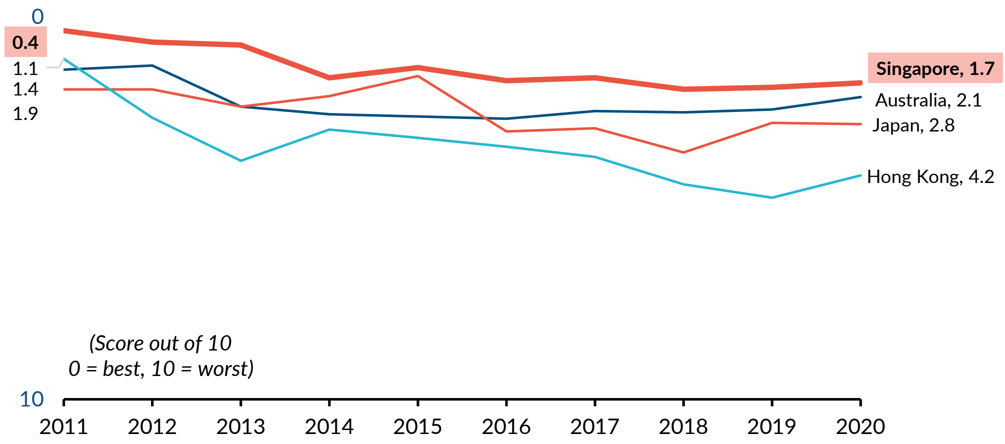
Public sector is clean but private individuals are not

It is arguable that these perceptions chiefly apply to the public sector where, like Hong Kong, there is a sense that graft among government officials has largely been relegated to the history books. The private sector meanwhile continues to keep investigators busy - individuals that is, rather than companies which are rarely prosecuted. Judging by the crudeness of some of the corruption, one could question to what extent the government's anti-graft message has permeated society. Case in point was the July 2020 conviction of a 44-year-old man who tried to stuff bank notes into the hands of auxiliary police who caught him smoking, or the jailing for four weeks in October 2020 of a 28-year-old woman sitting a driving test who tried to bribe an inspector.

Corruption perceptions are sliding

Figure 3

Not as clean as it used to be: Changes in perception of corruption in Singapore, 2011-2020



Source: Political & Economic Risk Consultancy

Whither whistleblowing?

No universal protection for whistleblowers

Singapore lacks an overarching law on whistleblowing in relation to corporate crime, public and private-sector corruption, fraud and other crimes. Rather it addresses these issues through different pieces of legislation. Individual government agencies have whistleblowing mechanisms, such as the Inland Revenue Authority (it gives incentives to whistleblow on tax evasion), the Economic Development Board (whose system is managed by KPMG), SGX and the Accounting and Corporate Regulatory Authority (ACRA). The Prevention of Corruption Act allows for anonymous tips to the police or CPIB. But these efforts have been described as "piecemeal" and do not cover all types of unlawful or improper behaviour. Meanwhile, MAS has its own Code of Conduct governing the behaviour of its staff.

Scrutiny of government is lacking

There is no independent ombudsman in Singapore, although the Auditor-General's Office (AGO), describes itself as independent and audits the finances of government departments, organs of state, statutory boards, government funds, and other public authorities such as GLCs (if they request an audit). The organisational structure does not appear to have a complaints division. The AGO produces an annual report that it is quite revealing of organisational weaknesses in public agencies. While its 2019 report criticised numerous ministries and public bodies, it had nothing to say on the accounts of ACRA, MAS or the Inland Revenue Authority of Singapore (IRAS)! While Singapore does well generally in the World Bank's "Worldwide Governance Indicators", it scores averagely for "voice and accountability".

Next steps

Singapore needs a CG plan

Does Singapore need a CG roadmap? Some might say that it is sophisticated and developed enough not to need one. We think an overarching policy document would help to set a clearer path forward - especially in terms of linking CG and ESG/sustainability risk management, CG and investor stewardship, and ESG reporting and auditing (as we argue in our opening thematic chapter).

Ditching dual-class shares would benefit Singapore

Renounce dual-class shares? Singapore has arguably lost the big battle with Hong Kong for tech listings from China. It might be time to accept this reality and regain the moral high ground.

Anti-graft agency should improve its disclosure

More information from the CPIB on its enforcement work, funding and capacity would be welcome.

Protect whistleblowers

Time to consider an overarching whistleblowing law? We think so.

Who is AMTD?

Singapore's first dual-class share listing fails to excite

There was no great fanfare when Singapore's first dual-class share (DCS) listing made its debut in the spring of 2020: it came two years after rules were changed in the hope of luring mega tech plays and took the form of a relatively unknown financial services firm.

At the time, AMTD International was incorporated in the Cayman Islands, headquartered in Hong Kong and listed on the NYSE. Its main revenue came in the form of fees and charges for IPOs and other financial advisory work, as well as asset management and insurance. AMTD had an office in Singapore but it was not a major market.

Corporate governance activist and academic Mak Yuen Teen was "far from excited". In his blog, "Governance for Stakeholders", Mak pondered the virtue of allowing what is essentially a financial institution to have a DCS structure, never mind one that seemed to belong in Hong Kong.

AMTD counts several large PRC banks as its biggest clients and helped tech firms such as Xiaomi Corporation and Meituan Dianping list with DCS in Hong Kong. While it holds a Hong Kong virtual banking licence with Xiaomi and claims to scope fintech ventures via its pet "SpiderNet" project, its most notable investment is a strategic stake in the Bank of Qingdao.

Meanwhile, back in Hong Kong it turns out that AMTD did try to list its insurance brokerage unit on the stock exchange in mid-2017. Its IPO prospectus was returned by the exchange a few months later with no comment.

2. Regulators

Singapore jumps to 4th place with a score of 63%

Singapore's overall score for Regulators improved significantly from 54% in 2018 to 63% in 2020, placing it 4th in the region - up from 8th previously. These scores are an average of two sub-categories: Funding-Capacity Building-Regulatory Reform and Enforcement. Singapore performed better overall in each category, though not in all questions.

Are regulators sufficiently resourced?

The aim of the first category is to assess whether the level of resources available to securities commissions and stock exchanges is sufficient for their regulatory role. This is a challenging question to answer, as we explain in our Overview chapter. Nevertheless, it is impossible to even begin answering this question unless adequate data is provided. This category also looks at the extent to which regulators are investing in people and technology, and the range of CG- and ESG-related reforms they are undertaking.

Enforcement statistics are meaningless on their own

The second category assesses progress made by regulators in enforcing rules and regulations, and explaining their actions on both a case-by-case basis and in aggregate. Ideally, we would like to see regulators producing an annual enforcement report - or detailed chapter in their annual report - and statistical tables dating back five or more years. Numbers on their own usually mean very little, hence the value of providing some accompanying narrative.

MAS oversees financial sector while SGX is at the frontline

In brief, the regulatory structure in Singapore consists of the Monetary Authority of Singapore (MAS) acting as a combined central bank and regulator of the banking, insurance, asset management, and securities sectors. Since MAS lacks criminal investigatory or disciplinary powers, it must work with the Commercial Affairs Department (CAD) of the police to enforce criminal offences such as insider trading, market manipulation and fraud. The frontline regulator of the stock exchange listing rules is the Singapore Exchange (SGX). In late 2017, SGX formed a new subsidiary, SGX Regulation (SGX RegCo) to undertake enforcement. This change sought to address the inherent conflicts of interest that SGX faces as a dual regulator and commercial business.

2.1 Funding, capacity building, regulatory reform

Singapore jumps to 5th from 8th on a score of 56%

Singapore's score for this sub-category showed a material increase from 48% in 2018 to 56% in 2020, taking it from equal 8th in ranking regionally to 5th. While we have seen no significant improvement in the limited information Singapore provides on regulatory funding and investment - indeed, it is one of the least transparent jurisdictions in this regard in the region - it has performed well in terms of reform.

MAS staffing remains flat

MAS financial statements to 31 March 2020 show that total personnel expenditure was flat over 2019 and 2020 at around S$260m. Salaries stayed the same at S$223m. However, there is no breakdown in the report of personnel numbers or spending by regulatory sector (ie, banking, insurance, capital markets). In the area of information technology, MAS increased its spending from S$24m in 2019 to S$31m in 2020, but it is not clear what this increase comprised.

Points deducted for poor data disclosure by MAS

It is worth noting that Singapore lost points again in this year's survey because it failed to show progress in improving data transparency, namely that it has sufficient funds and skilled staff to execute its regulatory objectives (Q2.1, for which it scored 2/5, losing a point), while also investing in its surveillance, investigation and enforcement capacity and technology (Q2.2, where it also lost a point, scoring 2/5).

SGX fares better than MAS but still doesn't disclose enough

As we noted in 2018, SGX is more transparent than MAS since it is a listed company and produces an audited annual report, with notes to the accounts and more substance on HR matters and expenses. Yet it also provides only an incomplete picture. Salient facts from its FY2020 report:

- Total salaries for the SGX Group, which includes the Stock Exchange and two wholly owned subsidiaries, the Baltic Exchange and the Energy Market Company, increased from S$119.6m in 2019 to S$128.7m in 2020. Salaries for the "company", which operates the Singapore Stock Exchange, rose from S$70m to S$77m.
- Staff numbers totalled 846, an increase of just over 1%. This included 107 new hires and 90 resignations. The overall retention rate was 89%.

SGX beefs up whistleblowing and enforcement functions

SGX RegCo describes its staffing as relatively stable over the past few years. There has been some reorganisation: a new dedicated Whistleblowing Office and a standalone enforcement function. As with the Strategic Planning Office, they report directly to the CEO of SGX RegCo. Additional budget and headcount to support these changes were reflected in the 2019 budget, but no breakdown of actual figures was given.

Spending on IT is slightly up

SGX investment in technology:

- Overall expenditure by the group increased modestly from S$386m in 2019 to S$397m in 2020 (however, S$90m of this was depreciation, up from S$63m in 2019). Spending on technology amounted to S$69m in 2020 for the group, down from S$79m the previous year. For the company it also went down from S$50m to S$47m. As in previous years, the largest component was "system maintenance and rental", but no further details were provided in the notes to the accounts.
- SGX RegCo launched the Automated Clearance Regime (ACR) in February 2019 to enable "straight-through processing for circulars of certain corporate actions". This allows a faster clearance and shorter time to market. SGX RegCo also enhanced its real-time monitoring system with AI in February 2020 to help isolate unusual activity and eliminate false negatives in its surveillance.

SGX takes its profit-making seriously

While SGX does appear to be making a genuine effort to enhance its regulatory role, it is clear that it takes its profit-making function very seriously as well. It had a bumper year in 2020, crossing the S$1 billion mark in terms of revenue, its highest since listing. Net profits were up 21% to S$472m. In other words, it faces similar conflict of interest challenges as HKEx. One way to address this concern would be to produce more detailed disclosure on resources invested in regulation.

MAS-led reforms

MAS makes an impression with its regulatory initiatives

In contrast to its underwhelming budgetary disclosure, MAS has been more impressive over the past two years on its the range of regulatory initiatives it has undertaken. For example:

- MAS consultation on proposed guidelines on environmental risk management for asset managers in mid-2020. The regulator in December 2020 responded to submissions. Senior management is expected to integrate environmental considerations into strategy, business plans and products.
- A proposed client identification rule to identify beneficial owners of shares held in the name of foreign intermediaries (FIs): FIs would have to provide MAS or law enforcement client information within five days of a request being made. A consultation which concluded in September 2019 is still under review.

- Guidelines on Fit & Proper Criteria were revised in January 2020.
- In September 2020 MAS responded to a consultation on improving accountability and standards of conduct across the financial industry.

SGX-led reforms

SGX is also tweaking the regulatory landscape

SGX has also had an active couple of years, making numerous improvements to its listing rules in areas such as interested-person transactions (ie, related-party transactions), market manipulation, and continuous disclosure - with some of the changes benchmarked against higher standards in Hong Kong. Despite the shadow cast by DCS and the dilution of quarterly reporting, SGX's efforts earned it a 4/5 for our question (Q2.6) on the extent to which the exchange is modernising its rules to improve CG. In 2018 it scored a paltry 1/5 because we judged that the negatives heavily outweighed the positives. (See the section on CG Rules in this chapter for a fuller discussion of the above rule changes.)

Short public consultations

Singapore's consultation process needs work

A new question included for the first time in our 2020 survey relates to the public consultation exercises conducted by financial regulators. Singapore scored 3/5, indicating it has room for improvement.

Consultation periods are often short, online publishing of submissions could be better

Since our last CG Watch, MAS has held around five public consultations related to CG issues (broadly defined) and SGX has held five. While the management of these consultations is professional - detailed consultation paper, consultation conclusions, formation of ad hoc committees - the length of the consultation period is usually no more than four weeks at both MAS and SGX. In late June 2020, MAS increased this to six weeks for three consultation papers on guidelines for environmental risk management at banks, asset managers, and insurers, but it was the same six-week period for all three! As for publishing submissions online: MAS does, but SGX only publishes a list of respondents by name. SGX has said that it will consider linking to individual respondent feedback in future.

Deadline extensions granted on occasion

But on the topic of the narrow timeframe for consultations, it is believes a month is "typically sufficient" and on occasion it does allow extensions. This is true and is something ACGA has benefitted from in the past. Still, given the often long lapse between the consultation deadline and SGX's response, requesting another few weeks for submissions does not seem unreasonable.

SGX corporate archive continues to underwhelm

Revisiting the SGX website

We were critical two years ago about the SGX website archive of company reports for a number of reasons:

- Annual reports were only provided for the past four to five years. HKEx archives them for up to 20 years or more, depending on when the issuer listed.
- Database organisation was inefficient: company reports and announcements are organised by type of document, then company. A simpler approach would be to give each company one landing page for all documents, organised chronologically, and then searchable by report type, date.
- Search engine did not work well.

Annual reports only stretch back 5-6 years

While we note that annual reports are still only kept on the website for five to six years, other announcements and prospectuses are available for up to 20 years. We see no change, however, in the database structure or search engine.

Next steps

MAS and SGX should shine a light on funding and capacity

Disclosure from MAS on its regulatory funding and capacity building to the same level as the Australian Securities and Investments Commission (ASIC) in Australia and the Securities and Futures Commission (SFC) in Hong Kong would be very welcome. SGX could benchmark its funding disclosure against best practice in the region, not other stock exchanges (which typically give limited information). SGX could also explain how it plans to allocate its surpluses in enhancing its regulatory function.

Consultations need to be longer

Introduce longer consultation periods of at least two months for most consultations. Four weeks is too short to allow international investors and groups based outside Singapore, like ACGA, to respond properly. Regulators should be aware that their consultations often come at precisely the same time as major consultations in other markets. SGX should provide access to full submissions on its website.

A comprehensive archive of corporate reports

SGX website to provide a full archive of company reports and announcements dating back from the time a company was listed.

Singapore's response to Covid: Rapid

Singapore acted quickly on Covid-19 disruption

During 2020 Singapore was relatively swift in responding to Covid-related corporate disruptions, extending AGM and financial reporting deadlines as well as providing tangible guidance on virtual meetings and continuous disclosure. SGX also provided a S$5,000 grant for companies to help with the costs associated with virtual AGMs.

AGM extensions and virtual briefings

AGM respite for issuers

SGX RegCo was quick off the mark in early February 2020, giving an automatic 60-day AGM extension for issuers with significant operations in China and a 31 December year-end. By the end of February this was extended to all issuers with a 31 December year-end. Issuers were also encouraged to consider pre-AGM virtual briefings as well as a webcast of the meeting itself. In April, all issuers with a 31 March year-end were given a 60-day extension. Issuers were advised to extend the 14-day notice period of an AGM for shareholders to 21 days.

Financial reporting extension (with caveat)

Some leeway on financial reporting

In April 2020, 60-day extensions for annual report (AR) filing were granted for issuers with a year-end on or before 31 March. In line with pre-Covid-19 practice for all companies, these issuers would not have to publish their ARs until two weeks before their new AGM date. But there was one notable proviso: issuers with a 31 December 2019 year-end were entitled to a 60-day extension on AGMs, but they still had to publish their annual reports by the usual deadline of 15 April 2020.

Delays to be justified

For issuers with a 31 December 2019 year-end, there was also no change to the 60-day deadline at end-February 2020 for the release of unaudited 2019 financial statements and any issuer taking advantage of the waiver would have to notify SGX and apply to ACRA. SGX also warned issuers that any material adjustments subsequently made by auditors which materially affected the previously announced audited full-year results would have to be immediately disclosed.

Timely disclosure expected

Reinforcing continuous disclosure
Within the region, Singapore has taken a fairly firm stand on the need for listed companies to keep the market up to date on the impact of Covid-19 on their businesses. This was stressed from the outset in February 2020 and reinforced in April with an outline of what SGX expected issuers to disclose where there were ongoing developments or where an issuer had insufficient information to divulge the financial impact with certainty. By August, SGX published a commentary, "Corporate Governance Amid Covid-19", which discussed board disclosure on operations, earning prospects, liquidity and balance sheets as well as threats to the viability of a company as a going concern.

Greater ability to raise capital

Other forms of support
In March 2020 SGX unveiled a S$5m relief package, of which S$1.5m went to healthcare support with the remaining S$3.5m earmarked for listed companies. On 8 April 2020 it relaxed capital raising limits: companies would be able to seek a general mandate to undertake a rights issue up to 100% of their share capital, up from 50%. This was a boon to secondary equity fundraising in Singapore for 2020, led by a mega S$5.3 billion rights issue by Singapore Airlines (SIA). According to a report in The Business Times, S$12 billion was raised in 2020 through private placements, preferential offerings and rights issues, the highest figure in 10 years.

In April, SGX also temporarily suspended its Financial Watch-List, which tracks companies with three years of losses and market capitalisation below S$40m.

Singapore jumps to joint 2nd place with Taiwan, with a score of 70%

2.2 Enforcement
Singapore saw a strong rise in its score for the Enforcement sub-category from 60% in 2018 to 70% in 2020, taking its ranking from equal 6th to be equal 2nd with Taiwan. Some of the main contributing factors included better outcomes by both MAS and SGX, and more useful disclosure of enforcement actions, especially by MAS. It remains six percentage points behind Hong Kong, however, which has long been the regional leader in this area.

Singapore score benefits from broader underlying analysis

Another reason Singapore gained points here is because of changes to our underlying analysis. For example, in a question (Q2.14) on whether the securities commission has robust powers, both civil and criminal, we broadened our analysis to include the criminal investigation and sanctioning powers of the CAD in the police. Formerly we took a more narrow view and docked points because MAS only has civil powers. Since it has worked in a collaborative enforcement arrangement with CAD since March 2015, we felt a more systemic approach to the question was warranted.

MAS flexes more muscle

Talking and acting tougher
Both MAS and SGX have made a concerted effort to talk more publicly about enforcement over the past two years. While there has not been a significant rise in the MAS caseload, there have been notable developments. The severity of penalties appears to have increased compared to 2017-2018 and the authority is being more creative in the use of its powers. It imposed a life ban in October 2020 for market misconduct and has barred others for periods of up to 25 years. MAS has also achieved a few firsts over the past two years: for example, prosecutions for front-running as an insider dealing offence, a civil penalty for providing false shareholder information and a joint market misconduct probe with CAD.

Report on MAS enforcement lacks detailed analysis

In March 2019 MAS produced its inaugural Enforcement Report, specifically designed to enhance the accountability and transparency of its work. The second edition appeared in November 2020. The two reports are a step in the right direction and give a general overview of the division's work, but do not offer much in the way of original insight. They are easy on the eye and in large font set out the principles and priorities of MAS on enforcement, albeit in generic terms. For example, in making insider dealing a priority going forward, the only elaboration given is that MAS will continue surveillance and investigations into suspected insider trading.

Data spotlights the big enforcement wins

There are some colourful pie charts and bullet points but the empirical data is selective and spotty rather than a methodical dissemination of facts, figures and analysis. Some of the bigger cases of the year are highlighted but repeat what is given in press releases:

- In the first report which covered July 2017 to December 2018 there was one criminal conviction for false trading, S$16.8m in financial penalties and compositions applied to 42 financial institutions, and S$698m in civil penalties.
- A first: a market misconduct conviction arising from a joint investigation with CAD: Dennis Tey Thean Yang was jailed for 16 weeks in March 2017 after he made a profit of S$30,239 through spoofing (or bluffing) two providers of contracts-for-differences.
- Details were given of an initiative to curb market abuse, Project Apollo, an AI tool to help triage cases for investigation.

The second enforcement report is formulaic

The second report covered the January 2019 to June 2020 period, by which time there was a new executive director of enforcement: Peggy Pao had replaced Gillian Koh Tan. It adopted an identical format. Some of the highlights:

- Nine criminal convictions (all jailed), S$3.4m in financial penalties and compositions, S$11.7m in civil penalties relating to one insider trading case, one of deceptive trading and one of failure to disclose shareholdings.
- A civil penalty against a bulge bracket bank: a fine of S$11.2m against UBS for deceptive trades involving trade price or spread for transactions.
- Singapore's first prosecution for front-running as an insider dealing offence resulted in some jail terms of 20 months to 36 months (who got what exactly is not clear).
- Long bans for misbehaviour, including a 25-year prohibition order and a life ban in October 2020 for Kevin Michael Swampillai after illicitly pocketing fees from scandal-ridden 1MDB.
- The first civil penalty for providing false shareholder information was imposed in January 2020, eight years after the regime was extended to cover such breaches.
- Project Apollo gets another (pretty much identical) write-up.
- Looking ahead, insider dealing is out and the enforcement division will enhance its focus on senior management accountability for breaches by their foreign intermediaries or subordinates.

SGX also talks tougher . . .

The frontline regulator is sharpening its teeth

SGX has made numerous statements of intent about tougher action through SGX RegCo, which now has another two years under its belt since our last report. The Exchange has stepped in on behalf of shareholders more actively than in the past:

since 2019 there have been at least five occasions where it has warned stockholders to trade with caution in respect of issuers, and it sees fit to comment on individual cases (for example where an external investigator has been appointed to scrutinise a company).

SGX took a stand on Noble Group resurrection

In December 2018 it worked with MAS to knock back a key part of Noble Group's restructuring attempt which would see it transfer its listing status to New Noble, the commodities giant under investigation since 2015. Its August 2020 rationale for a new enforcement framework suggests a regulator itching to flex its muscles, as it seeks the power to issue public sanctions. In its press release at the time, SGX made a point of stating that it is "acutely aware of the perception that few public enforcement actions have taken place in recent years" and said it hoped to have greater scope to punish wrongdoing.

A dedicated SGX office set up to report misbehaviour

In late 2019 SGX also set up a dedicated office for investors to blow the whistle on errant issuers. Tan Boon Gin, SGX RegCo chief executive officer, described the Whistleblowing Office as akin to a neighbourhood watch. "Some bad behaviour is best addressed by peer pressure, scrutiny and advocacy," he told *The Business Times* in August 2019. There is no phone number for the office, only an email address, and meeting requests are assessed on a case-by-case basis. Reasonable steps will be taken to protect confidentiality and the identity of a whistleblower, subject to legal or regulatory requirements. No word on the scale or scope of complaints has been made to date.

. . . how about the action?

Singapore still comes up short on enforcement results

Despite a high profile on certain cases, the evidence does not suggest a significant change in enforcement outcomes by SGX. Its score here has not changed (Q2.18).

Disciplinary body flounders

Things have not quite worked out as SGX hoped when it set up an independent disciplinary arm in October 2015 to boost transparency and avoid conflicts as a for-profit exchange. With the power to fine up to S$1m, issue a public reprimand and deny access to the market, the 17-member Listing Disciplinary Committee (LDC) would mete out the more serious sanctions. Five years on, the LDC has met three times and has yet to publish a decision - it has made decisions but the cases are on appeal.

Inability to get a quorum nixes hearings

The problem, according to SGX, is that it has found it difficult to get an independent quorum of five (including the chair or deputy chair) for an initial hearing, which can later be whittled down to three. Indeed the 17 members include the great and good from Singapore's largest banks, law firms, accountants and corporates. The quorum requires members with experience in at least three out of four disciplines: corporate finance, accounting, the law or listed issuer directorship. The current list includes seven lawyers (two from the same firm despite a pool of 5,000 practitioners to choose from), accountants (some retired) from PwC, Deloitte and KPMG, several INEDs, bankers and corporate finance experts from the major players in town. In the four cases which have been referred to the LDC, there have been many stops and starts, and at times, conflicts among members were discovered late in the game, according to SGX.

SGX RegCo seeks expanded powers to discipline

Rather than expand the pool of candidates or seek out new ones, SGX has decided to change tack. It proposed in an August 2020 consultation that SGX RegCo's powers be widened to allow it to issue public reprimands, deny access to the market, impose conditions on issuers and demand that directors resign or not be appointed in the first place. Unlike the LDC, this wider scope of powers would not be appealable. The LDC and its appeals arm, meanwhile, would still continue to exercise their existing powers and have oversight of cases where a fine was warranted. While this does not solve the problem of the LDC's quorum, it may at least break the disciplinary impasse.

Singapore's track record on disciplining market misbehaviour suffers

This has left Singapore in somewhat of a disciplinary vacuum. We know there are private warnings given by SGX RegCo but it is selective in disclosing its decisions, which are anonymised in the form of case studies. It gave six examples in 2019 after a three-year gap. One example cited an issuer who delayed the release of an annual report and an AGM, as well as non-disclosure of a major transaction. These acts might seem heinous enough to warrant greater condemnation but given the inability to get the LDC off the ground, it is perhaps not surprising SGX RegCo opted for a private rebuke.

Fines and private rebukes are issued

SGX RegCo does have the ability to issue fines of up to S$100,000 where breaches are not serious: from none in 2019 these increased to five composition fines in 2020 and just one by mid-February 2021. Again, the details have been kept private. On occasion the regulator (privately) reminds companies to behave and issues warnings: 13 were given in 2019 and 12 in 2020. A fair number of referrals are also made to other industry bodies and authorities, although there is no explanation why. In 2019 there were 20, in 2020 there were 25, and as at mid-February 2021 there have been five.

SGX forces remedial measures on issuers

Notices of compliance are issued by SGX RegCo as an administrative measure where the Exchange forces companies to appoint special auditors, compliance advisors, legal advisors or other professionals. There were nine such notices in 2019, rising to 25 in 2020 and four to date as at mid-February 2021.

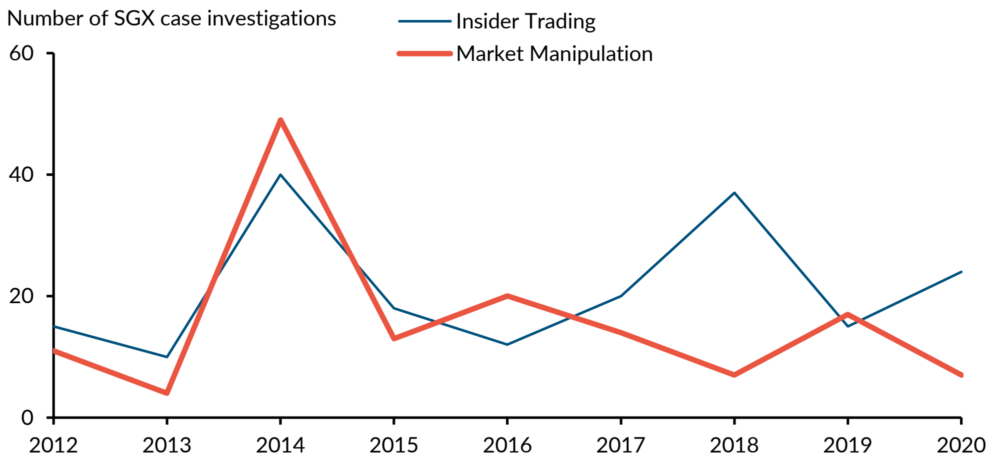
More insider dealing referrals to MAS but less for manipulation

SGX continued to refer cases of a more serious nature to MAS for investigation, including 15 for insider trading in 2019, rising to 24 in 2020, and four as of mid-February 2021. As for market manipulation, it referred 17 in 2019 but just seven in 2020. As the figure below shows, referrals for insider dealing are up (although still lower than the figure in 2018) but market misconduct is down and continued to hover in a narrow range (except for 2014). One of the challenges in interpreting this data, as noted in CG Watch 2018, is that it is not clear from either MAS or SGX disclosure what happens next to these referrals. How many turn into serious investigations and prosecutions?

A mixed bag of MAS referrals

Figure 4

SGX case investigations referred to MAS: What happens next?



Source: SGX website

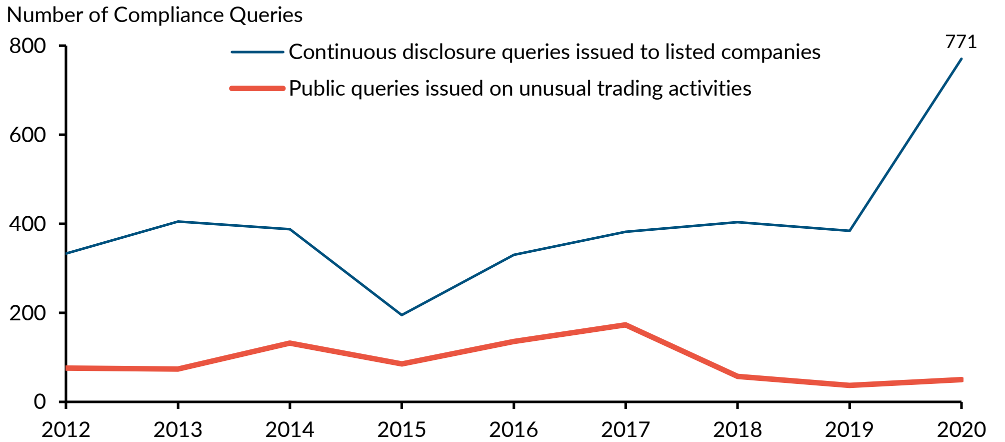
SGX increasingly puts companies on the spot

Companies may not be publicly admonished for their misbehaviour in Singapore but they do receive a dressing down through the backdoor: SGX RegCo's continuous disclosure queries. These more than doubled to 771 in 2020 compared to 384 in 2019, which SGX attributes to additional queries related to Covid-19. Similarly the number of public queries on unusual trading activity rose to 50 in 2020 from 37 the previous year. Some of the questions are refreshingly punchy as listed issuers at times come under detailed and dogged scrutiny. The process puts the public spotlight on questionable corporate behaviour, from sketchy disclosure and murky finances to dicey relationships and cryptic payments. Ultimately the interrogations may lead to nowhere, discipline-wise, but have the effect of a public flogging nevertheless.

SGX demands more answers

Figure 5

SGX compliance queries: The impact of Covid-19



Source: SGX website

Next steps

More detailed analysis of enforcement trends would help

The MAS Enforcement report is a useful document, but rather light on detail and narrative. It could benchmark itself against the more detailed reporting by ASIC in Australia and the SFC in Hong Kong.

SGX's website needs to be more user-friendly

SGX could revamp its website and provide a more user-friendly section called Enforcement, with accompanying narrative around what the numbers mean. HKEX is the benchmark here.

Give SGX RegCo greater powers

The conclusions to the SGX enforcement consultation are eagerly awaited. SGX RegCo needs stronger powers to become a more effective regulator.

SGX on the front foot

Regulators band together over troubled hotel REIT

MAS and SGX joined forces in April 2020 to probe troubled hotel REIT, Eagle Hospitality Trust (EHT), following a US$341m loan default. EHT's manager was obliged by the regulators to get trustee approval before transferring any funds. By October, a number of executives were arrested by the Commercial Affairs Department in relation to suspected disclosure breaches.

SGX puts its foot down after Camsing Healthcare arrest

SGX stepped in at Camsing Healthcare in December 2019 with a Notice of Compliance following the arrest by Shanghai police of its chair, majority shareholder and executive director, Ms Lo Ching, and her subsequent attempt to eject new INEDs via an EGM. The company was required to get SGX approval for director and executive appointments for three years.

Regulator thwarts dubious divestment

SGX stymied an attempt by film and TV company Spackman Entertainment Group in September 2020 to divest its stake in an associate company to a substantial shareholder purportedly as part of a restructuring. Amid concerns that it might prejudice minority investors, given the price on the table was significantly lower than what the company paid for the stake initially, SGX RegCo ordered a "holistic review" of previous acquisitions, including background checks on vendors.

3. CG rules

Singapore ranks 4th with a score of 75%

This category also brought a significant increase in score for Singapore, with its category total rising from 68% in 2018 to 75% in 2020. Its ranking did not change, however, and remains at equal 4th with Hong Kong - which means that other markets also saw large increases in score. Indeed, Malaysia and Thailand both rose by similar percentage amounts as Singapore, scoring slightly higher at 77% and 76%, respectively. Overall, scores in this category increased by an average of five percentage points across the 12 markets covered - a large change only matched by the Investors category, which posted the same average increase in score.

Score benefits from changes to our underlying analysis

One explanation for the broad rise in scores is methodological: our underlying analysis of CG rules was more granular than in previous surveys and we apportioned scores in a more precise way, leading to increases across the board. Indeed, of all the individual market scores across the 24 questions in this section (ie, 12 x 24 = 288 different scores), 91, or 32%, were higher compared to the 50, or 17%, that were lower. Hence, an upward tilt in scores. The only other category with a larger proportion of higher scores was Investors at 37%, with its lower scores also comprising 17%.

Moving forwards: Rule changes

But Singapore also gets credit for rule book changes

Yet methodology is not the whole explanation. There were some genuine improvements in Singapore's rule book as the following analysis shows:

- **Continuous disclosure** requirements were strengthened in areas of "high investor interest", notably related-party transactions, as well as issues relating to significant financial assistance, significant transactions and secondary fund-raising. From February 2020, SGX has the power to deem a person or entity an "interested person" while significant asset disposals will require the appointment of a competent and independent valuer. There is additional disclosure for rights issues, including providing a rationale for an issue when it comes within a year of pervious equity fund-raising; and shareholder approval is required where a company provides significant financial assistance to a third party and it is not in the company's ordinary course of business.

New rules on PSI

- **Price-sensitive information (PSI)**: SGX also introduced new regulations and guidance in February 2020 on PSI, notably how it expects issuers to manage material information particularly where there is a change in a company's near-term earnings prospects or where there are ongoing developments.

Limits on dubious trading

- **Questionable trading**: In November 2019, SGX RegCo announced it would restrict trading accounts deemed to be involved in questionable trading activities and simultaneously issue a "Trade with Caution" alert. It also said it would improve the financial watchlist which alerts investors to financially weak companies.

Tighter audit and valuation oversight

- **Auditor and valuers**: SGX introduced new rules on auditors, valuers and valuation reports in January 2021 with all primary-listed issuers required to appoint an auditor registered with the Accounting and Corporate Regulatory Authority (ACRA) to conduct statutory audits, effectively making them subject to ACRA oversight. This addressed the problem of foreign companies, mainly from China, using audit firms from their own jurisdiction. SGX RegCo may also require issuers to appoint independent professionals and special auditors in exceptional circumstances, for example where it suspects there have been significant misstatements. In addition, property valuers are expected to have at least five years' relevant practical experience.

Fairness boost to voluntary delistings

- **Exit offers**: Changes to the voluntary delisting rules were introduced in July 2019: exit offers must not only be reasonable, but be fair; and the offeror and parties acting in concert with the offeror must abstain from voting on the voluntary delisting resolution. The approval threshold is maintained at 75% of the total shares held by independent shareholders present and voting but the 10% block (a requirement that the resolution must not be voted against more than 10% of the total issued shares) has been removed.

Listing rules upgrade for IPO due diligence

- **IPO due diligence**: In January 2020, SGX RegCo incorporated listings due diligence guidelines issued by the Association of Banks in Singapore (ABS) into the listing rules, along with ABS independence requirements for issue managers.

Moving backwards: Quarterly reporting

Quarterly reporting is limited to high risk companies . . .

Singapore removed quarterly reporting for most issuers in January 2020, a requirement which had been in place since 2003. By scrapping the rule and adopting a "risk-based approach", regulators claimed they would be able to focus on the most troubled firms while cutting compliance costs among others. Only high risk companies have to report their financials on a quarterly basis: those with disclaimed, adverse or qualified audits, companies with going concern issues or where SGX RegCo flags regulatory concerns. As of October 2020, SGX RegCo listed 106 companies required to issue quarterly reports, the vast majority (92) being dogged by audit concerns.

. . . a bad move which makes it a stick not a carrot

While many issuers and investors may cheer the removal of quarterly reporting, we believe this is a mistake and uses this tool as a form of punishment rather than a more positive platform for keeping investors, small as well as large, informed about company performance.

CG advisory committee backs move

SGX claimed the support of its CG Advisory Committee for this move, but while the latter endorsed the move in a statement, it gave no reason for doing so. Instead it only noted areas in the CG code where accountability and reporting to shareholders would be improved, such as the recommendation that companies issue voluntary interim updates and that audit committees strengthen oversight.

Voluntary updates by corporates tend to skim over facts

To date, many of these "voluntary updates" are long on hyperbole and short on facts. Some companies have released financial information but a number of large companies have preferred woolly write-ups of their work during the quarter. For example property giants CapitaLand and City Developments (CDL) issued 1Q updates that waxed lyrical about the impact of Covid-19 on their business in general terms but neglected to include any financial information. CDL has been embroiled in high-profile board resignations amid concerns over its investment in a PRC property firm. Similarly, some of Singapore's biggest REITs, such as Ascendas and Manulife, provided information on their balance sheets but no income statements. Given that the property sector has been hit particularly hard by Covid-19, ongoing details of financial performance are decidedly more pertinent than a long-winded explanation of the risks they face.

Where Singapore lost points

CG reporting disappoints

Apart from quarterly reporting, Singapore lost points on only two other questions in this section of our survey. They are as follows, with the reasons why included:

- **Q3.2: CG reporting**: As noted in our last CG Watch, we were greatly disappointed by SGX's decision to shorten its CG Code during the last revision in 2018 and hive off part of it into a separate and voluntary "Practice Guidance" document. We believe this has weakened the foundation for board governance in Singapore and done little to improve CG reporting.

No safe harbour for collective engagement

- **Q3.24: Collective engagement**: Best practice globally is for the regulator to produce a safe-harbour document for institutional investors that outlines the difference between acceptable and unacceptable collective action by investors. For example, a joint effort of shareholders to encourage a listed company to improve its governance practices or dividend payouts is acceptable, whereas any attempt to control a company through stealth, such as through secret voting agreements, is unacceptable. While this issue is still somewhat academic in Singapore given the paucity of investor activism, for the sake of consistency in scoring we deducted a point because Singapore lacks a safe-harbour guideline. ASIC in Australia offers a good example of such a document. Singapore's Code on Take-overs and Mergers considers concert parties to be anyone who cooperates to buy shares and obtain control of a company, while the Securities and Futures Act provides oversight of takeover regulation. Note the Takeover Code does not have the force of law, but a breach may result in sanctions by the Securities Industry Council (SIC).

Next steps

Keep the quarterly updates coming

While quarterly reporting may no longer be mandatory, we hope that issuers will at least publish quarterly business and operational updates if they choose to stop their full quarterly reports.

SGX's CG code and guidance needs an overhaul

We believe SGX should review the status of its CG Code and Practice Guidance documents. We hold out little hope that this will happen anytime soon, but raise it here because it is something we think is important.

Consider a safe-harbour document on collective engagement

MAS could review the need to publish a safe-harbour document on collective engagement for institutional investors. While such engagement is extremely rare in Singapore, this would be a useful and proactive housekeeping exercise that indicates the regulator is thinking strategically about the relationship between issuers and their shareholders, and Singapore's position in international capital markets. Collective engagement may well become more important quite quickly in Singapore around issues of climate change and other ESG risks.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

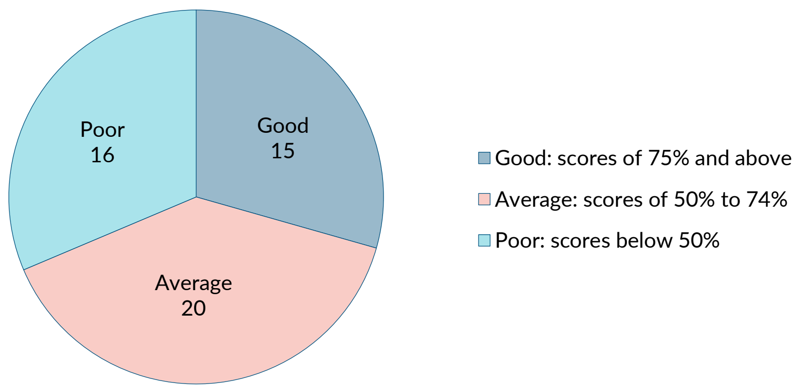
Singapore falls to equal 5th place with a score of 60%

This was the only category in our survey where Singapore lost points, falling from 63% in 2018 to 60% in 2020 and dropping in ranking from equal 2nd to be equal 5th with Thailand. What happened? In technical scoring terms, Singapore earned lower scores in nine of the 20 market-level questions and a higher score in just one. It also suffered from the more focussed list of questions in our latest survey and a tighter scoring evaluation process. Our aggregate results showed that large caps performed well in only 15 of 51 questions, averagely in 20 and poorly in 16. In practical terms, the prevalence of Bermuda-incorporated companies among its private-sector large-caps helped to drag the score down, as did some poor quality reporting from mid-caps.

Large-caps fail to hit the CG mark

Figure 6

Singapore: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Where Singapore does well

Corporates make timely disclosure

In general, companies in Singapore provide investors with comprehensive and quick access to information. Issuers make timely announcements on corporate actions either on their company websites or the website of SGX. Similar to Hong Kong, Singapore issuers publish their AGM agendas and circulars prior to the meeting, and voting results shortly afterwards. However, Singapore scored higher than Hong Kong on this question because most companies also share investor Q&A from their AGM, either in the form of summaries or minutes.

Internal audit structure is sound

Singapore is also one of only two markets where large-caps scored perfectly for the organisational structure of their internal audit departments; the other being Malaysia. Companies should have an internal audit function that reports directly to the audit committee of the board. Singapore's 15 large-caps all met the two criteria, whereas some of the selected large-caps in other markets outsource their internal audit function or it reports to executive directors such as the CFO.

Board governance is disclosed but tends to be basic

In terms of board governance, issuers disclosed detailed attendance statistics, basic training is provided to most directors, and the remuneration of each director was reported by name. Companies disclosed that they provide induction and ongoing training to their directors (executive and non-executive). However, companies at most gave brief statistics on topics or hours. Another positive was that most independent directors are not paid with stock options - Genting and Dairy Farm being the exceptions.

Where Singapore performs averagely

Board evaluations are superficial

We found areas of weakness in board evaluations. The CG Code only has a provision for disclosing how the assessments are conducted, with no discussion of third-party assessors or the sharing of assessment results. Therefore, although most companies mention board assessments in their annual reports, they provided limited details on results, and only one of the 15 large-caps disclosed that it had appointed a third party. As a result, Singapore scored averagely in conducting third-party board assessments, and poorly in disclosing details on board assessments.

Autonomy issues among board and audit committee chairmen

We also found areas of weakness in the independence of chairmen and of audit committee (AC) chairmen. Out of the 15 large-caps, 10 had chairmen whom we consider non-independent due to their relationship with the company, an affiliate company, or the largest shareholder, although eight of the 10 appointed lead independent directors. As for AC chairmen, two of the 15 were related to their auditors (as former partners at the auditing firm), and another two could not be considered independent due to their tenure as directors of their company for more than 12 years.

Limited evidence of whistleblowing policies and codes of conduct

When it comes to policies for mitigating corruption, Singapore scored averagely on the quality of whistleblowing policies, and poorly when it comes to their codes of conduct. Issuers should disclose a public whistleblowing policy, and should have public codes of conduct that extend to suppliers. A majority of the 15 issuers disclosed a whistleblowing policy, but one did not mention the policy at all, while another three only briefly referred to their policy in annual reports or websites. As for codes of conduct, 10 of the 15 did not have a publicly available code but only briefly mentioned its existence within their annual report or websites. Of the five that did publish a code, only three extended it to their suppliers.

ESG materiality falls short

Lastly, while issuers in Singapore address the issue of materiality in ESG or sustainability reports, we noted areas for improvement, including the discussion of the materiality process and the management of material issues. Most of the 15 large-caps provided a summary of material issues in the form of a matrix, table or list; however, there was limited discussion as to how materiality was determined and relevant to the business. As for the management of material issues, with the exception of two Bermuda-incorporated companies which had little discussion on their management of material issues, the others discussed all or most of their respective Sustainability Accounting Standards Board (SASB)-identified issues. In general, issuers in Singapore could improve the quality of this discussion by setting and disclosing quantitative and/or qualitative targets for their performance in addressing material issues.

Where Singapore does poorly

Scant detail on operating expenses

Many issuers in Singapore - 10 out of 15 - scored badly on a question as to whether they provided a detailed breakdown of operating expenses, by function and nature, or conversely have a substantial amount of unexplained "other expenses".

Disclosure on shareholder engagement is lacking

Issuers provided inadequate levels of information on engagement with shareholders. Most disclosed only the types of such engagement. Some disclosed the frequency of engagement, but gave no details on the nature of the discussions.

There is minimal information on the work of board committees

The quality of reporting on board committee activities remains minimal. Many companies at most have a brief overview section on committees in the CG section of annual reports. Although the CG Code has a provision for disclosing committee terms of reference, many companies do not even share this with the public. And more substantively, only five out of 15 discussed activities specific to their audit committee for the year (ie, what the committee did in concrete terms during the year), and only one each did so for their remuneration and nomination committees. In other words, the majority of reporting on board committees was boilerplate.

Issuers are reticent to discuss independent director and senior executives' pay

Despite the principle of "formal and transparent procedure for developing policies on director and executive remuneration" within the CG Code, Singapore issuers generally do not disclose clear policies on how independent director fees are derived. Also lacking is full disclosure of senior executive remuneration, as the CG Code only requires the "top-five key management personnel (who are not directors or the CEO)" to be disclosed in bands. Only three of the 15 large-caps disclosed the top-five's remuneration by name.

Companies only give basic information on director skills

Singapore companies must also improve the quality of their discussion on board composition. Although most companies mentioned the issue of board diversity, only two of the 15 large-caps provided a plan for improvement. Ideally, companies should also provide a "skills matrix" illustrating the broad range of skills that each director brings to the board, with a link to the business and future challenges. However, issuers in Singapore typically disclosed individual director biographies only, with just two of 15 having a skills matrix in their annual reports but with no clear link to their business. This should be an activity that nomination committees perform regularly, hence an easy discussion to include in reports to justify board composition.

The good, the bad and the ugly

Figure 7

Helicopter view: Rating Singapore's CG disclosure and governance, 2020

Good	Average	Poor
❑ Corporate notices and announcements beyond five years ❑ Detailed AGM circulars, voting results and Q&A with shareholders ❑ Internal audit reports to audit committee ❑ Director attendance statistics ❑ Director training given to executive and non-executive directors, including induction and ongoing professional development ❑ Individual director remuneration disclosure	❑ Companies undertake annual board evaluations, but appear not to use third-party assessors ❑ Independence of board chairmen limited, but many companies have lead independent directors ❑ Some audit committee are chaired by non-independent directors ❑ Whistleblowing policies and procedures not available at almost a third of companies ❑ Discussion on the management of material issues and materiality matrix, with limited discussion on the materiality process	❑ Limited details on board assessments or training content ❑ Codes of conduct not available to the public ❑ Insufficient breakdown of operating costs and limited explanation of "other expenses" ❑ Inadequate levels of information on shareholder engagement ❑ Brief committee reports ❑ Limited discussion of policy for INED fees ❑ Top 5 senior manager remuneration: mostly aggregated or not provided ❑ Limited use of board skills matrices and no targets for improving board diversity

Source: ACGA, ARE

Where Singapore could improve

Next steps

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Detailed disclosure of director training by individual
- ❑ Better disclosure on operating costs, with minimal aggregation of "other expenses". If the latter are aggregated, they should be explained
- ❑ Higher quality corporate governance reports, with specific references to activities undertaken by the board nomination and remuneration committees during the year - not just the audit committee
- ❑ Clear disclosure of INED fee policy
- ❑ Disclosure of top-five executive remuneration by individual name
- ❑ Discussion of board diversity and board skill matrices to ensure an appropriate mix of skills relevant to the business

Medium to long-term challenges

- ❑ The use of external third-party consultants for board evaluations
- ❑ Boards to have independent chairman, with no links with the company, affiliates or the largest shareholder
- ❑ Audit committee to be chaired by an independent director with no links to the auditor or the company
- ❑ Better disclosure of policies for mitigating corruption: clear whistleblowing policies and public codes of conduct
- ❑ Improve the quality of ESG/sustainability reports, including the materiality process and the management of material issues
- ❑ Proactive shareholder engagement

Electronic AGMs: Singapore goes virtual

Singapore experiments with electronic annual meetings

Bans on large gatherings and a 10-person limit for meetings came into force on 27 March 2020. SGX at the time was giving 60-day extensions for AGMs and issued an advisory on how small meetings could mitigate the Covid risk, such as segregating attendees and providing video links. But given the constraint on holding large-scale AGMs, Singapore was swift in drafting and enacting a circuit-breaker law which contained a provision on company meetings.

Temporary Covid measures act passed on 7 April 2020

The Covid-19 (Temporary Measures) Act 2020 was passed on 7 April. Under the Act, an Order (retrospective as of 27 March) on alternative arrangements for company meetings allowed for virtual AGMs: minutes would be published on both the SGX and company's website, and matters could be raised through video conferencing, tele-conferencing or live chat. Companies only had to deliver a one-way broadcast on the day of their virtual AGM, which only required two members of the company to be present in-person or virtually to form a quorum.

No live Q&A or voting at the virtual meetings

Shareholders were to appoint the chairperson of the AGM to act as their proxy, and questions had to be submitted in advance, which could be answered latest at the AGM. In other words, live Q&A and voting during the AGM were not envisaged, and voting could be finalised before questions were answered at the AGM AGMs.

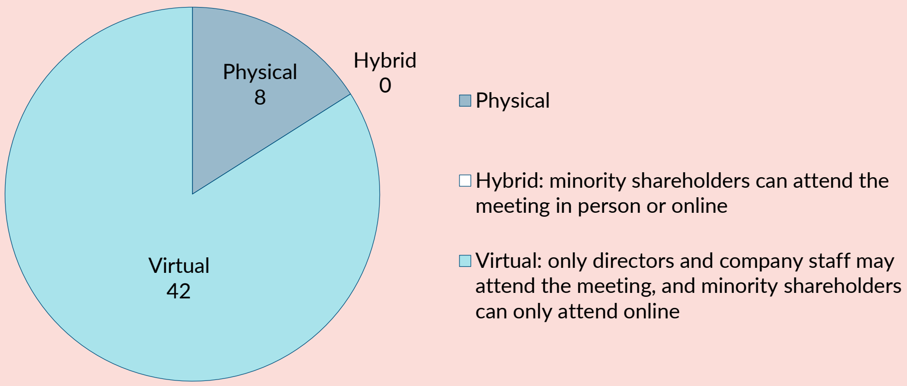
A majority of companies hold electronic AGMs

Out of Singapore's top-50 public companies by market value, most companies held virtual meetings, and eight held in-person meetings, as the figure below, based on ACGA research, shows.

A migration to tech

Figure 8

AGM modes in Singapore: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

Only eight companies hold in-person AGMs

Of the eight physical meetings, three were held in January before Singapore's main Covid-19 wave arrived in April. The other five were Jardine companies: Jardine Matheson, Jardine Strategic, HK Land Holdings, Dairy Farm, and Mandarin Oriental. All their meetings were held in Bermuda within two days in May.

No surge in shareholder engagement at the virtual meetings

Although most Singapore annual meetings were held virtually, there was no surge in shareholder engagement: all 48 companies only allowed questions in advance, while voting by proxy ahead of the AGM left any questions to be addressed after shareholders had cast their vote. The Order was amended in September and issuers were encouraged to adopt real-time communication to allow questions to be raised at AGMs. Prior to the meeting, companies were urged to respond to shareholder queries through the SGX website, or its own site or through a virtual information session. This should be done before the deadline for proxy forms to be submitted. Note this is only guidance and is not binding on companies.

5. Investors

Singapore ranks 6th with a score of 39%

Singapore's score in the Investor category rose from 32% in 2018 to 39% in 2020 and it moved up one rank to 6th. As in the CG Rules section, and like many markets, Singapore benefitted from an overall increase in scores in this category. This was due in part to our adjusted research and scoring methodology, and also to genuine improvements in investor practices.

Retail investors are more active on CG than their institutional peers

In contrast to Hong Kong, Singapore does much better on retail than institutional shareholder involvement in CG. The former sub-category scored 52%, while its larger cousin managed a paltry 34%. Indeed, in ranking terms, Singapore came a clear 2nd in the retail category, whereas it collapsed to 9th for institutional investors. The main culprit for this poor performance was domestic institutional investors.

Domestic investors disclose little

Domestic institutions keep a low CG profile . . .

ACGA surveyed the public disclosure documents of the top asset owners (state pension and investment funds) and asset managers on a range of criteria: CG/ESG policies, voting policies, stewardship reporting, company engagement, voting disclosure, and so on. We found extremely limited information available and attempts to elicit more through direct contact produced only minimal results. This is in sharp contrast to other developed markets such as Australia and Japan, where investor transparency on voting and engagement has become a major issue. Even Hong Kong is moving up this value chain faster than Singapore - albeit remaining well behind the leading markets.

. . . yet big institutional investors sign up for stewardship

At first glance this seems surprising: there were 58 supporters of the Singapore Stewardship Principles (SSP) and 37 PRI signatories in Singapore as of January 2021. The biggest local names on the SSP register are Temasek, UOB Asset Management (and two other UOB vehicles) and Fullerton, a Temasek subsidiary. The list has several smaller local funds, as well as listed firms like CDL. These are all big names.

Large domestic players are not leading the charge

Temasek moreover has long had its “Temasek Charter”, which outlines in high-level terms its approach to governance and portfolio management. It has a strong focus on sustainability and green finance too. However, it tends to talk only in general terms: there is no copy of the Charter or a voting policy on the Temasek website. Meanwhile, UOB AM has no substantive link on its website to CG or ESG content, despite saying that it has been integrating this into its investment process since 2017. The only two points of interest are a “sustainability roundtable webcast” it held in June 2020 and its endorsement of PRI in January 2020. Other large domestic PRI signatories, including Fullerton Fund Management and Lion Global Investments (LGI), formerly OCBC AM, also have little to no CG/ESG information on their websites.

Stewardship principles are only voluntary

One factor for this relative silence is the Singapore Stewardship Principles themselves. In contrast to other markets, which have created action-oriented “stewardship codes” that impose clear obligations on institutional investors, Singapore took a light-touch approach and developed only a short set of voluntary “principles”. No one needs to follow them and even if you do become a “supporter” you do not need to report your progress in implementing them. Moreover, in a uniquely Singapore twist, the concept of stewardship has evolved to focus more on listed company and family business governance than on enhancing the influence of institutional investors.

Singapore lacks a vocal institutional base compared to other markets

It is not suprising, therefore, that domestic investors in Singapore do not act with the verve or enthusiasm of their counterparts in other markets. Sadly, this extends to areas where a stronger investor voice would be useful, namely participation in regulatory consultations. A review of submissions to MAS and SGX consultations over the past two years throws up few examples of domestic investors writing in. For instance, of the 43 named responses to the MAS consultation on the revised CG Code in 2Q18, only one represented domestic institutional investors - and it was the Investment Management Association of Singapore (IMAS).

Key industry body could be more proactive on CG

Could IMAS do more?
One solution could be for IMAS, the local industry trade body, to become more active in representing investors in CG policy discussions and consultations. Although IMAS has played this role to an extent, it does not have a high profile in this area.

Ethics guide falls short on stewardship

Interestingly, the IMAS Code of Ethics encourages investors to have a policy on the CG of investee companies, to "consider the process required to implement this policy", and "wherever possible, maintain a dialogue with companies, vote actively and inform their clients about their policy on voting and other corporate governance matters" (4.2). But this is far from being a stewardship code and does not, for example, include any encouragement to take a more public stance.

A shake-up is called for

What could IMAS do? Here are some ideas:

- ❑ Participate more actively in regulatory consultations and CG/ESG policy discussions.
- ❑ Expand its Code of Ethics into a broader-based and more public stewardship code for investors. Such a code could focus on both the internal governance of investment organisations and their external obligations around engaging with investee companies.
- ❑ Explore the potential to bring domestic and foreign institutional investors together to discuss emerging CG and ESG challenges in Singapore. One immediate topic should be the quality of corporate sustainability reporting.

Temasek could set an example

Could Temasek do more?
As a major national asset owner, Temasek has a high profile and presses a lot of the right buttons at a high level on ESG. It highlights some sustainability case studies on its website for example. While it does not divulge a great deal of information about its activities, as the controlling shareholder of Singapore's major government-linked companies (GLCs) it has a fine line to tread between encouraging better company behaviour and imposing its views. Traditionally, it has operated behind the scenes.

Greater disclosure of its CG initiatives may help

Taking Australia and Korea as examples, here are some actions Temasek could take:

- ❑ Disclose its CG/ESG charter and talk more about the importance of these issues; and
- ❑ Disclose its voting policies and records.

For example, AustralianSuper, an ACGA member, has an ESG page on its website containing ESG/stewardship policies, voting records, and other information such as material issues that it is addressing through its "Active Owner Program".

Domestic players are voting and some engage with companies

Despite having a low profile on corporate governance issues, domestic investors do vote their shares and some of them engage with companies. From their perspective, they no doubt feel that they are doing more than in the past. Yet compared with other markets, a lot less activity is taking place in investor stewardship.

Institutional investors chalk up some wins

Rare sightings
Although rare, there have been a few notable bursts of activism among institutional investors in Singapore during the past two years: Quarz Capital Management and Hong Kong-based Black Crane Capital slugged it out with Sabana REIT over a proposed merger - and won. In December 2020, Sabana shareholders voted against a tie-up with ESR REIT and Sabana, a rare victory for activists. Quarz has since turned its attention to Singapore plastic components maker Sunningdale Tech, which in November 2020 announced a proposed buyout by a private equity firm.

ACGA surveyed its members in Q3 2020 on voting and engagement in Asia-Pacific

The foreign dimension
As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members in Q3 2020 to understand their level of voting and engagement in the 12 Asia-Pacific markets we cover. More than half of ACGA's investor members - 45 out of 92 - responded. At the time of the survey this group managed in aggregate more than US$26 trillion globally. As the responses showed, Singapore is an important investment destination:

- 82% or 37 respondents invest in Singapore - a result slightly below Australia and Thailand at 84%, and slightly higher than Malaysia at 80%.
- Only 23 respondents answered the question on the exact size of portfolios. The average number of Singaporean investee companies held per respondent was 51, with a range from one to 266. The average figure is notably higher than the Philippines, broadly in line with Malaysia, Indonesia and Thailand, and well below the 100 to 130 in most North Asian markets (with the exception of China and Japan that are significantly higher).

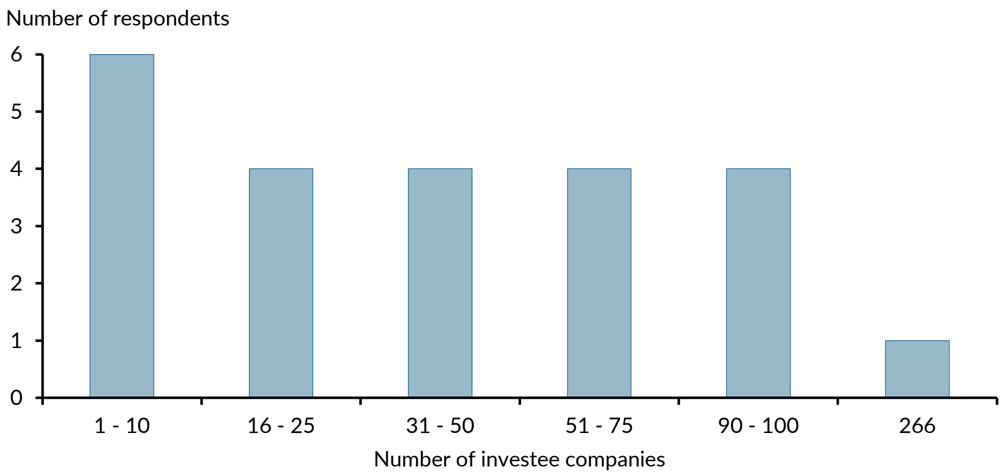
Most respondents invest in 50 or fewer stocks

Another way to show the extent of investment in Thailand is to group portfolios by size. As the following figure shows, while a few ACGA members invest in 90 or more companies each, most have portfolios of less than 50 companies, and a large proportion owns less than 10 stocks.

Size of foreign investor portfolios in Singapore

Figure 9

Foreign investors in Singapore: By size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

Foreign investors are active voters

Although Singapore, like other Southeast Asian markets, is a relatively small market from the perspective of global institutional investors, respondents still take voting seriously in Singapore. They also vote against a reasonable number of management resolutions:

- Most respondents with holdings in Singapore vote in 100% of their investee-company AGMs each year. One votes in 40% of meetings, one in around 30%, and one votes in zero.
- On average, they voted against at least one management resolution in 18 meetings in 2020. The median figure was 12 meetings and the range was zero to 71.
- As a proportion of their holdings, respondents voted against at least one management resolution in an average of 34% of meetings. This places Singapore 7th among the 12 markets we covered. By respondent, however, the proportion ranged from 0% to 87%.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Not a whole lot of engagement going on

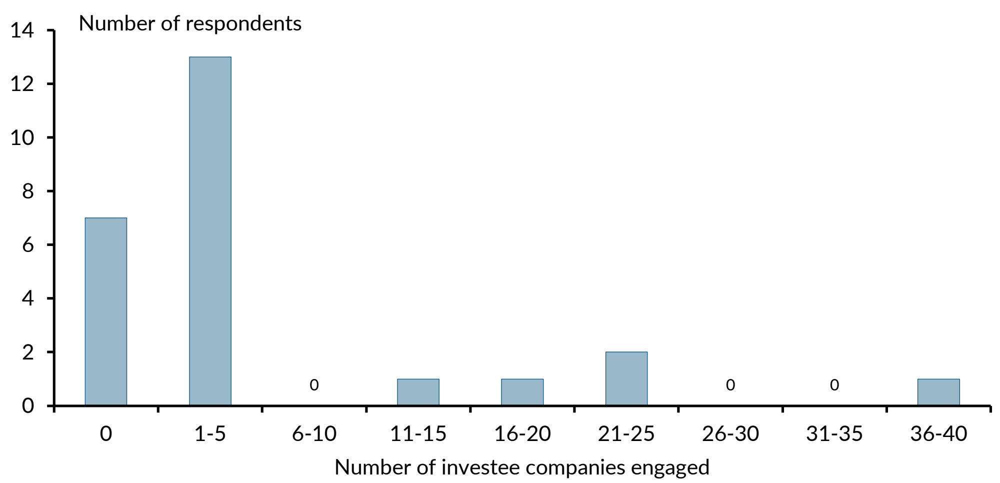
Company engagement

Company engagement on CG and ESG topics is becoming an important part of foreign investor stewardship activities in Singapore and around the world. Of the 37 respondents who indicated they invest in Singapore, 25 answered our question on company engagement. Of these, seven said they undertook no engagement at all over 2019 and 2020. As the following figure shows, while a few respondents engaged with more than 20 companies over the two years, most engaged with five or fewer.

Most investors engage with five firms or fewer

Figure 10

Foreign investor engagement prevalence in Singapore, 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Most respondents engage with 20% or less of their investee companies

In terms of the relative level of engagement in Singapore (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 20% or less, but rises to 33% for one institution and 70% to 75% for another two (including one that owns 55 listed companies).

Foreign investors modify CG policies for Singapore

More encouragingly, 36% of respondents said they adapted their global CG/ESG, voting or stewardship policies to Singapore. (By “adapt” we mean such things as translating or amending your policies to take account of local rules or governance practices.)

Retail shareholders

A local shareholder group is taking on corporate giants

For more than 20 years the Securities Investors Association (Singapore) (SIAS) has led the way in Singapore in its advocacy for the rights of retail shareholders. When China Aviation Oil (CAO) collapsed circa 2004, it met with management. When in 2003 steel producer NatSteel made a special dividend payout conditional on shareholder approval for M&A changes that would allow the company to raise capital via convertible instruments, SIAS launched a campaign against. The board capitulated after 37% of shareholders rejected the resolutions. SIAS also stepped in on behalf of Lehman minibond investors after the Global Financial Crisis of 2007-2008 and in 2016 helped shareholders get a better offer price in the delisting of Tiger Airways.

Its Q&A forum subjects corporates to investor scrutiny

Founded and still headed up by lawyer David Gerald, the association also runs conferences and educational initiatives. Its Q&A on Annual Report programme, where listed companies are quizzed by investors on financial statements, can produce some enlightening results (see box below, “Still monkeying around”). Recent campaigns have included troubled water treatment firm Hyflux: in June 2020 SIAS urged the board to quit amid CG lapses and a criminal investigation. The association also held a dialogue with Singapore Airlines (SIA) when it rankled retail shareholders with a massive rights offering to shore up its balance sheet in response to Covid, and held townhall meetings for investors of oil and gas company KrisEnergy, which was undergoing a restructuring.

Funding will be increasingly met by MAS

One of SIAS’s challenges, however, is funding. Although it has more than 55,000 members, SIAS earns little revenue from them. Instead it relies on income from sponsorship of its Investors’ Choice Awards, seminars, other sponsorship and donations. It recently disclosed that it had secured long-term funding from MAS. It is fair to say, therefore, that its independence from government is limited.

A few mavericks also take on companies over CG

In addition to the company engagement work of SIAS, there are ad hoc campaigns by groups of minority investors who take on individual companies from time to time. For example, the battle against a management buyout at Challenger Technologies that was led by an investor called Pangolin Investment Management, which owned 2.94% of Challenger. And there is Mano Sabnani, former editor of *The Business Times*, who was a one-man pro-CG band for many years until a defamation lawsuit against him by hotel developer Stamford Land in 2018 curtailed his activity. Professor Mak Yuen Teen is another maverick CG advocate, he writes regular opinion pieces for *The Business Times*, and sometimes acts on his own volition as a retail shareholder.

Retail shareholders work alone and don't litigate

What do retail shareholders not do? They do not launch lawsuits, in part because class-action suits are not possible in Singapore and because such actions would be frowned upon for political and cultural reasons. They also do not collaborate with institutional investors. In contrast, the Minority Shareholder Watch Group (MSWG) in Malaysia works actively with domestic institutions and acts as the secretariat for the Institutional Investors Council, which has responsibility for managing the local stewardship code.

Next steps

A stewardship overhaul is needed and Temasek could step up

We recommend that the Singapore Stewardship Principles be revised into a "code" and require a more structured response from domestic institutional investors. This would bring Singapore more into alignment with other developed markets and would help to narrow the gap with Hong Kong, which is considering revising its more detailed code. In this context, Temasek, as the lead local asset owner investing in Singapore-listed companies, could play a stronger leadership role and set a benchmark for improved disclosure by investors on both voting and company engagement.

IMAS could nurture an institutional voice

IMAS could play a greater role as a focal point for institutional investor input into governance and ESG policy development and regulatory submissions. It could take the lead on developing a stewardship code for investors (if the current Principles cannot be amended). It could also bring investors together for practical discussions on how listed companies could improve their sustainability reporting.

Still monkeying around

A Jeff Koons masterpiece was buried in a balance sheet

Punters who invested in SGX-listed property firm MYP discovered a rare gem on the balance sheet under plant and equipment: a S$2.7m Jeff Koons oil painting in the safekeeping of a mystery shareholder. Quizzed by SGX-ST on the reclassification of assets in July 2020, MYP had to admit that "Monkey Train Blue" (2007) did not belong with buildings, cranes and trucks, nor did a further S$3m of artwork it had purchased. Hence, it reclassified the art under "other".

The painting was being kept by the majority shareholder

MYP also had to reveal the identity of the shareholder keeping the painting on trust: majority shareholder, executive chairman and CEO, Jonathan Tahir. The son of Indonesian billionaire Ang Tjoen Ming (aka Tahir), who founded the Mayapada conglomerate, promised to foot the bill for any damage or loss.

Investors were not impressed

Palpably irked investors took the opportunity of a Q&A led by the Securities Investors' Association of Singapore (SIAS) to ask why a loss-making property company that had not paid a dividend since 2015 was buying pictures of a smiling blue monkey. The Q&A initiative has over the years issued more than 1,000 questions to nearly 600 listed companies, focussing on directors' responsibilities, remuneration, board independence, diversity, director training. And now, for the first time, monkeys.

Art as an alternative investment fails to resonate

Not surprisingly, MYP's claim that art was an alternative form of investment failed to resonate with shareholders. Moreover, the paintings represented a mere 0.66% of the group's total assets so could make no material difference to its bottomline. Would the company not do better to reduce debt or pay dividends with the cash? MYP did not waste time dismissing the suggestion, saying the artwork had recently been appraised and had increased S$1.1m in value. When MYP titled its 2020 annual report, "Focusing on New Possibilities", buying art was probably not what shareholders had in mind.

6. Auditors & audit regulators

Singapore ranks 3rd with a score of 81%

Singapore retained 3rd place in this category with a slightly higher score of 81%, compared to 79% in 2018. It now shares this ranking with Hong Kong, which has improved significantly in score and moved up one place following the formation - after a very long wait - of an independent audit regulator in late 2019.

Equal billing with Hong Kong despite gains in key areas

Singapore would have edged ahead of Hong Kong this time were it not for dropped points on two questions: adopting international standards of auditing (Q6.2) and disclosure of audit and non-audit fees (Q6.4). It did, however, earn higher scores on four questions: auditor independence (Q6.3), mid-cap preparedness for the annual audit (Q6.8), disclosure by the audit regulator of its enforcement activity (Q6.12), and whether or not the audit regulator publishes an annual report on its inspection activities, including data on audit industry capacity (Q6.13).

Where scores fell

Scores dropped in two places:

The process for updating auditing standards a drag on overall score

- **Auditing standards**: While Singapore's auditing standards are largely in line with international standards, we raised the bar on this question and awarded full points only if a market's standards are fully converged with International Standards on Auditing and efficiently updated. Singapore lost one point because it generally takes longer to amend auditing and related standards than other leading markets such as Australia and Hong Kong. For example, while Hong Kong moved quickly to complete its review of the new 2018 IESBA Code of Professional Conduct and Ethics, publishing its version in November 2018, Singapore only released an exposure draft in March 2020 and with the new version to take effect from January 2021. Similarly, Singapore took its time to update SSA 250 on "Consideration of Laws and Regulations in an Audit of Financial Statements", a key standard related to the IAASB's stronger guidance in recent years on how auditors should respond when clients appear to have broken the law. Whereas Hong Kong revised this standard in June 2017 and again in September 2019 and July 2020, Singapore only released its new version in June 2020.

Non-audit fees remain an issue

- **Audit and non-audit fees**: While Singapore has a listing rule (1207.6) on the disclosure of audit and non-audit fees, and requires audit committees to confirm they have undertaken a review of all non-audit services provided by the auditors and that they "would not, in the audit committee's opinion, affect the independence of the auditors", there is no specific requirement for commentary on the non-audit fees. Accordingly, information provided by companies is limited. We applied a stricter scoring standard on this question in our 2020 survey and so deducted a point. Again, Singapore still scored a respectable 4/5 for this question.

Where scores increased

Gains in four areas

Scores increased in four places:

Auditor autonomy but weak duty to report fraud

- **Auditor independence**: While auditor independence in Singapore today is not dramatically different from two years ago, this score increased for both methodological and substantive reasons. Our new scoring methodology here started at five points for each market, deducted one point for each item missing, then added back a point for each improvement. Singapore lost points because it has no general whistleblower legislation that can protect auditors, among others, and the requirement for auditors to report fraud is somewhat weak in our view. A point was then added back for the adoption of the new 2018 IESBA Code of Ethics, giving a final score of 4/5 or one point higher than in 2018.

Mid cap audits provide a boost

- **Mid-cap preparedness for audit**: This score increased one point to 4/5 and largely for methodological reasons. The focus of our question was tightened to look only at mid-caps, not "small and medium-sized enterprises" (SMEs) as in the past, and since the mid-cap universe contains some quite large and professionally run companies an uptick in score was warranted.

Enforcement data is reasonably sound

- **Disclosure of enforcement activity**: This score also increased one point to 4/5 and largely for methodological reasons. While the volume and quality of disclosure by Singapore's audit regulator has not changed greatly since 2018, our scoring methodology was somewhat more generous this time: we started at five points and deducted points for items lacking. We accordingly deducted one point for limited disclosure of enforcement activity in the latest annual reports of the Accounting and Corporate Regulatory Authority (ACRA). We could potentially have cut a further point for the obscure placement of audit enforcement information on the ACRA website - you need determination to find it! But that was not part of our assessment question this year.

Credit is given for data on audit industry capacity

- **Annual inspection report/audit industry capacity**: This is one question where the increased score reflected a genuine improvement in objective practice: in addition to ACRA's long-standing Practice Monitoring Programme (PMP) reports published annually, ACRA does now provide statistics on audit industry capacity and updates them every six months. The statistics are based on figures provided to ACRA by CPA firms and are reproduced, but not verified, by the regulator. They appear quite robust, however, and include key metrics for both the Big Four and non-Big Four firms on things like: partner to manager/professional staff ratio; manager to professional staff ratio; years of experience for group engagement partner/EQCR, manager, professional staff; and overall attrition rate. Needless to say, the information is hard to find on the ACRA website! It is buried under the section on audit quality indicators.

Where is the new Act

Still no sanctions for bad accountants

At the risk of repeating a topic raised in the last three CG Watches, one glaring weakness in Singapore's audit regulatory regime is ACRA's limited powers with regard to CPA firms. While it can sanction individual auditors, the Authority has never had the power to discipline firms - unlike most of its counterparts in the region. Indeed, the annual inspections it carries out of CPA firms are done on an "advisory" basis only. Hence, it can cajole or persuade firms to improve their auditing practices - and to be fair has had some success in doing so - but cannot sanction them for auditing irregularities. While Singapore is hardly a hotbed of auditing failures, it seems sensible that ACRA has these powers if and when it needs them.

Disciplinary reform flounders

Here is the history of this issue from our last three CG Watch reports:

- **2014**: "An amendment to the Accountants Act will give ACRA these powers, but the passage of the new legislation, originally expected this year, has been delayed to the last quarter of 2015 or thereabouts."
- **2016**: "As the independent audit regulator, ACRA has been seeking enhanced powers over CPA firms for several years and while in the legislative pipeline, the necessary amendments to the Accountants Act have been further delayed."
- **2018**: "For many years the government has talked about amending the Accountants Act to give ACRA greater powers . . . It is understood, however, that a promised public consultation should take place in early 2019, with a draft Accountants Amendment Bill going to parliament in the second half of that year."

The audit quality scheme makes progress

AQI programme firms up

On a more positive note, ACRA has done solid work in recent years in promoting improved audit quality through its Audit Quality Indicators (AQI) programme, launched in October 2015. The AQIs were designed to help the audit committees of listed companies "better evaluate and select the right auditor". ACRA selected eight indicators or "quality markers that correlate closely with audit quality". They included such things as: the time spent on an audit by senior team members; the number of partners and managers in quality control functions; average training hours; the ratio of staff per partner and manager; years of audit experience, and so on. ACRA has monitored the progress of its AQI programme and consulted regularly with audit firms and audit committees. As a result it has revised and updated the AQI disclosure framework for audit firms a couple of times since 2015, most recently in January 2020. The programme remains voluntary.

Audit industry capacity is mapped out

Figure 11

Audit capacity in Singapore: Audit staff oversight ratios, September 2020

Audit Staff ratio	Big Four	Non-Big Four(in listed segment)
Partners to managers and audit professionals	23.8	16.7
Partners to managers	6.1	3.0
Managers to audit professionals	3.9	5.5

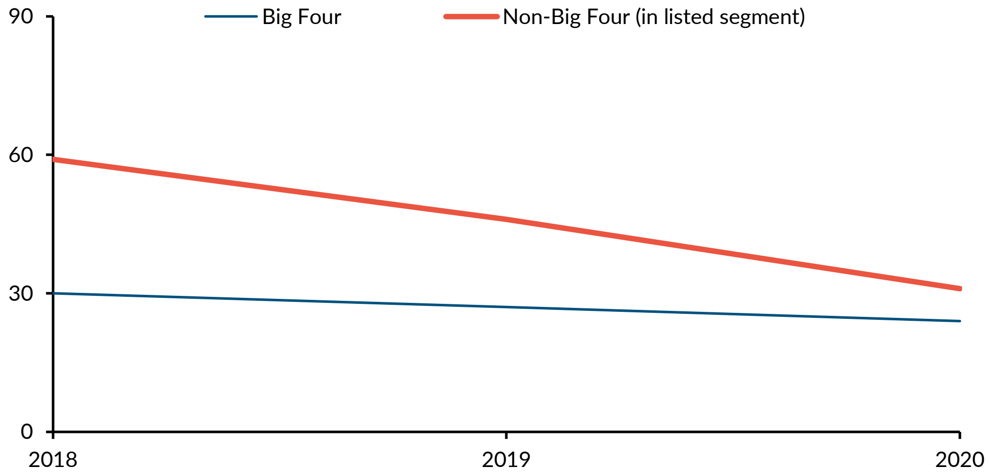
Source: Accounting and Corporate Regulatory Authority, ACGA analysis

Turning to attrition rates, these have declined only slightly at the Big Four firms and stand at 27%. In contrast, the attrition at non-Big Four firms has halved from a high of 59% in 2018 to 31% in 2020.

Attrition rates fall in CPA firms

Figure 12

Attrition rate at audit firms in Singapore, 2018-2020



Source: Accounting and Corporate Regulatory Authority

Next steps

Amend the law to discipline CPA firms

We recommend that the amendment to the Accountants Act be completed so as to give ACRA disciplinary powers over CPA firms.

Standard setters need to keep up with global trends

It would be helpful if audit standard setters in Singapore could explain the reasons for the slower adoption of new standards.

Explain non-audit fees

More explanation from listed companies on non-audit fees would be welcome.

Auditors flag holes in Allied results

Allied Tech's disappearing cash
2019 turned out to be an eventful year at Catalist-listed Allied Technologies Limited (ATL) for all the wrong reasons. The firm's auditors Ernst & Young first spotted discrepancies in ATL's Q1 results, including its purchase of Asia Box Office Group (ABO) from Kenneth Low, a board member at ATL since June 2018, and of Activpass Holdings in July 2018 from apparently independent parties. ATL was transformed from metal stamping to ecommerce ticketing virtually overnight. EY however questioned the valuation reports and poorly documented loan arrangements between the companies and apparent third parties.

Local law firm flounders with Allied cash held in escrow

At the same time it emerged that S$33m of ATL's total S$44m cash balance as at end December 2018 was being held in an escrow account of local law firm, JLC Advisors LLP (JLC). By May 2019, demands for repayment were not being answered and the Law Society took over management of the practice after the disappearance of senior partner, Jeffrey Ong.

SGX RegCo mandates special auditor as police investigate

SGX RegCo stepped in as ATL admitted doubtful recovery of the cash. A special auditor was to be appointed by which time, however, JLC had no knowledge of the escrow monies, nor any record of ATL's communication with Ong. ATL's offices were raided by the Commercial Affairs Department on 29 May. Ong was arrested in Kuala Lumpur the same day and returned to Singapore to face forgery charges.

The money vanishes

PricewaterhouseCoopers was appointed as special auditor in June 2019 and the following month ATL's cash balances were adjusted from S$44m to just S$9m.

7. Civil society & media

Singapore still ranks 3rd with a score of 64%

Singapore's score increased two percentage points to 64% in this category and it remained in 3rd place. While business groups are not particularly active on CG issues, industry bodies provide credible training for directors and company secretaries. There is some good research on CG and ESG from local professional and academic organisations. Within the non-profit space, environmental groups tend to have CG only in their peripheral vision. But there is promising engagement and research coming from WWF Singapore in respect of sustainable banking and the benchmarking of asset managers on ESG issues.

Promoting CG and ESG

Industry groups are big on training and seminars

A number of professional groups set the tone in CG and ESG awareness: the Singapore Institute of Directors (SID) and the Chartered Secretaries Institute of Singapore (CSIS) are both well-run organisations which provide solid training. SID offers a wide range of courses for directors at different stages of their development, from "fundamentals" to "essentials" and then "advanced". It also offers courses for non-profit directors. CSIS does not offer quite the same breadth of training for its members, but has been active in co-organising regional CG-related events such as a webinar on the "Impact of Covid-19 on Annual General Meetings in Asia-Pacific, with specific reference to ASEAN", in which ACGA participated in July 2020.

Other groups are more active on surveys and events

Other associations are active in conducting surveys and providing materials on CG and ESG, such as the Association of Chartered Certified Accountants (ACCA), an international body, and the Institute of Singapore Chartered Accountants (ISCA), though not all the research is original. The CFA Society and the Institute of Internal Auditors Singapore (IIA Singapore) include CG topics in their events. IIA Singapore and the REIT Association of Singapore (REITAS) also hold regular training and events with a CG or ESG flavour.

What are business associations doing?

Business groups tend to take a back seat on CG bar a few initiatives

Business groups are less active than the professionals in promoting CG. The Association of Banks in Singapore indirectly raises awareness through its due diligence guidelines for IPOs, while the Alternative Investment Management Association (AIMA) and the Singapore International Chamber of Commerce (SICC) both held some CG/ESG events over 2019 and 2020.

The greening of governance

Green groups are becoming more CG aware

While there are some environmental NGOs in Singapore, historically there has not been much evidence of them working directly on the governance part of ESG. This is gradually starting to change:

- **WWF Singapore** responded to the CG Code consultation in 2018 and then launched the Asia Sustainable Finance Initiative (ASFI) in January 2019, with the aim to encourage the financial sector to bring ESG factors into their decision-making. As part of ASFI, WWF Singapore has been engaging with banks via its Sustainable Banking Assessment (SUSBA) tool and will be launching its Resilient and Sustainable Portfolios that Protect Nature and Drive Decarbonation (RESPOND) tool in 2021 to further engage with asset managers. Specifically, RESPOND will use a six-pillar framework, one of which is "People", that will look at asset managers' governance and board responsibility to embed sustainability into their investment decision-making.

- The **Singapore Environment Council**, a non-profit established in 1995, is the Singapore member of the Roundtable on Sustainable Palm Oil. It is primarily focussed on eco-awareness and runs conservation training and issues awards. It indirectly works on governance issues through partnerships with companies on sustainability. For example it has worked with HSBC on an eco certification for green loans.

- The **Singapore Green Finance Centre** could be promising. Run by the Imperial College Business School and Singapore Management University with backing from MAS, it launched in October 2020 as Singapore's first institute to focus on green finance research and talent development. Its list of partners include BNP Paribas, Goldman Sachs and UBS. However, it has not updated its website since its launch and gives limited public information. To date, no resources have been shared.

Participation in public consultations

Civil groups are not active on CG consultations

Singapore lost points on this question. Although SGX and MAS have launched quite a few CG-related public consultations since the last CG Watch, there has been limited participation from civil groups, as seen in figure 13. Some groups only participated in major consultations, such as the CG Code review early 2018. The most prolific respondents on other consultations have tended to be banks, law firms, investors, and individual experts.

Poor showing on CG proposals

Figure 13

Response to SGX public consultation papers, 2018-2020

Public Consultations	Year	Selected civil society respondents
Listing Rule changes consequential to Code of CG review	2018	ACCA, CGIO at NUS Business School (CGIO-NUS), IIA Singapore, IMAS, Investor Relations Professionals Association (Singapore), ISCA, Law Society of Singapore, REITAS, SIAS, SICC, SID, WWF Singapore
Proposed Listing Framework for Dual Class Share Structures	2018	CGIO-NUS, CFA Society Singapore, SID
Proposed Amendments to Voluntary Delisting Regime	2018	SIAS
Regulation of Issue Managers	2018	(None)
Review of Tools Used to Deal with Market Manipulation Risk	2019	CFA Society Singapore

Source: SGX, ACGA research

Original research

Academics and professionals impress with their CG research

Singapore scored well here, with local professional groups initiating original research on CG and ESG, while academics are quite prolific in publishing high-quality work. Some key regular reports include:

- The **Singapore Governance and Transparency Index** (SGTI) each year ranks listed companies on CG disclosure and practices, including the timing, accessibility and transparency of their results announcements. The latest scores were released on 4 August 2020. The SGTI is led by the Centre for Governance, Institutions and Organisations (CGIO) at NUS Business School, in collaboration with the SID and CPA Australia, and is supported by The Business Times.
- The **ASEAN Corporate Governance Scorecard**, which also annually assesses the CG performance of publicly listed companies in participating ASEAN member countries. The latest results were shared in December 2020. This is a joint regional initiative of several organisations led by the Asian Development Bank and the ASEAN Capital Markets Forum. The domestic ranking bodies in Singapore are SID and CGIO.
- The **Singapore Directorship Report**, which provides an in-depth analysis of 3,603 directors on the boards of 737 companies, business trusts and REITs listed on the SGX as at 31 December 2017. (While the latest 2018 version is not freely available, the 2016 version is published on the SID website.) It covers a range of topics such as director remuneration, gender diversity, multiple directorships, size of boards by company type and market cap, committee sizes and numerous other data points. It is published by SID and supported by ACRA, SGX and three industry partners: Deloitte, Handshakes and NTU Singapore.

Media

Business journalism is generally improving

Media is limited in terms of its ability to criticise government or Singapore Inc but *The Business Times* gives a fairly complete roundup of local business news and has a good grasp of CG and ESG issues, *The Straits Times* less so. *The Edge Singapore* also does a reasonable job of covering corporate news. Other news outlets tend to show a lack of diversity, although among television stations Channel News Asia is fairly credible. There are several seasoned business journalists in Singapore who know their beats well, can put out credible features and analysis, and financial reporting generally is becoming more detailed.

Next steps

Industry groups should be more proactive on CG

Business associations in Singapore could play a larger role in promoting improved corporate governance. The Association of Banks, for example, could put a greater emphasis on CG in its due diligence guidelines for IPOs. Key areas of pre-IPO governance development include such things as director training, the appointment of independent directors and the creation of audit and other board committees well before listing (ie, at least 6-12 months).

Don't forget governance, green groups

The ongoing focus by environmental groups on green and sustainable finance needs to accord sufficient emphasis on "sustainability governance" (ie, the governance frameworks of listed and unlisted companies most appropriate to manage ESG risks and opportunities).

More input from civil society

A wider participation of civil society groups in regulatory consultations would be welcome.

The media could be bolder

The Singapore press has shown a good working knowledge of CG issues and offers comprehensive business coverage but could be bolder in its critique.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- ❑ A regression in the positive trends in enforcement by MAS and SGX
- ❑ Any further changes to listing rules that undermine CG standards
- ❑ No improvement in corporate reporting around CG or sustainability
- ❑ No improvement in domestic investor policies on CG/ESG and more active engagement in stewardship, including reporting publicly on progress made
- ❑ No discussion of a universal whistleblowing law

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ MAS and SGX to provide more details on regulatory funding and capacity
- ❑ MAS to enhance detail in its new Enforcement Report, while SGX could provide narrative around its enforcement statistics
- ❑ SGX consultations could be lengthened and links provided to submissions
- ❑ Listed companies could write more meaningful and specific board committee reports, focussing on actual activities over the past year
- ❑ Listed companies could enhance the discussion of materiality in their sustainability reports
- ❑ Domestic investors to publish CG/ESG policies and publicly commit to stewardship

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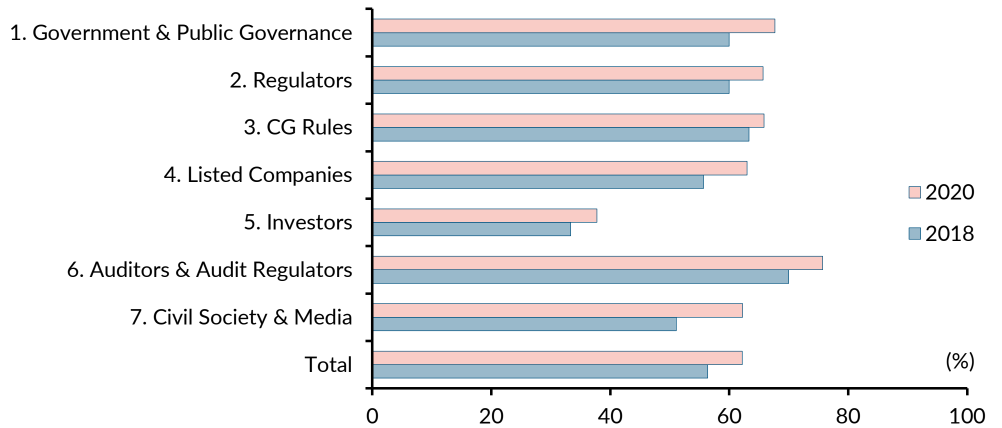
Taiwan – Making it real

- Fragmentation of regulatory regime began to be addressed as CG unit claims ownership of reforms
- Flurry of updated rules, enforcement and audit oversight disclosure
- Discharge of directors is now permitted through civil suits
- Taiwan contained Covid, but missed out on virtual AGMs
- Shareholders are overwhelmingly voting their shares, but detailed disclosure and voting against remain rare
- Related-party transactions (RPTs) and legal-entity directors are still not subject to shareholder approval
- Company disclosure improved, but often limited to ticking boxes
- Journalists are reluctant to tackle tough topics despite media freedom

Taiwan enjoys an increasingly coherent regulatory regime

Figure 1

Taiwan CG macro category scores (%), 2020 vs 2018



Source: ACGA

Introduction

Taiwan advances to 4th on a score of 62%

Taiwan advances one rank to 4th in CG Watch 2020 on a score of 62.2%, behind only top-ranked Australia and joint-second Hong Kong and Singapore. Key factors contributing to the improved performance include consistent support across the political spectrum for a healthy CG ecosystem and an increasingly coherent regulatory regime methodically updating rules and practices. As a result of improvements to disclosure rules, listed companies' score also enjoyed a bump, while increasingly active new civil society groups also contributed. Updates to the Stewardship Code and strong legal remedies exercised by the Securities and Futures Investor Protection Center (SFIPC) also made their mark. Although score rose in the investors section, it was held back by a lack of detailed investor stewardship disclosure, making it difficult to assess performance. There were similar concerns with regulatory disclosures: A new enforcement report filled a gap but lacked detail on criminal cases, while a new-and-improved oversight report offered better but not complete insight into the auditing industry.

A plethora of small changes added up to a big result

The overall story, therefore, for CG reform in Taiwan since late 2018 is not one big noteworthy event. Rather, it is a shift in regulatory mindset resulting in increased alignment across the CG ecosystem and a wave of small changes to rules and increased disclosure.

Taiwan adopted a step-by-step approach to bring basic CG structure to the market

Regulators know that people in Taiwan respond well to clear requirements and checklists, and hence have adopted a step-by-step approach to CG reform that has brought the basic structure of CG to the market. The rules are in place, the board committees have been implemented, the reports have been filed. But the question remains, does it work?

The system looks largely complete, but needs more development to mature

The conclusion of our research is no, not quite yet. While the system looks largely complete on paper, it needs more development to become fully mature. One veteran observer of Taiwan's CG efforts who has served as both a listed company executive and independent director summed it up well. He said the financial regulator had worked hard to promote CG reform and plucked all the low-hanging fruit. The focus now has to be on achieving the 'real substance of corporate governance: how to add value to a company.' While Taiwan's system may 'look like an adult, a young adult', in reality it is 'still a teenager.'

Managing a change in culture is tough

This view was echoed by a veteran auditor, who said the major challenge for Taiwan was managing a change in culture. The most difficult shift is from awareness to buy-in and ultimately to ownership. Awareness of CG among business people is the easy part. Shifting them to higher stages is quite difficult and a long journey.

Regulators are on a cultural journey too

Indeed, regulators have also found the cultural transition a long journey. Only recently has the CG team in the Securities and Futures Bureau (SFB) explicitly shown willingness to take ownership and communicate necessary changes up and down the regulatory hierarchy. Their experience serves as a useful model for the rest of the market in embracing CG culture.

High-quality discussions on CG issues reflects broader embrace of CG culture

The good news is that CG culture is genuinely beginning to take root. This is especially apparent in the high-quality and candid media opinion pieces and discussions within civil society groups such as the Taiwan Corporate Governance Association (TCGA) and the Independent Directors Association Taiwan (TIDA). Strengthening CG culture is also one of the objectives of the government's latest Corporate Governance Roadmap.

Regulators must be ready to stand firm as new CG problems surface

As regulators increasingly walk the talk of good governance, a challenge for them will be to stand firm as the systems they have put in place begin to work. Entrenched problems are bound to bubble to the surface across the CG ecosystem, as a recent spate of bribery cases portends. When they do, regulators will need to steel themselves and allow these issues to come out into the open so they can be addressed. Only by continually demonstrating and modelling their commitment to good governance will they be able to make it real.

Recapping CG Watch 2018

Taiwan made progress on several ACGA recommendations . . .

Among the key recommendations from CG Watch 2018 were suggestions to improve investor stewardship, beef up the annual report on the inspection of auditing firms and keep the chairman of the Financial Supervisory Commission (FSC) in his position for a four-year term. Although none were fully implemented, progress was made on each. There have been updates to the Stewardship Code calling for more detailed reporting on company engagement. The audit inspection report has been significantly expanded. And while the FSC chair has been assigned to another position, he was the second-longest serving person in the role's history.

. . . but not in the composition of the FSC board

We also suggested adding practitioners or other independent elements to the FSC board, but this did not happen. An explicit requirement for voting by poll has been added to the sample template for shareholder meetings, while the trigger for enhanced audit fee disclosure was reduced, as we had hoped, from 15% to 10%.

Other developments since 2018 include:

Progress in many areas, but still some weaknesses

Figure 2

Taiwan's CG recap of 2018

	Recommendations	Outcomes
1.	Produce more coherent regulatory enforcement reports	New enforcement reports issued, but narrative and comprehensive perspective are still limited
2.	Develop a systemic approach to reform	Regulatory CG unit takes ownership of CG reform, but do they have the power and resources they need?
3.	Make online legislation easier to scan	New legislative database launched; still cannot compare old and new text of laws
4.	Boost ESG reporting on materiality and risk	Requirements enhanced and extended, filling in gaps in GRI[1] Core standards. Next step: Targets
5.	Set substantial ownership threshold at 5%	No change, still 10%

[1] Global Reporting Initiative. Source: ACGA

1. Government & public governance

Taiwan scores 68% and ranks equal 1st with Australia

Taiwan comes in equal 1st with Australia in this category rising eight percentage points to 68% in 2020, a little ahead of Hong Kong at 65% and some way in front of Japan, South Korea and Singapore, all on 60%. Factors contributing to the strong showing were clearer regulatory disclosure, improved bank governance and enhanced disclosure from majority state-owned enterprises. The biggest boost in Taiwan's score on an individual question related to improved disclosure of FSC funding, 93.5% of which comes from a market levy, enhancing the independence of the institution.

Strong public governance was evident in Taiwan's response to Covid

The most important contributing factor in this section was the generally high level of coherence and effectiveness across the public governance landscape. While there are problems, institutions are solidly in place and serving their intended functions. Perhaps there is no clearer example of the quality of public governance in Taiwan than its success in containing the coronavirus pandemic. Building on its experience following the SARS epidemic in 2003, Taiwan established a comprehensive system to handle future outbreaks and activated it quickly to contain and prevent the spread of Covid. The approach worked: As of the end of 2020, there were only seven coronavirus deaths in Taiwan and only one confirmed locally-transmitted infection since 12 April 2020, with a total of around 800 cases, most of them imported.

Government support for CG reform has been fairly consistent since 2013

In terms of corporate governance, there has been consistent political support for reform regardless of which political party has been in power. This has continued unabated since 2013, when the first CG Roadmap was unveiled, and marks Taiwan out as quite different to most Asian markets in our survey.

Taiwan's CG Roadmaps indicated reforms are in the pipeline and their timeframe

Now into their third edition since 2013, Taiwan's CG Roadmaps have acted as a useful guide and messaging tool for regulators. They have provided a clear indication of what reforms are in the pipeline and over what timeframe. However, with Taiwan entering the next stage of reform, beyond the low-hanging CG fruit, it is worth asking whether the latest Roadmap has what it takes to lead the way.

Awareness has shifted to environmental, social and governance (ESG) factors in addition to CG

So many maps, but can directors drive?

The first thing to note is that awareness has shifted to the importance of environmental, social and governance (ESG) factors in addition to CG, and thus there are now three relevant plans which take a broader perspective. In August and September 2020, the FSC unveiled the latest CG Roadmap, the Green Finance Action Plan 2.0, which was updated from 2017, and an outline of its Capital Market Roadmap. Although the CG Roadmap has been somewhat misleadingly renamed Corporate Governance 3.0–Sustainable Development Roadmap, implying a higher-level focus, the plan that offers the best bird's-eye view is the revised Green Finance Action Plan. The three plans overlap, but do not indicate how they are intended to align. Nor do they relate clearly to other government goals, in particular Sustainable Development Goals or the nationally determined contribution (NDC) to the Paris climate agreement that Taiwan might adopt. We understand that the NDC will be updated in 2021.

The Green Finance Plan lacks a clear climate change target and does not mention Taiwan's water scarcity

Although the plans offer an unusually clear window into the FSC's strategy for a more sustainable economy, there are other shortcomings: The Green Finance Action Plan lacks a clear climate change target and does not explicitly mention Taiwan's water scarcity. And there is one glaring omission: None of the plans say exactly what responsibility companies (or boards) have in this endeavour, nor exactly how they will be guided to meet those responsibilities. Instead, they rely a great deal on market forces and hope. Two quotes from the Green Finance Action Plan serve to illustrate:

> 'The majority of domestic companies and investors still underestimate the impact of ESG factors on investment allocations and asset values, and fail to include ESG considerations in business decision-making and risk management. In an effort to enhance the international competitiveness and visibility of domestic businesses, the FSC plans to use the financial markets to ensure that businesses and investors properly appreciate the importance of ESG, and to hopefully (emphasis added) bring about a healthy cycle of investment and economic development.'

And:

> 'Climate governance and ESG encompass a wide range of issues and produce varying impact on different sectors so that it is difficult for regulators to stipulate specific requirements. It is best to use the market mechanism, and leverage the power of shareholder activism and the business activities of financial intermediaries such as lending, investment or products, to call the attention of businesses to climate change and ESG issues. It is hoped (emphasis added) that businesses ultimately become aware of the importance of managing ESG risks and opportunities for their sustainable operations.'

Corporates need a transition from awareness of CG and ESG challenges to actual buy-in and ownership

There is much to applaud in these passages: The forthright assessment of the current situation and its challenges; the realisation and articulation that this is not, and cannot be, all the regulator's responsibility; the ecosystem view and approach; and the explicit intention to invite shareholder activism. However, as emphasised in the introduction to this chapter, what is really needed is a transition from awareness of CG and ESG challenges to actual buy-in and ownership among the corporate sector. These must be achieved quickly to avert imminent damage from climate change. Merely hoping that business will become aware of the importance of managing ESG risks and opportunities sets the bar well below what will be needed for substantial change to occur.

Yet guidance for directors is limited

Indeed, the plans seem to assume that business leaders will never have to make a difficult choice between making a profit and doing what is environmentally or socially sound, and that hewing to their fiduciary duty will be enough to guide them. The plans appear to take the view that with enough information and badgering from investors, business leaders will find their way. But even if boards and management have the motivation to improve and are able to access all the latest data, will they know what to do with it? More guidance and training will be necessary.

The good news: SASB and TCFD are on the way

A significant improvement, however, is that the plans call for reporting aligned with the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-related Financial Disclosures (TCFD) as well as more assurance of ESG reports - all welcome developments. Another positive is that the government wants to establish ESG data integration platforms and databases so that businesses can easily use data from the Environmental Protection Administration to assess risks and analyse scenarios.

Taiwan's approach in fighting Covid could help it tackle climate change

All in all, the plans are a solid start to addressing sustainability challenges. We encourage Taiwan to refer to the suggestions in the opening thematic chapter to this report and to replicate the approach that brought success in tackling the coronavirus pandemic, namely early, aggressive and comprehensive action, and apply it to climate change.

Expanding CG thinking

The new CG Roadmap lacks the creativity of the Green Finance Action Plan

Beyond the sustainability angle, more traditional CG topics can be found in the CG Roadmap and to some extent the Capital Market Roadmap. The latter discusses enhanced investor protection efforts in relation to civil cases, more English accessibility and enhanced functionality of disclosure websites. The CG Roadmap focusses on tried and true topics: Board duties, functions, diversity and evaluation; information transparency; the timing of AGMs; stakeholder communication; promoting international norms and stewardship; and deepening CG culture. While these topics are important, the CG Roadmap lacks the clear communication, creativity and comprehensive systemic thinking apparent in the Green Finance Action Plan.

Taiwan needs a more fundamental transformation in governance thinking

Our view is that the time has come for the CG Roadmap to be much more ambitious. While it is important to provide companies with detailed guidance on achieving sound governance systems, the danger is that most translate this into yet more box-ticking disclosure without any deeper CG understanding. What the CG Roadmap should seek to engender in coming years is more meaningful disclosure and a fundamental transformation in the way corporate boards in Taiwan think about governance and sustainability, in particular how these two major challenges intersect, and then extending this to change company culture.

Taiwan's devotion to standardisation produces only incremental results

The days when rote, standardised answers were enough are gone. This out-dated approach is embedded in the education system and an economy designed to reward OEM manufacturers who are good at reducing costs. While there is still some value to be had from this, such incremental changes will not produce the answers that Taiwan needs for today's most pressing challenges. Instead, the regulatory approach must shift to challenging companies to differentiate themselves and communicate their individual CG situations clearly and honestly, instead of churn out reams of nearly identical reports. The Roadmap as it stands does not inspire confidence that it can bring about such a result.

Banking regulators beefed up rules on beneficiary disclosure and proxies

Bank governance: Plugging holes

Beyond the CG Roadmap and Green Finance Plan, banking regulators have been active in updating governance rules, most notably requiring a greater proportion of financial institution directors to be natural persons and calling for whistle-blower systems. The FSC, which is also the banking regulator, has done the following:

- Updated the Instructions for Reporting Voting Shares in Accordance with Paragraph 2, Article 25 of Banking Act in December 2019 to enhance disclosure of ultimate beneficial owners.
- In addition to overt enforcement efforts - including NT$300m (US$10.7m) in fines for 2020 - the regulator also holds regular coffee meetings with all heads of local financial institutions as a form of soft pre-emptive enforcement.
- Toughened requirements by amending Article 6 of the Regulations Governing the Use of Proxies for Attendance at Shareholder Meetings of Public Companies. The new rules, effective July 2019, require those soliciting unlimited proxies for financial institutions to hold at least 10% of the total outstanding shares of the firm for at least one year, a threshold which triggers an FSC fit-and-proper review. This closed a loophole that in 2018 allowed the notorious case of a shareholder with only 4% of shares, which required no disclosure at all, to solicit proxies to amass a 17%-share voting block and seize five of 15 board seats in a bank.

Numerous embezzlement cases indicate gaps in bank governance regulations

However, gaps in bank governance remain as indicated by the seemingly endless embezzlement cases involving wealth-management specialists. To address these problems, the regulator has sought to strengthen internal controls at banks and encourage consolidation, which would minimise the number of banks and enhance their ability to manage risks. Despite one possible nibble at a merger, none have been completed. As a financial industry expert said to ACGA, in the era of e-finance there is little appetite for existing banks to acquire brick-and-mortar assets from other players.

Reform is kept out of the legislature as much as possible

Getting around the legislature

Taiwan's score in this section was damaged by a bribery scandal involving several legislators from across the political spectrum (see box below). The case allegedly involved a businessman paying legislators to amend the Company Act so he could control a local department store. The Legislative Yuan also has a reputation for being slow, unpredictable and somewhat difficult to work with as politicians juggle the demands of a diverse electorate. In response, regulators devise their own workarounds in rules and regulations as much as possible rather than seek amendments to legislation. Examples include adding corporate governance officer requirements to the CG best practice code after legislators abruptly eliminated them from proposed Company Act amendments in 2018. The Banking Bureau, meanwhile, added whistle-blower requirements to internal control measures because the legislature has been dragging its feet on passing comprehensive whistle-blower protection legislation despite years of talks. This has even prompted the Agency Against Corruption (AAC) to issue a statement on 15 January 2021 to promote passing such legislation and to point out that it must cover both public and private sectors, a stance with which ACGA agrees. Interviewees told us such legislation is expected and will be a real game changer.

Legislator sleaze

Four legislators were indicted in 2020 for taking bribes

On 21 September 2020, prosecutors in Taipei indicted four legislators and one former legislator on charges of violating the Anti-Corruption Act for allegedly accepting bribes from local businesspeople. Four were allegedly paid to help a businessman retain control of a lucrative department store chain, while one was alleged to have received payments from two funeral service companies to arrange rezoning land in a national park for a cemetery. Also indicted were the businessman himself, four legislative aides, one former legislative aide and one other person.

The accused came from across party lines

The accused came from across party lines. An independent legislator was indicted in the cemetery case. In the other, two politicians from the Chinese Nationalist Party (KMT), one from the ruling Democratic Progressive Party (DPP) and one from the New Power Party were accused of receiving bribes from Lee Heng-lung, chairman of Pacific Distribution Investment, to help him regain ownership of the Pacific SOGO Department Store from the Far Eastern Group. One of the legislators, Su Chen-ching of the DPP, has been portrayed as the aggressive ringleader and his involvement in the case reportedly accounts for half of the 100-page indictment.

The legislators tried to amend the Company Act to benefit a local businessman

Lee's quest to maintain control of Pacific SOGO dates back to 2002, when Far Eastern began capital injections into Pacific SOGO that continued until 2008 and totalled NT$4 billion (US$137.5m). These injections made Far Eastern the largest shareholder. While Lee fought the legality of this in court, citing improper registration procedures, a final court decision in 2012 left Far Eastern still in control. Prosecutors alleged that Lee then launched a campaign to entice legislators to pressure the Ministry of Economic Affairs (MOEA) to amend the Company Act, particularly Article 9, and make the changes retroactive, so that he could keep control of the department store.

Officials spoke out about the abuse they received from the legislators

Prosecutors alleged that Su Chen-ching took more than NT$25.8m (US$921,000) in bribes, while the two KMT legislators - Sufin Siluko and Chen Chao-ming - were accused of accepting NT$7.9m and NT$1m, respectively. The case is highly unusual in that former and current officials from the MOEA spoke plainly in the indictment and to the media about the pressure and sometimes outright abuse they received. One said that Su Chen-ching would shout at MOEA staff in public and bombard them with meetings on the company law amendments, three per month for three months.

Too many anti-corruption bodies?

Evidence of public corruption arose, but who will address this going forward?

Coincidentally, when the news broke about bribery in the Legislative Yuan there was banter about eliminating the Control Yuan, which is a unique arm of the government equal in stature to the legislative, judicial and executive branches. It serves as an ombudsman holding the powers of audit, censure and impeachment of government officials and politicians. Among the reasons opponents mooted for eliminating the Control Yuan was a concern about the arm being used for political persecution, particularly after Chen Chu, a stalwart of the ruling party, took the helm in 2020. Ironically, she supports eliminating the body.

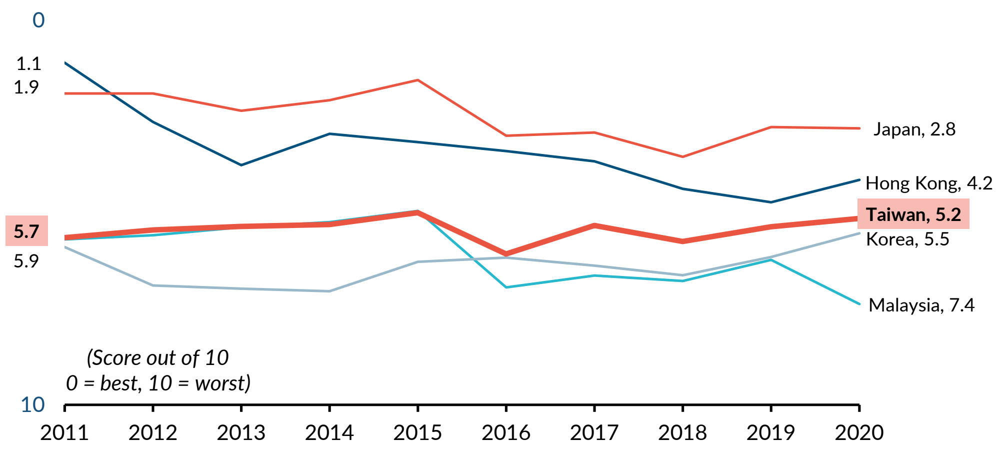
Taiwan has yet to create a fully coordinated or independent set of anti-corruption agencies

At any rate, this implies that Taiwan has still not resolved the concerns raised in CG Watch 2018 about its willingness to maintain institutions outside of direct government control and with independent administrators. While it is true measures to ensure independence and impartiality of the Control Yuan could be implemented, or other government units such as the Ministry of Justice Investigation Bureau or Agency Against Corruption (AAC) could take over some of the Control Yuan's work, it is not clear how this would be handled nor whether those units have the necessary powers to do the work effectively. Taiwan's meandering and middle-of-the-road score in the annual Political & Economic Risk Consultancy (PERC) survey of corruption perceptions in Asia underlines its fragmented approach to fighting corruption (see Figure 3).

Taiwan's corruption perception scores have fluctuated within a middle range

Figure 3

Perception regarding corruption: Taiwan has been stable over time, 2011-2020



Source: Political & Economic Risk Consultancy

The number of citizens caught for corruption rose since 2017

AAC figures on its anti-corruption work shows that the number of cases, individuals involved - including civil servants, elected representatives and citizens - and value of monetary fines have either held broadly steady or trended downwards between 2015 and 2019. Interestingly, while the number of senior civil servants being prosecuted has remained near or more than 40 during most of those five years, the number of associate and junior civil servants involved has been declining. Citizens on the other hand are being prosecuted in larger numbers since 2017 - a trend also seen in Hong Kong and Singapore.

Number of corruption cases has held steady since 2015

Figure 4

Taiwan: Prosecutions for corruption and malfeasance, 2015-2019

Year	Total cases	Number of individuals prosecuted						Monetary value (NT$m)
		Total	Senior public servants	Associate-level public servants	Junior public servants	Elected represent-atives	Citizens	
2015	368	1,082	54	204	228	35	561	431
2016	301	997	41	239	268	7	442	246
2017	287	703	27	152	145	43	336	533
2018	271	750	38	147	183	21	361	170
2019	279	805	40	127	158	23	457	176

Note: Corruption and malfeasance cases prosecuted by District Prosecutors Offices. Elected representatives includes members of the Legislative Yuan, county and city councillors and township representatives. Since July 2000, District Prosecutors Offices have investigated and prosecuted 25,210 individuals for corruption and malfeasance offences, with a conviction rate of 64.1%. Source: Agency Against Corruption 2019 Annual Report; reformatted by ACGA. NT$1m = US$35,700

Internal policy changes should speed up judicial rulings

Judiciary

While the judiciary in Taiwan is generally considered clean and independent, news of another bribery scandal involving a judge did figure into our scoring, which was initially previewed in our CG Watch 2020 mini report released in November 2020. Since then, the scale of the scandal has mushroomed raising serious concerns (see box below). Beyond this worrying case is the continued slow rate at which financial court cases are resolved, a topic we cover in the Regulators section. A person familiar with the judiciary said that an internal policy had been partly to blame for this lag, but it had recently been changed. Under the old policy, there was no penalty for putting off complicated and difficult financial cases. Under the new policy, judges cannot be promoted or otherwise change their positions until their roster of cases is cleared, which should result in faster verdicts. One can only hope that this addresses the problem without creating an equal-but-opposite incentive toward sloppy rulings.

More than 200 officials and judges were snared in massive bribery scandal

The biggest corruption scandal

In a case that only fully came to light in September 2020, more than 200 judicial and government officials, including two former defence ministers, a former Supreme Court judge and a member of the Control Yuan, were all implicated in allegations of taking bribes, abusing authority, conflicts of interest and other illicit behaviour in what legal experts and the media have described as the biggest corruption scandal in the history of Taiwan's judiciary. At the centre of the case stood Weng Mao-chung, president of Chia Her Industrial, and Shih Mu-chin, who is both a former Supreme Court judge and former secretary-general of the Commission on the Disciplinary Sanctions of Functionaries, ie, the disciplinary committee for civil servants.

Weng wove an intricate web of favours and influence with Shih's help

In a relationship spanning more than 25 years, Weng is alleged to have woven an intricate web of favours and influence with the help of Shih. The Control Yuan said in a report on 9 September 2020 that the case dated back to 1995 when Weng sought to curry favour with Shih and various judicial and government officials by treating them to expensive meals. At the time Weng was involved in litigation with Barclays Bank over a cheque for US$10m and the report alleged he sought to buy influence so that judges would find in his favour.

Weng's tactics included wining and dining and offering shirts made by his textile company

From then on, Weng has allegedly embarked on a charm offensive to gather a network of sympathetic officials. His tactics included wining and dining, and offering shirts made by his textile company which were monogrammed with the name of the recipients. He also allegedly offered insider trading tips on the companies he controlled as an indirect bribe. No doubt to his regret and those he paid, the time and place of every transaction was meticulously recorded in at least 27 notebooks citing the names of recipients, the gift and who profited from insider trading. These notebooks have since been dubbed the "Notebooks of Death" for the named officials.

A senior judge, three former generals and two former ministers of defence were arrested

Shih was impeached on 14 August 2020 for not recusing himself in cases involving Weng and also providing him legal advice. It is also alleged that he made NT$54m (US$1.83m) via insider trades involving Weng's LandMark Optoelectronics and RF-Link System, later renamed AVY Precision Technology. Among the 200 implicated are three former generals and two former ministers of defence who allegedly paved the way for Weng to obtain 28 military procurement contracts worth NT$240m (US$8.5m).

The Control Yuan said prosecutors had not been fully cooperative

There is also evidence of a lack of cooperation with the Control Yuan's efforts. In its September 2020 report, the agency complained that prosecutors had more than 130 files related to the case but it had been given access to only about a dozen. As for the "Notebooks of Death", only references to judges were given to the Control Yuan; no references to prosecutors were made available. The Control Yuan demanded a further review, forcing the Judicial Yuan and the Ministry of Justice to announce the results of their own investigation on 18 January 2021. That review found Weng had improper contact with 20 judges, 11 prosecutors and nine Investigation Bureau officials. However, the Control Yuan said it still found omissions and inconsistencies in the latest report and it has asked that all the relevant files be declassified.

While this case is still developing, one thing is clear: Without the Control Yuan, this case would not have seen the light of day. Even with the Control Yuan, it almost didn't.

Next steps

Taiwan may fall behind other Asia markets which have learned how to run fair electronic AGMs

Taiwan should study the mechanics of hybrid and virtual AGMs. While virtual AGMs were not necessary in 2020, Taiwan risks falling behind other Asia Pacific markets that are fast learning how to use new technology to run fair and efficient electronic meetings.

Boards should become climate-ready

The government should clarify that listed company boards have a responsibility to develop sustainability plans and become climate-ready. Produce guidance and arrange training on how to balance multiple objectives and publish informative reports. We also suggest making explicit the board's responsibility for the accuracy and quality of all sustainability disclosures.

CG reform needs to transform business culture

The CG Roadmap could be more creative and put more emphasis on individual company governance culture and transformation, instead of just offering checklists. Government should also provide regular status reports on the Roadmap, with point-by-point updates.

Track bribery cases involving politicians and judges

The administration should track and disclose bribery cases involving legislators and judiciary officials, as well as give status updates of major cases. It should also plan and execute any changes to anti-corruption units carefully to avoid diminishing their powers to deal with public corruption.

Whistle-blower law needed

The government should also pass a comprehensive whistle-blower law that protects both public and private sectors.

2. Regulators

Taiwan ranks 2nd with a score of 66%

Taiwan scored 66% in the Regulators category in 2020, up from 60% in 2018, coming in 2nd to Hong Kong at 69% and ahead of Australia at 65%, Singapore (63%) and Japan (62%). The main factor for Taiwan's higher score was a substantial improvement in the Enforcement sub-category (see section 2.2 below).

Apart from regulating the financial markets, the FSC also sets a target for the number of companies it hopes to see listed

Taiwan's financial market and regulatory regime is unusual in certain respects, having developed in partial isolation over past decades. Like many other markets, it has an integrated financial regulator, the Financial Supervisory Commission (FSC), which regulates the securities market as well as banking and insurance. Established in 2004, it is the competent authority for the Securities and Exchange Act and related regulations. Its missions are to develop, supervise, regulate and examine Taiwan's financial markets and financial service enterprises. A way in which the FSC is different, however, is that it has been known to announce annual targets for the number of companies it hopes to see listed - behaviour one normally equates with stock exchanges (see box below: The FSC's many missions).

The Taiwan Stock Exchange functions more like a public-interest entity

The Taiwan Stock Exchange (TWSE) is also somewhat different from its counterparts in other markets. Its functions are less like a profit-oriented commercial venture and more like a public-interest body. It is a private, unlisted company whose founding principles are to enable easier fundraising for enterprises and ensure safer investments for the public. It oversees listing rules, the Corporate Governance Best Practice Principles, the Corporate Social Responsibility Best Practice Principles and the Stewardship Code. The TWSE is the main board, while the Taipei Exchange (TPEx) or Emerging Board lists smaller firms.

The SFIPC is devoted to investor protection and can launch class-action suits

The agency that is unique, at least in regional terms, is the Securities and Futures Investor Protection Center (SFIPC), a quasi-governmental organisation founded in 2003 and singly devoted to investor protection. This entity, which has no exact counterpart in the region, undertakes consultation, mediation and civil litigation involving securities and futures trading. It owns shares in every listed company and once it obtains permission from 20 fellow shareholders, has the right to launch class-action suits. It has become the de facto civil regulator, launching 12 suits in 2019 alone, representing 2,700 investors with claims of NT$1.7 billion (US$61m). Shortly after the SFIPC was set up, there was talk of China following suit. That did not happen - at least not until 2014 when the China Securities Investor Services Center was established in Shanghai. It also has powers to own shares in companies and go to court on behalf of retail shareholders.

2.1 Funding, capacity building, regulatory reform

Taiwan ranks joint 1st for capacity building and regulatory reform

Taiwan's score in this sub-category rose slightly from 60% in 2018 to 62% in 2020, making it equal 1st with Australia and Hong Kong, and leading Japan and Singapore at 58% and 56%, respectively. Among the factors contributing to Taiwan's strong performance is sustained effort in modernising CG rules and codes, as well as sorting out e-voting arrangements with intermediaries to handle peculiarities such as cumulative voting. One area where it falters is the usefulness of the regulatory website for issuer disclosures.

The FSC has a sizable budget and staff

In 2020 the FSC had a budget of NT$26.3 billion (US$938m) with 1,058 staff across all the bureaux under its sprawling remit. One such bureau is the Securities and Futures Bureau (SFB), which is responsible for the supervision and regulation of public companies, securities and auditing. It issues administrative sanctions for breaches of securities regulations, but criminal cases are handed over to the Ministry of Justice Investigation Bureau (MJIB), which handles Taiwan's security as well as criminal investigations. The MJIB's Economic Crimes Unit investigates financial crimes and sends cases for prosecution.

The former FSC chair Wellington Koo brought stability to the regulator

Staff move up the food chain

As we noted in CG Watch 2018, the FSC has historically been plagued by a revolving leadership. Back then, the regulator was headed by Wellington Koo, who was appointed in 2017 and already its fourth chair in the time since President Tsai Ing-wen took office in May 2016. A politician with a background in human rights law, Koo was seen as a proactive reformer and won plaudits from most people we interviewed for this report for the quality of his leadership, including those from the financial sector. Key strengths cited were his independence from industry, strong will and principles-based approach, which are unusual characteristics for a political appointee.

Finally, a non-politician takes charge of the FSC

We expressed the hope in 2018 that Koo would continue as FSC chair for some time. Indeed, he lasted until 2020 and provided much-needed stability to the regulator. Then, in her second term commencing in May 2020, President Tsai reassigned Koo to a security role and she filled the FSC position with the appointment of Thomas Huang, a career civil servant who has diligently worked his way up the regulatory ranks, serving in bureaux related to insurance, banking and monetary affairs, as well as heading the SFB for a period. Huang brings more inside perspective to the chairmanship and his appointment serves as motivation for those within the system. At last the regulator can be trusted to run itself without politicians. The two vice-chairs are no longer politicians either, with one coming from the Banking Bureau and the other is a career prosecutor, who should be able to enhance coordination with the MJIB in its handling of economic crimes. The remaining four commissioners are all leaders from the ministries of finance, economic affairs, justice and national development.

Stock exchange president is now a career employee too

Over at the TWSE, similar moves are afoot, with the president's position now finally held by a career employee of the Exchange rather than a politician - another positive sign. The board features a mix of banks, securities firms, industry and government representatives. However, they are almost all legal-entity representatives instead of natural persons. Also, there is limited information available about the individuals holding these roles - even the chair. A detailed annual report with narrative information about a board filled by natural persons would serve as a welcome CG model for the market.

The FSC's missions include financial market development and supervision

The FSC's many missions

In most of the markets we cover, it is the stock exchanges who are chomping at the bit to boost the number of listings and their profits, while securities commissions grapple to rein them in and remind them of their regulatory obligations. Taiwan, while neither exactly backward nor superior, is somewhat different. The Financial Supervisory Commission's (FSC) many missions include developing Taiwan's financial markets while its subordinate Securities and Futures Bureau (SFB) supervises and regulates public companies, securities and auditing. Meanwhile, the frontline TWSE seeks to ensure safer investments, maintaining a more public-interest stance.

And it sometimes sets annual targets for listings

As part of its market development role, the FSC has been known to announce annual targets for the number of companies it hopes to see listed - behaviour one would usually expect from a stock exchange. It has also loosened rules, such as profitability requirements for certain kinds of new listings to help young companies find funding, while at the same time maintaining guardrails to limit volatility, such as only allowing stock prices to fluctuate by 10% each day, as well as strengthening CG regulations. Overall, the FSC seems to balance its contradictory objectives quite well - as Taiwan's equal first place in this sub-category would imply. Its score of 62%, however, shows that there is still much room for improvement.

Legal system challenges

Taiwan's dream of being an international financial hub is held back by language and its legal regime

The Taiwan legal system is based largely on European Civil Law, which tends to be more prescriptive and less adaptive than the English common law system found in Singapore and Hong Kong. The former chair of the FSC, Wellington Koo, once expressed the view that alongside the limited English ability of Taiwan's labour force, which is the subject of yet another government improvement plan, it was this Civil Law system that posed one of the biggest challenges to Taiwan becoming a major international financial centre.

Rule of law is a mantra that regulators sometimes hide behind

One thing that made Koo unusual and effective was his willingness to take a firm and visible line against innovations in the bending of rules by entrenched local interests, particularly powerful financial families. Under normal circumstances when faced with those twisting the rules, regulators would typically say 'Taiwan follows the rule of law', then leave it to the system to deal with wrongdoers. The enforcement process could take years if the courts got involved or legislative changes occurred (see the Tatung case in the Listed Companies section). In other words, the rule of law mantra served as something of a shield for regulators to hide behind to avoid difficult decisions and assuming personal responsibility.

Regulators need to enforce the spirit as well as the letter of the law

By taking an outspoken and more principles-based approach, the former FSC chair provided quick and unequivocal feedback to the market about what would be tolerated and what would not, thus borrowing a strength of the common law system and ultimately reducing uncertainty in the financial landscape. A few market-observer interviewees we spoke to speculated that Koo was moved to another position because he stepped on too many powerful toes, while others felt he was genuinely needed for the security role. Whatever the truth, we hope that the FSC will continue to have the independence to be proactive in promoting the spirit as well as the letter of the law.

The enforcement centre of gravity is shifting to the SFIPC

Another effort to speed up response time is coming via the SFIPC. Unlike the full to-do list of the FSC, the SFIPC's only mission is investor protection, which it exercises via mediation and class-action lawsuits. With its single focus, long-serving staff and experienced leadership - its chair has been in the position since 2009 - the centre of gravity for substantial enforcement effort is slowly migrating to its sphere. For example, the Capital Market Roadmap, mentioned earlier in the Government & Public Governance section, expressly calls for enhanced functions at the SFIPC to exert external control of listed companies. Furthermore, amendments to the Securities Investor and Futures Trader Protection Act in June 2020 (covered in more detail in the Enforcement section) further strengthen its hand. Indeed, this Act is beginning to supersede the criminal code as the primary means of discharging and disqualifying directors. (See Figure 5 and 6 below for an overview of the SFIPC's work.)

A new Commercial Court aims to streamline civil cases

One reason this has been necessary is the slow rate at which criminal cases are resolved via the courts. To address this, Taiwan promulgated legislation in January 2020 to set up a new Commercial Court, expected to begin operations in July 2021. This court will be devoted to civil, instead of criminal, actions and non-litigation matters concerning commerce, both of which are directly the responsibility of the SFIPC and bypass the MJIB. The aim is for faster court verdicts by offering appeals only to the Supreme Court. Under a new Commercial Court Adjudication Act, the court will hear cases involving claims of NT$100m (US$3.6m) or more and it will cover cases such as those related to securities fraud, false financial documents, missing or false prospectuses, illegal public acquisitions, market manipulation, short-term trading, insider trading, irregular business transactions and illegal loans.

SFIPC launched 257 class actions in 2003-2019

Figure 5

Taiwan SFIPC actions at a glance: Litigation activities, cumulative 2003-2019

Class Action Cases	Number of cases	Amount at stake (US$m)	Investors represented
Total	257	1,937	170,000
In court or enforcement	121	1,679	145,000
Closed	136		
Total and partial victories	89	1,263	121,000
Final verdict	56	797	82,000
Payments collected for investors	152	197	120,000

Note 1: Twelve cases were filed in 2019 alone, with US$54m at stake, representing 2,700 investors
Note 2: US dollar figures were calculated using an average conversion for 2003-2019 of NT$31.5 to US$1
Source: SFIPC 2019 Annual Report

SFIPC has also taken on cases regarding short-swing disgorgement, derivative and discharge

Aside from the class-action cases above, the SFIPC has taken on a number of other kinds of cases, including: short-swing disgorgement cases (8,210 cases from 2003 to 2019, with 220 such cases in 2019); derivative suits (56 cases since 2003 and two in 2019); and discharge suits (58 since 2003 and five in 2019). Of the 58 discharge suits, the SFIPC won 19 and in 24 cases the subject was otherwise removed. It also undertakes a range of non-litigation activities, including tracking developments in areas where CG irregularities might occur and issuing formal letters requesting rectification when concerns arise and taking the issues up at AGMs, as outlined in Figure 6.

SFIPC undertakes a range of non-litigation activities

Figure 6

Taiwan SFIPC actions at a glance: Non-litigation activities, 2019

Activity	Reviews	Letters	Replied & rectified	Raised at AGM
Private placement	175	150	150	4
Director/supervisor remuneration	29	10	10	6
Capital decrease	64	41	40	
Dividend distribution		1	1	
Large-sum endorsement/excessive lending	271	39	39	
Cases under follow-up & monitoring: 34				

Note: The SFIPC conducts regular reviews (Reviews) of the activities of its investee companies in the categories above (Activity). When they find cause for concern, they first issue a formal letter to the company (Letter) requesting an explanation or rectification. Issues are either resolved following the review and letter (Replied & rectified) or otherwise they are raised at the AGM. Source: SFIPC 2019 Annual Report

Cross-departmental coordination poses challenges

"Kua bu men de wenti": The cross-departmental problem

Regulatory integration and departmental cooperation can be as much a challenge in Taiwan as anywhere else. If something needs to be changed within one unit or regulatory arm - a rule, a website, a process - the change can be almost immediate; in some cases within 24 hours. But as soon as any other unit is added to the mix, the wait can be indefinite. This problem is so frequent and onerous that it has its own name - "*kua bu men de wenti*" - which means "the cross-departmental problem".

User experience on the TWSE website needs improving

One place where this has reared its ugly head is the Market Observation Post System (MOPS), an issuer announcement website administered by the TWSE but including information from different agencies. The MOPS website in English is, simply put, painful to use. It is non-intuitive and little attention is paid to the user experience. The TWSE is aware of the problem and the new CG Roadmap promises solutions. We live in hope.

Websites to check laws are numerous, but vary in comprehensiveness

"*Kua bu men*" is also apparent in the staggering array of websites available to check laws and regulations: MJIB, FSC, SFB and the TWSE. There is no indication as to which of these sites is intended to be the complete repository of official information. One might think that the higher the entity, the more complete the information. But one would be mistaken. The TWSE site has the most information, including relevant templates, codes, rules, regulations and laws. It is also the only site to offer a clear notice in English when a specific regulation has been changed and the user is viewing an outdated version.

Taiwan's sound handling of the pandemic meant that it needs few restrictions

Taiwan's response to Covid-19: Efficient

With only a few hundred cases of COVID-19 and a small number of deaths for a population of nearly 24m, Taiwan weathered the early phases of the coronavirus storm better than most places. This allowed it to impose fewer societal restrictions and meant that listed companies could largely complete their filings and schedule AGMs as per the normal deadlines: Audited accounts within three months of the financial year-end on 31 December and a generous six months for AGMs.

Companies could apply for reporting extensions, but few needed them

Financial reporting extensions

Nevertheless, the SFB first issued guidance on 28 January 2020, urging companies that might have difficulty completing audit work because of the virus outbreak in China to apply for an extension to the normal 90-day period for disclosing their audited annual financials. On 25 February, the SFB repeated that suggestion, adding that applications for extensions must be approved by the board of directors and submitted to the regulator by 27 March. The regulator affirmed these instructions on 23 March. By 1 April 2020, six firms were granted permission to postpone their submissions until the end of April, while applications from two firms were rejected.

Companies were reminded to hold AGMs by the end of June

AGMs: Hybrid, not virtual, permitted

On 4 March 2020, the FSC reminded firms to hold their annual meetings by the end of June, though penalties for not doing so might be adjusted depending on the situation at that time. In the end, sanctions were not necessary.

Fully virtual meetings not permitted in Taiwan

Listed companies are not permitted to hold fully virtual AGMs under Article 172-2 of the Company Act, but recording of meetings and live streaming is allowed. Taiwan also has a well-established electronic voting system, which accepts votes up to two days before an AGM and facilitates remote participation. Indeed, the FSC encouraged shareholders to use e-voting to exercise their rights. On 13 March, after consulting with local securities issuer associations, the Taiwan Depository & Clearing Corporation issued guidelines stating that shareholders should first seek to utilise e-voting in the 2020 voting season. Those attending meetings in person would be required to wear a mask, have their temperature taken and sit at least one metre apart. Updated guidance on 20 April stated that those who did not wear a mask or had a fever would not be allowed to enter the venue.

All companies surveyed by ACGA held physical meetings

Interestingly, the FSC said in a 9 April 2020 press release that between 2017 and 2019, statistics show that 95% of companies holding AGMS attracted less than 100 attendees. As of early April 2020, 12 companies had already held their shareholder meetings and most of them recorded 20 to 30 shareholders in attendance. Although hybrid meetings are permitted in Taiwan, ACGA research found that none of the top 50 listed firms by market cap organised an electronic option (see box in the Listed Companies section).

The common law has something to offer Taiwan

Next steps

We suggest Taiwan could adopt the strengths of the common law system to buttress the weaknesses of the existing Civil Law framework. Namely, the more principles-based approach with a focus on market participants following the spirit as well as the letter of the law.

FSC leadership needs stability

The government should ensure stability in the FSC leadership and independence from interference from political or other interests, while safeguarding the same for the supervisory and enforcement arms.

Strengthen SFIPC

It is important to continue to strengthen the SFIPC and its work with the new commercial court. But the standing of the SFB or the handling of criminal cases should not be diminished.

A single website needed for all financial and CG/ESG rules

Taiwan may create a complete rules and regulations website. Highlight in English and Chinese exactly where a rule has changed between one version and the next, perhaps starting with the most recent revisions. Hong Kong does this particularly well, with changes highlighted in red.

Departmental cooperation

It may also emphasise developing skills in cross-departmental coordination.

2.2 Enforcement

Taiwan's score leaps 10 points to 70% and ranks 2nd

Taiwan leapt a full 10 percentage points in this sub-category from 60% in 2018 to 70% in 2020, ranking joint 2nd with Singapore and behind Hong Kong at 76%. The key contributor to this jump in performance was greatly improved disclosure of enforcement action by the government in the form of a new Law Enforcement Report that brought together hitherto fragmented information sources. The TWSE also received an uptick for the quality of its own enforcement disclosure. Taiwan's score benefitted from our more refined scoring methodology that gave greater credit to the FSC, SFB and TWSE for their range of supervisory and enforcement powers, for their willingness to better communicate internal processes to ACGA and for Chinese-language data. The effective work undertaken by the SFIPC further contributed to the increased score, as did some new powers it acquired to take action against misbehaving directors.

The score rose due to improved disclosure, survey changes, and better communication with ACGA

Overall, scores on four out of 10 questions in this sub-category improved. They stayed the same on five questions and declined on only one: A question regarding whether actual enforcement efforts had improved or evolved. We decided to cut a point because the narrative in the Enforcement Report, although more detailed and coherent, offered little insight into the government's enforcement philosophy.

The way things were

Enforcement data has been scattered and not always easy to digest

Although regulators in Taiwan have a broad range of enforcement powers and apply them regularly, ACGA has long noted how difficult it is to assess effectiveness because no coherent picture existed of inputs or outcomes. The irony is that there is a lot of data available, but it is scattered across a number of websites and comes in varying forms:

- The TWSE offers at least five different places to check for enforcement information;
- The Exchange's Market Observation Post System organises violations, mystifyingly, not by stock code but only by year;
- The SFB website is, refreshingly, easy to navigate with useful information readily searchable and available;

- The MJIB consolidates information only in its annual reports; and
- The SFIPC provides the most comprehensive and well-organised source of enforcement data, but only for its own civil cases.

Tracking enforcement against one firm over time and by different agencies is still an onerous task

The data certainly shows that regulators have been active, yet there has been no way to quickly and easily find out what action has been taken against a firm over time, although the SFB website comes close. Second, there was no simple way to track enforcement against one firm across the different enforcement agencies. Third, with the exception of the SFIPC civil cases, there was no statement - either a final conclusion or the current status of a case - from regulators on what happened in well-known cases.

Disclosure on MJIB cases is lacking, suggesting weak coordination

This final point is particularly important: Once criminal investigations are transferred by the FSC to the MJIB and cases go on to prosecutors and end up in the courts, they seem to evaporate into the ether, never to be heard about again, at least in the official regulatory record. This creates the impression that there is no follow through from the FSC and no one is providing market oversight in terms of economic crimes. Cooperation from prosecutors and the judiciary is needed to produce follow-up information and updates on the status of these cases. The gap here speaks to another cross-departmental coordination problem that can only be resolved with attention from a high level. However, this should not be difficult to achieve given the fact that the Minister of Justice sits on the FSC's board of commissioners.

New Enforcement Report

In response to feedback in CG Watch 2018 on these issues and the difficulty of finding comprehensive enforcement information, regulators now prepare an annual enforcement report compiling statistics from across the regulatory landscape. The report effectively consolidates information from the TWSE, SFB and SFIPC in one place and provides statistics on the actions taken by each of these entities. The numerous case studies are also quite illuminating, although the fact they are anonymised robs the reader of the chance to link these stories to other information they may have.

The new Enforcement Report collates data from different agencies

Figure 7

Taiwan enforcement action at a glance for 2019

Type of Violation	Number of Violations	Number of Suspects	Amount at Stake (NT$m)
Criminal Violations			
Counterfeit documents	9	64	4,497
Stock price manipulation (abnormal trade)	14	40	3,256
Insider trading	12	40	85
Unconventional transactions	9	47	1,997
Special breach of trust and embezzlement	12	72	4,960
Fraudulent financial statements	3	20	1,146
Stock price manipulation (unreliable information)	1	1	0
Administrative Sanctions by the SFB			
Appointment of independent directors, procedures for board meetings	7		
Registration of insiders' equity	149		
Acquisition of large shareholding	5		
Share repurchase	16		
Proxy for attendance of shareholders' meeting	1		
Financial reports	32		
Accounting officers	6		
Certified public accountants	15		

Note: The above table does not include all administrative sanctions by the SFB, only a selection
Source: SFB, 2019 Law Enforcement Report on Securities and Futures Market. NT$1m = US$35,700

Report lacks information on overarching enforcement philosophy

Despite the big improvement in disclosure, the fragmentation apparent across the many regulatory websites carries over to the report. There is still no evidence of an overarching enforcement philosophy or approach, nor a coherent treatment of particular topics such as insider trading or market manipulation that shows trends and whether current enforcement efforts are having the desired impact. There is also no way to tell if the system is working or delivering consistent outcomes, particularly because of the lack of detail on criminal cases.

Depth of analysis and insight are missing from the report

The key issue here is narrative. While most of the numbers are there, there is not enough narrative to ferret out what the statistics mean. This suggests that the report is prepared by people who either do not have the time to generate explanations or lack the power to do so. When asked, regulators have been forthcoming about providing additional data and explanation, particularly about insider trading, so it is not the case that they do not know what is happening or are unwilling to share. It seems more that it has never occurred to them that an outside observer might care what they are doing and why. Or perhaps they want to maintain a cloak of strategic ambiguity. Whatever the case, we encourage regulators to devote significantly more resources and at a higher level in the hierarchy to preparing this report.

New act makes it easier for SFIPC to petition to dismiss misbehaving directors and supervisors

Misbehaving directors watch out!

While the new Enforcement Report is a major step forward, perhaps the most exciting regulatory development in Taiwan over the past two years has been the amendments to the Securities Investor and Futures Trader Protection Act of August 2020. It is this law that significantly strengthens the de facto civil regulator, the SFIPC. The most important amendments make it easier for the SFIPC to petition to discharge misbehaving directors and supervisors, and to file derivative suits. These suits are now possible in cases of fraud, insider trading and price manipulation because the new rules specify it is not necessary for infractions to have occurred 'in the course of performing one's duty'; they are allowed for cases when conduct affects orderly trading. Among other provisions:

- Expands scope to include companies on the Emerging Board;
- Retroactive so it applies to the SFIPC's existing slate of cases;
- Retroactive so it also applies to past directors and supervisors (closing the loophole highlighted in CG Watch 2018 in the case of Mega Financial Holding Company's former chair McKinney Tsai, who evaded some legal action by resigning before a suit could be filed);
- Applies to foreign firms listed on the Taiwan exchanges; and
- Derivative suits may also be filed against managers.

Disqualifications only last for three years

But there is one disappointment in the new law: Directors and supervisors discharged under the act are disqualified from holding board positions for only three years.

Next steps

Create a website collating all enforcement actions

The authority could create a website landing page where one can quickly and easily find a complete picture of enforcement actions involving firms and individuals across the regulatory regime. It would be ideal if such a portal were also in English.

Provide updates on investigations, court cases

We suggest regulatory bodies to provide updates and conclusions on economic criminal investigations and court cases on their websites.

Enrich announcements

It will be helpful if more detail on TWSE enforcement announcements are made available.

Revamp and expand the new Enforcement Report

We suggest the authority to revamp and expand the Enforcement Report, and consider organising it not by regulatory arm, but by theme, eg, insider trading or breach of fiduciary duty or fraudulent disclosure. The report should explain the current status, trends and enforcement approach and include not only statistics and at least five years of data, but also narrative detail to explain what the statistics mean. The production of the report should involve those at a high level of the hierarchy with the knowledge and authority to explain trends and policies. The report should also differentiate between major and minor cases, and include the latest updates on major cases, including criminal court cases. It should either not anonymise the cases or explain why it is necessary to do so. It should include basic statistics about pre-enforcement activity such as coffee meetings. It may also discuss enforcement challenges and provide information on how whistle-blowers can help. The production team could refer to the Agency Against Corruption annual report, especially to the appendix, for ideas.

3. CG rules

Taiwan ranks 7th with a score of 66%

Taiwan ranked 7th in this category on a score of 66%, up slightly from 63% in 2018, but trailing well behind Australia in first (82%), Malaysia in second (78%), Thailand in third (76%), Hong Kong and Singapore in joint fourth (75%), and India in sixth (69%). CG Rules is one of the weaker areas of performance for Taiwan, where long-standing issues related to substantial ownership disclosure, legal-entity directors, and related-party transactions (RPTs) remain unresolved, and weak requirements for narrative disclosure across the board nibbled away at scores.

Clinging to anomalous rules

Substantial shareholding disclosure rules are set at 10% and not easy to change

This market still has two rules that are unusual. The first is that Taiwan sets the threshold for disclosure of substantial shareholding at 10% when the international norm is 5%, an issue we have raised for years. In response, regulators have updated rules to require this 5% disclosure in quarterly financial reports, but understand the market needs it much faster. Part of the difficulty in changing the threshold for disclosure is that it requires legislative approval, always a time-consuming process. Secondly, and posing the greater challenge, existing rules link the definition of substantial shareholders to the definition of insiders, which triggers a host of other regulations, including Taiwan's strict pre-disclosure of share transfers. This unique requirement states that directors and major shareholders can only sell their shares three days after disclosing to the market that they intend to do so. Regulatory monitoring and enforcement of this rule are strict.

Regulators are trying to find a solution without creating undue headaches

The challenge regulators have is how to de-link the two definitions in the law so that the market receives timely information of potential moves to seize corporate control without sending signals that could be misinterpreted by the market or creating reporting headaches for institutional investors, including foreign institutional investors, who may move in and out of holding positions of around 5% with no intention of seeking control and who do not want to wait three days to sell their shares. Regulators have collected information on how other markets have managed this problem, including via exemptions and waivers, and are in the process of crafting a solution to send for legislative approval.

Taiwan also allows legal-entity directors, where companies not individuals hold the board seat

The second rule that is out of sync with regional and international norms is the issue of legal entity directors, where seats on boards are held by an organisation instead of a natural person. In these situations, which are extremely common, the organisation appoints a natural person to fill the director position and can change this person at will with no vote from other shareholders. There has been modest movement on this - amendments to banking rules that took effect in July 2019 increased the required proportion of natural-person directors for financial institutions, but still made exemptions for financial institutions wholly owned by the government or a single entity. Several people familiar with the government's position, including lawyers and reporters, said this rule was unlikely to change any time soon because it was convenient, particularly for state-owned enterprises. However, just because it is convenient does not make it a sound CG practice. Such directorships should be eliminated entirely or, at the very least, replacements should be put to a shareholder vote. We see no reason why this cannot be done since Taiwan has one of the best e-voting systems in the region.

Making changes from within

All TWSE and TPEx firms undergo CG evaluations

Beyond the rulebook, one approach used in Taiwan that has been effective is the Corporate Governance Evaluation system, first implemented in 2014 and evolving out of earlier evaluation frameworks. Under this programme, all companies listed on the TWSE and TPEx are evaluated and ranked, and the results are publicised, leaving those that score well to earn bragging rights and those that score badly to reflect on the error of their ways.

The evaluation system harnesses Taiwanese culture to produce changes

The evaluation system is in line with Taiwan's largely non-confrontational culture. As one former executive and current independent director told us, in the past business leaders might object to new CG regulations, complaining that such requirements were merely 'importing the latest fashions from the USA'. Once the evaluations got going, however, they started to worry about losing face if they scored badly and became motivated to make changes from within. In this way, regulators have found a clever way to use Taiwanese culture to serve as the mechanism by which business leaders come to want to embrace sound CG practices without resorting to the brute force of regulation. The interviewee especially applauded regulators for sticking to their guns in maintaining the system despite complaints from businesspeople who did not want their poor performance publicised.

New rules often begin life as CG evaluation indicators

The evaluation system is under the control of the stock exchange and regulators, and thus can be changed and updated without entailing cross-departmental coordination problems or requiring legislative approval. Because of this, it has often become the first port of call for new rules before they move into the official regulatory system of codes, laws and regulations, serving as another adaptation to the Civil Law system. This "go slow, be patient" approach gives the market time to get used to new ideas when they are completely voluntary and reduces trigger points for vociferous outcry. The greatest drawback is it can be quite slow in producing substantive change, but it has been effective enough to be replicated to enhance investor stewardship disclosure.

Disclosure rules often do not produce meaningful disclosure

Narrative versus template box-ticking
As noted in the opening of this chapter, reforms have brought a basic CG structure to the market, but full development and a firmly embedded CG culture are still elusive. One way to evaluate whether a company has truly embraced sound corporate governance is its degree of transparency and the effort it puts into helping outsiders understand its inner workings, and this comes through in the quality of the narrative in disclosures. It is important to note that by narrative we do not mean more words! Indeed, more information can often obfuscate a reader. Instead, we are looking for meaningful descriptions and explanations of governance practices. Ironically enough, regulators may be the victims of their own success here because as they have laboured to implement CG requirements, many companies have been able to coast by and just fill out templates and tick boxes instead of doing the deeper work required to produce excellent communication. There are a few places in the rules where this pops up:

- CG Reports and CG Code compliance statements: Disclosure frequently consists of little more than a tick indicating compliance, with no discussion of how something was achieved. Perhaps the authority should reword requirements to comply and explain and show.
- Stewardship Code compliance statements: Disclosures are often a mere copy and paste of the code itself.
- Quarterly reports: Explanatory notes are required, but only to IAS 34 Interim Reporting standard. There is often no deeper management discussion and analysis.
- Annual reports: Disclosures often make reference to macro developments, but offer few specifics on how an industry or a company is adjusting to them.

Taiwan's CSR Code functions like a CG code for ESG issues

ESG reporting extended
ESG reporting is handled under two systems in Taiwan and regulators have made several updates to both since 2018 to close loopholes. The first is the Corporate Social Responsibility Best Practice Principles, which functions like a comply-or-explain CG code for ESG matters. It now calls on all listed firms to track water, waste and energy usage as well as greenhouse gas emissions, and to assess and manage material ESG risks. This links with the Stewardship Code, which instructs investor signatories to understand and engage in the ESG risks of investee companies.

GRI reporting is required for 213 of the 944 firms listed on the TWSE

More stringent reporting requirements are found in the Rules Governing the Preparation and Filing of Corporate Social Responsibility Reports. Under current regulations, listed companies with share capital, which is defined as the number of issued shares multiplied by par value, of more than NT$5 billion (US$178m), as well as those in the food, chemical, finance and insurance, and food and beverage industries must file an annual corporate social responsibility report following the Global Reporting Initiative's GRI Core option. This requirement covers 213 of the TWSE's 944 listed companies and 80% of Taiwan's market cap; though it is important to remember that TSMC alone accounts for 33% of the total market cap.

Sustainability reporting requirements will extend to more companies from FY22

Under the new CG Roadmap, regulators aim to include TCFD and SASB in their reporting requirements, although it is not yet clear under which rules, while CSR reports will be renamed sustainability reports. Also, from FY2022, the requirement for full sustainability reports will extend to firms with share capital of NT$2 billion and up, which includes about 400 TWSE-listed firms in total.

Old rules allow biggish fish to escape scrutiny

Extending the reporting requirement to more of the market is important because existing rules allow some pretty big fish to slip through the net. Regulators chose share capital as the basis for deciding which firms need to report because it does not fluctuate like market cap. That makes some sense, but when we conducted our analysis of mid-sized listed companies, we found that several firms with significant market values did not file reports because their share capital was below the threshold (see Figure 8 below). By extending the requirements to NT$2 billion (US$71m), it would appear that the problem is largely addressed - only Cayman-registered Concraft on the table below would still evade the requirements under the new rules. However, we encourage regulators to keep an eye on this issue.

Market value is no predictor of reporting requirement

Figure 8

Taiwan: Sustainability reporting requirements based on share capital vs market value

Code	Company	Market value (US$m)	Share capital (US$m)	Sustainability report required?
2903	Far Eastern Department Stores	1,209	484	Yes
2448	Epistar Corporation	1,208	372	Yes
1477	Makalot Industrial	1,143	75	No
2451	Transcend Information	1,112	146	No
5522	Farglory Land Development	1,077	275	Yes
1795	Lotus Pharmaceutical	927	83	No
2362	Clevo	795	229	Yes
4943	Concraft Holding	699	47	No
2855	President Securities	665	469	Yes
2607	Evergreen Int'l Storage & Transport	503	364	Yes

Note: Share capital is defined as the number of issued shares multiplied by par value, calculated 30 July 2020. Source: ACGA analysis; data from TWSE and SFB for share capital and reporting requirement; data from ACGA listed company research for market value (January 2020)

Related-party transactions: Back on the radar

The RPT issue quietly dropped off the radar in 2018, but is now back on

Related-party transaction (RPT) rules were a key focus of the original CG Roadmap released in 2013, but seemed to quietly fall off the radar with nary a whiff of explanation or update in the 2018 edition. We are pleased to note that the topic is back on the agenda for the latest CG Roadmap 2020, though it is disappointing that current plans only focus on disclosure after the fact.

Changing RPT rules faces an unholy trinity of obstacles

This rather modest objective begins to make some sense, however, when you understand the context. What is likely hampering action is that the RPT rules suffer from the regulators' unholy trinity:

1. Some of the relevant laws are in the Company Act, which applies to all companies, changing those will require cross-departmental coordination between the FSC and the Ministry of Economic Affairs;

2. To update the RPT rules, the amendments will require approval from the perennially preoccupied legislature, members of which, you may recall, have recently been accused of accepting bribes to influence Company Act regulation to the benefit of local moneyed interests (see boxes in the Government & Public Governance section); and

3. The existing rules bear no resemblance to international examples on the topic. Because the concept is a foreign one and existing rules have such a different basis and are strewn across the regulatory landscape, it is tough for local regulators to find a way to proceed. It is this topic in particular that fully showcases the limitations of Taiwan's Civil Law system.

Material disclosure rules on RPTs are a reasonable place to start

With this in mind, implementing more RPT disclosure is a reasonable first step and regulators can use existing rules to do so. While the new CG Roadmap only calls for disclosure at following-year AGMs, there are TWSE rules that could deliver a faster punch - if they are amended. Current material disclosure requirements call for same-day disclosure of RPTs where individual or cumulative transactions within one year reach 20% of a company's share capital, 10% of total assets, or NT$300m (US$11m). These thresholds are not only extremely high for most issuers, they do not apply to 'transactions with a parent company or a subsidiary of the TWSE listed company, or between subsidiaries of the TWSE listed company'. Tightening these thresholds and extending applicability to firms within the same group would send a credible signal to shareholders that regulators are serious about addressing this issue even if voting on such transactions is currently out of reach.

Next steps

Craft sensible substantial ownership rules

Regulators should continue with efforts to craft sensible substantial shareholding disclosure requirements and update annual report disclosure requirements to include beneficial owners, instead of just major shareholders.

Remove legal-entity directors

We suggest to dispense with legal-entity directors or give shareholders a say when they are changed.

Reword code requirements to comply, explain and show

The authority should find ways to encourage and promote meaningful narrative in CG disclosures, and consider rewording code requirements to comply, explain and show.

ESG reports need more metrics and sensible targets

It should also boost requirements in ESG reports on impacts, metrics and sensible targets and ensure that large firms cannot wriggle out of ESG reporting because of a small share capital.

Create a guidance document collating patchwork RPT rules

Regulators could produce a guidance document on the patchwork of existing rules and definitions regarding RPTs, so that laypeople can understand where the relevant regulations are to be found. Model this on the useful guidance provided on independent directors. The same idea could be replicated across a number of CG topics.

Lower material disclosure thresholds for RPTs

It could also lower material disclosure requirements for RPTs and include entities in the same group, and enforce the rule and disclose figures in the annual Enforcement Report.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and focussed on publicly available information from 15 selected large caps and 10 mid caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large caps, and four high-level questions with 25 sub-questions for mid caps. The aggregate scores for the high-level questions can be found in Appendix 2.

Taiwan ranks 4th on a score of 64%

Taiwan ranks 4th in this category on a score of 64%, behind Australia at 79%, Malaysia at 66% and India at 65%. Taiwan's score rose from 56% in 2018 due to changes in both firm performance and our research and scoring methodology.

The good performance partly reflects high levels of compliance, but disclosures still lack depth

The Listed Companies section is where the rubber meets the road and we find the evidence of how well the CG ecosystem is working. To paraphrase the famous quote, every market gets the corporate governance it deserves and that is the case in Taiwan. Regulatory efforts to implement a comprehensive network of rules, requirements and rubrics has produced a legion of listed companies who dutifully establish the necessary committees and file the necessary reports all by the required deadlines. This has led to reasonably high scores in this section. However, while the system may be largely complete, it is not yet mature and the results of our listed company assessments bear this out. The key issue is lack of depth in disclosure.

Where Taiwan does well

Taiwan issuers generally provide timely information to investors

Both large and mid caps did well in our survey, scoring 4/5, on a question asking if companies provide comprehensive, timely and quick information for investors. Indeed, the mid-cap score gained two points from 2018 in large part due to a change in methodology: We no longer include small-cap firms in our assessment and they dragged down the score last time. The higher scores can also be attributed to noticeable improvements in company websites, especially among large caps, that gave easy access to most information.

AGM agendas are released well before meetings

AGM agendas and voting information are mostly available in a timely manner, but see below for more detail on where pre- and post-annual meeting information is lacking.

Financial reports and auditor independence tend to be strong

Financial reports generally received high marks, as did questions on whether companies respected auditor independence in terms of non-audit fees being less than half audit fees, whether the internal audit department reports to the audit committee, and other reporting on internal controls. Taiwan also scored well on the independence of audit committees, though concerns remain (see box below).

Firms do not pay independent directors with stock options

Taiwan firms also scored well in their remuneration policy regarding independent directors, in particular not paying them with stock options.

Director training disclosure is quite comprehensive, but could be improved

Training disclosure is usually comprehensive, with directors and the courses they took specified by name. Taiwan gets credit on this question because our researchers identified which directors were new and had taken the mandatory induction training. Ideally, the date of every director's induction training would be included in the annual report, regardless of the year it took place. Disclosure on what skills directors need to develop, for example ESG expertise, and any plans to address this would be helpful.

Where Taiwan performs averagely

CG reports cover a range of topics, but provide very little useful detail

As in many markets, Taiwan listed companies do less well on questions relating to CG reporting. Both large and mid caps scored 3/5, with the mid-cap score rising one point and again largely due to the fact that small-cap firms are no longer included in the assessment. CG reports tend to be complete in that they include a response to every item in the CG code, but they are far from detailed and are often downright coy.

CG disclosures often lack substance

For example, CG report responses often consist of a game that is played like this:

1. Regulators require disclosure on a comply or explain basis, such as: Does the company keep track of the list of its major shareholders as well as the ultimate owners of those shares?
2. The company responds, 'Yes,' then under the detailed explanation section parrots back the rule, 'The Company tracks the shareholdings of directors, officers and shareholders' holding more than 10% of the Company's outstanding shares.' This is a real example from a well-known large cap. Notice it says nothing about ultimate owners.
3. Occasionally, the company embellishes the response with more words copied from the rules, or the dates they adopted a procedure to produce a list, details about the procedures for producing a list, or proclamations on the importance of maintaining a list. But no actual list or link to such a list is given.
4. The company gets credit for this response although it tells the reader nothing about who those major shareholders and ultimate owners are, or where one can find the most recent information.

Lack of meaningful CG disclosure points to the immaturity of the system

This is a ridiculous and frustrating game of cat and mouse. But it does make two things clear. First, such companies have missed the point of good corporate governance. Second, the CG system in Taiwan is still immature.

Board committee disclosure also lacks detail

Disclosure on the activities of board committees is often not much better. Taiwanese firms typically show only the dates when committees met, who was there and the broad topic of conversation, eg, approved financial reports. But such disclosure tells the reader nothing about the real content of these meetings or how the members addressed them. This raises doubts as to whether the board and its committees are fulfilling their oversight function.

Board remuneration is still disclosed in bands

Moving on to board and executive remuneration, we found this was still disclosed in bands in the companies surveyed. Seven of the 12 markets we cover scored 5/5 on this question compared to Taiwan's three, indicating that other markets disclose pay to the dollar amount and to the individual level.

Tick box template hampers board diversity disclosure

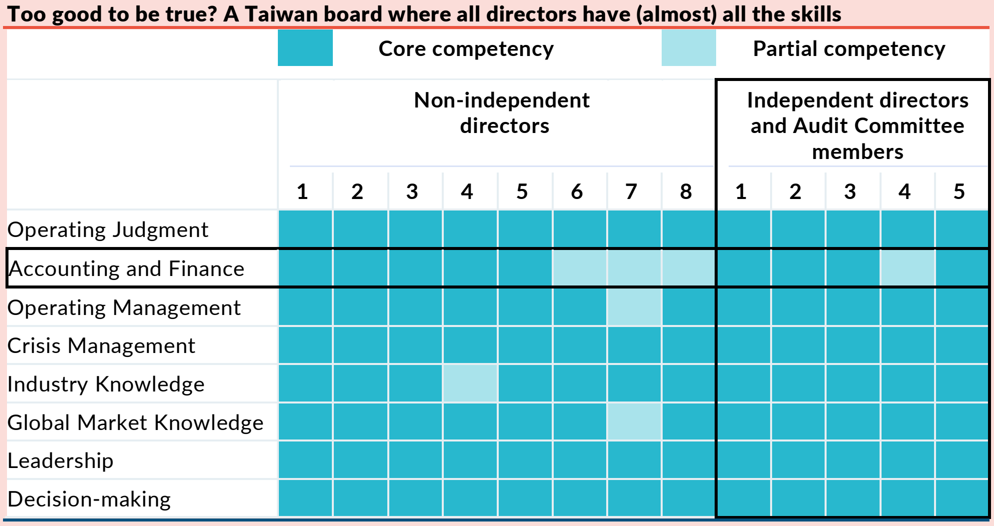
Painting in broad strokes

Board diversity disclosure is also formulaic in Taiwan, rooted as it is in a restrictive template that has some unfortunate knock-on effects. First, local conceptions of diversity seem to only consider types of experience and gender, but not age, length of experience, nationality or other factors. Second, diversity disclosure is mostly restricted to ticking the boxes under an excessively broad stroke category such as whether a board director has work experience in areas of commerce, law, finance or accounting necessary for the business of the company. So if someone is a lawyer or an accountant they check the same box, whether or not the length of their work experience is similar or even sufficient to be a director. Here is an example of an actual company that appears to have a perfect board:

A skills matrix from Taiwan that stretches credibility

Figure 9

Too good to be true? A Taiwan board where all directors have (almost) all the skills



Note: Each column represents a director. Source: ACGA research, annual report of an actual Taiwan firm

In this particularly egregious example, tick boxes hide a multitude of sins

Among the independent directors shown in Figure 9 above, independent director 1 appears at the top of the list of audit committee members which implies he is the chair, but even that is not specified. His biography reveals he has a master's degree in accounting, but no experience as an accountant or financial manager is disclosed. Is that really enough to warrant a core competence in accounting and finance? One hopes so, because the biographies of all the other audit committee members, who must all be independent directors, show that none of them have an accounting background either - despite all but one being marked in the table above as competent in accounting and finance.

Cracks appear in ESG reporting

Large-cap ESG reporting scores dropped slightly

It may seem surprising that large caps scored averagely on the materiality of ESG and sustainability reporting in our survey, falling to 3/5 in 2020 from a more respectable 4/5 in 2018; while mid caps held steady at 2/5. This will likely seem counterintuitive and no doubt disappointing to regulators who have mandated ESG reporting to a GRI standard for much of the market since 2014, and who have been working diligently over the past few years to plug holes in the rules as outlined in the Rules section. So, what happened?

Some mid caps are not required to file full ESG reports

The first thing to notice is that in terms of mid caps, only six of the 10 firms we surveyed were required to file a sustainability report for reasons explained in the CG Rules section above. Nevertheless, we wanted to know if the firms published metrics and targets on material ESG issues and shared realistic plans for achieving these objectives. We checked disclosure in both ESG reports and also in the CSR compliance section of the annual report to see if we could find answers.

Disclosure complying with the CSR Code runs the gamut in terms of quality

Similar to the situation in CG reporting, disclosure in line with the comply or explain CSR Code was often limited. For example, the Code asks the multi-barrelled question: Has the company measured its greenhouse gas emissions, water use and total weight of waste for the past two years, and established policies pertaining to energy conservation, reduction in carbon and greenhouse gas emissions, reduction in water use or management of waste disposal? One company simply replied, 'no,' and as explanation said it was designing 'simplified products…without over-using the raw materials.' In other words, no explanation at all. Yet another provided detailed greenhouse gas emission information, but nothing on water or waste. In contrast, on the same question, one mid cap provided an impressive analysis of the issues with detailed disclosure on policies, implementation and results across a range of production facilities.

Large-cap reports have improved since 2018, but targets were not always apparent

The situation for large caps was better in that they all had sustainability reports to the GRI Core standard, with many improving significantly since 2018. But one shortcoming of the GRI system is that the Core option does not require targets and so many of the reports were somewhat weak in this regard. They either did not include them on certain material issues like waste or said things like the target was, 'Waste recovery rate: 75%,' without specifying what that meant; and then said progress was on schedule, with no specifics on that either. Another difficulty was that targets were sometimes there, but buried in the text. An opportunity for improvement lies in linking company activities and targets to Taiwan's renewable energy and greenhouse gas emission reduction goals.

Explicit board responsibility for sustainability report content and accuracy is lacking

Another difficulty we found was that some of the reports identified material issues by talking to stakeholders, but obvious material issues could be glossed over and details were scant. How many groups? Was the conversation recent? We also did not see clear evidence that boards are explicitly responsible for ESG issues. Assurance is common and providers say that companies would like their ESG reports assured, but it is not clear which executives are asking for this, which raises questions about responsibility and accountability. Finally, it is not clear if or how remuneration is linked to the achievement of sustainability targets and long-term transformation.

Independent directors are seen to work for the person nominating them

Who do independent directors work for?

The prevalence of a dual chair/CEO and the lack of lead independent directors is also apparent in Taiwan. None of the firms we evaluated designated their chair as independent and it is common for the chair and CEO to be the same person - the case in 329 of 944 TWSE-listed firms as of the end of 2019. None of the firms we looked at has a lead independent director.

Regulators boost number of independent directors, but that may not help

Regulators aimed to address this, somewhat, in January 2020 by boosting requirements for the number of independent directors. For listed firms with more than NT$600m in paid-in capital, if the chair and general manager are the same person or are spouses or first-degree relatives, the company must appoint at least four independent directors by 31 December 2023. But it is doubtful that this will do much good. Although these independent directors will be required to meet a range of independence criteria, the fact remains that they are generally nominated by the controlling/major shareholders they are supposed to oversee. Independent directors often demonstrate allegiance to the parties that nominate them and are even included in media tallies of who controls a board. This is another example of where the letter of the law has been met, but the spirit is disregarded.

Where Taiwan does poorly

Board evaluations are in the process of being implemented

Predictably, the weakest areas of performance for Taiwan were those where no rule is in place. It is not all bad news, though, as shown by the first topic, board evaluations, which are in the process of being required and implemented, starting with self-evaluation. Seven of the 15 large caps we reviewed indicated they undertook board evaluations conducted by third parties, which would appear to be good. Three said they did their own evaluations and the remaining five said nothing. Yet the details of these board evaluations were not disclosed.

Nomination committees are still rare, but included in the latest CG Roadmap

Filling the skills gap on boards is the job of the nomination committee, but the latter function is not yet required in Taiwan either. Only two of the large caps indicated that they had one. The latest CG Roadmap calls for adding nomination committees to the CG Evaluation indicators, an encouraging first step. However, deeper coordination between nomination committees, regulators and civil society groups to promote the general development of the talent pool and aid in search and training will be crucial.

Details on natural persons holding legal-entity directorships are often scant

Investors want to know who is on the board and who is the chair. It is a basic question and, in most markets, crystal clear. Yet this is not always the case in Taiwan, thanks to its unique legal-entity director system where board seats are given to corporate shareholders not individuals. This can make it difficult to identify the natural person currently holding a particular board position or even the chairmanship! The name and CVs of these people should be easily available and up-to-date.

Annual reports are still only due seven days before AGMs

Another glaring weakness in Taiwan is that annual reports are only due seven days before an AGM. The new CG Roadmap calls for 14 days before, but longer would be better - ideally 28 days for all AGM materials. After the AGM, we also found that recordings of the meeting with shareholder Q&A or at least a summary of the Q&A in the meeting minutes were seldom available - another area where Taiwan is falling behind regional best practice.

Limited ageing analysis

Lastly, while financial reporting is generally good, we found that details on the ageing analysis of receivables and payables were often missing from company accounts.

Figure 10

Taiwan: Strengths and weaknesses

Topic	Strengths	Weaknesses
CG reports	Include relevant topics	Lack company-specific answers
ESG disclosure for CSR code	Includes water, waste and greenhouse gas emissions	Lack of compliance is common and "explanations" can be unsatisfactory
ESG disclosure for sustainability report	Much improved on materiality, follows GRI standard	Misses some mid-cap firms, targets may be missing, irrelevant or buried
Substantial shareholding disclosure	Required in annual report	Does not generally include beneficial owners
Director training disclosure	Included by name for each director and course	Does not link to directors' existing skills or gaps in expertise
Executive and board remuneration disclosure	Required in bands	Usually only in bands or suspiciously identical amounts for all directors
Board diversity disclosure	Includes range of skills and experience	Template too broad and forgiving to produce meaningful disclosure; limited disclosure beyond experience and gender
Board evaluations	Half of our sample conducts third-party evaluations	A third of firms only do self-evaluations
Nomination committees	A few firms have implemented nomination committees	Not common; doubts about them serving intended function
Lead independent director	None	No firm in our sample has done this

Source: ACGA

Action points for issuers

Next steps

Key advocacy points for companies following on from the above include:

Quick wins

- ❑ Commit to providing meaningful company-specific narrative in board and committee reports, as well as all CG and ESG/CSR disclosure
- ❑ Provide ageing analysis for receivables and payables
- ❑ Publish annual reports at least 14 days before AGMs, but ideally 21-28 days
- ❑ Institute board responsibility for the quality and accuracy of ESG reports
- ❑ If the chairman is not independent, appoint a lead independent director
- ❑ Conduct third-party board evaluations to identify gaps and implement independent nomination committees to find suitable candidates
- ❑ Disclose the date of induction training for each director; identify gaps in expertise and craft training plans to fill them
- ❑ Disclose the detailed CV of every director to the natural person level
- ❑ Provide practical explanations about what is considered relevant experience; disclose this in a meaningful way beyond overly broad tick boxes
- ❑ Supplement tick-box criteria for independence factors with principles-based statements

Medium- to long-term challenges

- ❑ Institute board responsibility for sustainability strategy and becoming climate-ready. Disclose ESG governance system and ensure high-level accountability that can produce change
- ❑ Move beyond a compliance mentality and take ownership of new CG and ESG best practices - a cultural transformation is necessary to fully respond to ESG risks and take advantage of new business opportunities on offer
- ❑ Provide comprehensive and real metrics on ESG performance and set meaningful targets that link to national sustainable development goals; measure performance against these
- ❑ Link remuneration to ESG performance and transformation
- ❑ Select independent directors who can truly add value; establish independent nomination committees to find suitable candidates, and consult with shareholders on candidates. Collaborate to enhance independent director pool.

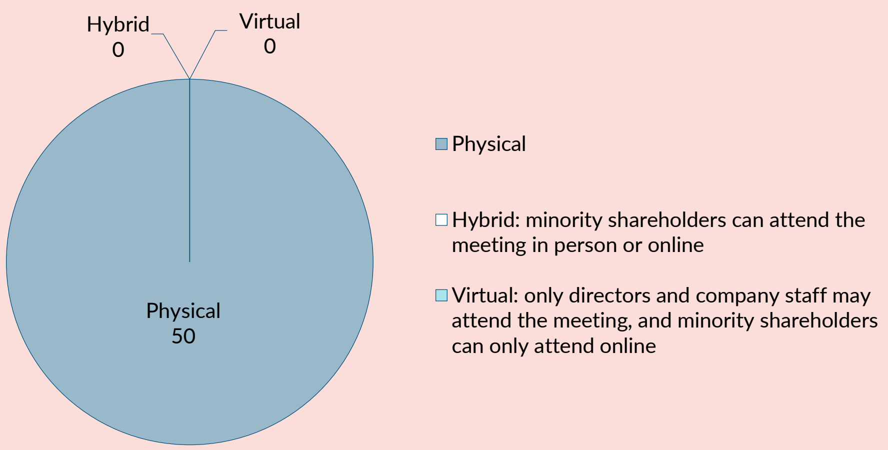
Taiwan AGMs were all physical

Electronic AGMs: Non-existent

Given the small numbers of Covid-19 cases in Taiwan and since fully virtual AGMs are not permitted, it was no surprise that few listed companies opted for electronic meetings in 2020. What was unexpected was that none of the top 50 listed companies by market cap chose to webcast their meetings, which is possible since hybrid meetings are allowed. As ACGA research shows, all held physical-only meetings.

Figure 11

AGM modes in Taiwan: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

Tatung exposes regulatory holes

After a long drawn out fight, the Lin family lost control

Control of Taiwan's iconic home appliance maker, Tatung, was finally wrested from the founding Lin family on 21 October 2020 at an EGM where dissident candidates took five director and two independent director seats, against just one director and one independent director seat won by Tatung-nominated candidates.

MOEA gave investors permission to hold an EGM after Tatung abused the AGM

The meeting was only made possible after the Ministry of Economic Affairs (MOEA) granted institutional investors permission to hold an EGM. This followed Tatung unceremoniously throwing out the votes of 27 investors representing a combined 53% stake at its AGM on 30 June 2020. It did so on the dubious grounds that some investors aimed to acquire Tatung and had not been truthful in their government filings, or that they represented capital from China.

Officials objected to Tatung's tactics, but could do little about them

Although senior officials from every branch of the regulatory regime strongly objected to Tatung's actions, it quickly became apparent that they had limited tools to address this appalling breach of protocol and shareholder rights. Their first response was to change Tatung's classification to full-delivery stock eliminating margin trading on the day after the AGM. This is the third most severe form of TWSE punishment after delisting and suspension of trading. Exchange spokesperson, Rebecca Chen, charged that Tatung had 'ignored the fact that it is not a judge nor a government agency' and had no right to block shareholder votes.

SFIPC filed a lawsuit to dismiss the chair

The SFIPC expressed sadness at Tatung's insistence on employing innovative measures to disrupt corporate governance. On 6 July 2020, it filed a lawsuit to dismiss Tatung's chair as the AGM tactics had severely breached shareholder rights and disrupted market order. However, it admitted that arriving at a result through the courts would take time.

MOEA said it considered the June AGM illegal, but lacked powers to remove board

The MOEA said it did not consider the June 2020 board election legal, but could not declare it invalid because only a court had the power to do so. The MOEA did reject the registration of the board members, but Stephen Wu, a lawyer from Lee and Li, pointed out that registration was not a requirement for a board to exercise its rights. 'To put it simply, there is nothing the government can do if Tatung is determined to ignore all the government's instructions and public opinion. Tatung must obey the court ruling, but the legal process will likely take a long time.'

FSC looks into revising SEA to give it more options in future

Thomas Huang, FSC chair, conceded this point on 9 July 2020, a scant seven weeks into his term as the new head of the regulator. He said plainly, 'We understand that the public hopes that we can quickly solve the situation, but the Securities and Exchange Act (SEA) does not offer us enough tools to do that.' After a week of review, the FSC found that what it could do was report the Tatung chair to prosecutors for breach of trust because the AGM had led to impairment losses, a first for malpractice in shareholder services. Huang said the FSC would look at ways to amend the SEA to give itself more options in future.

The system sort of worked, eventually

At long last, on 12 August 2020, the MOEA approved an application from individual and institutional shareholders to hold an EGM and new board election, setting the stage for the long-awaited 21 October 2020 transfer of control. The system worked - sort of - but not before exposing gaping holes in regulatory powers.

5. Investors

Taiwan scores 38% and ranks equal 7th with Thailand

Taiwan comes in joint 7th along with Thailand in this section with a score of 38%, up from 33% in 2018. Both markets are far behind Australia (66%) and Japan (60%), and also trail India and Korea (both with 44%) and Malaysia (43%). Interestingly, Singapore is just one percentage point ahead at 39%. The key issue for Taiwan in this section is the limited activity and detail outlined in investor disclosure.

Most institutional investors have signed the updated Stewardship Code

Starting with the good news - the number of signatories to the Stewardship Code continues to rise, with 152 domestic and foreign investors signing on. The vast majority (120) have updated their statements affirming adherence to the code since it was revised in August 2020.

New Stewardship Code

Stewardship Code calls on signatories to understand investee company ESG risks

The updated Stewardship Code, which is managed by the TWSE, explicitly calls on investors to monitor and evaluate ESG factors and include them in investment decisions; they should also understand the sustainable development strategy of investee firms. This policy links to the ESG and climate change risk assessment rules for all listed companies found in the comply-or-explain CSR Code. The revised Stewardship Code asks signatories to provide statistics and case descriptions of their stewardship efforts, including disclosure on processes, actual activity and results. In addition to expressly encouraging collective engagement, it calls on investors to establish voting policies, disclose voting statistics, and explain reasons for voting against.

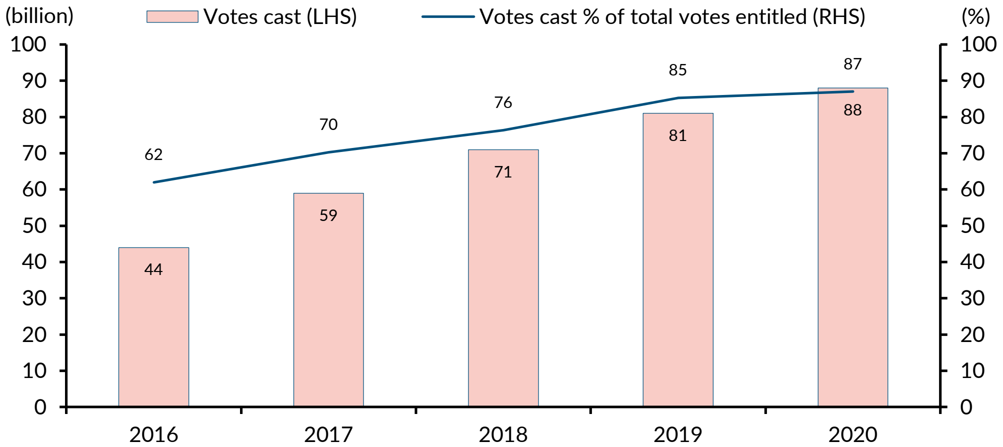
An e-voting platform and the Code have boosted domestic institutional voting rates

There is strong evidence that along with the implementation of e-voting, the code has had a substantial impact on voting rates. Statistics from the Taiwan Depository and Clearing Corporation (TDCC) show that foreign institutional investors have long voted almost all their shares. Most recent TDCC figures stand at 97%, which is in line with the 93% indicated by our ACGA investor member survey (see below in this section). Domestic institutional investors vote 87% of their shares, a full 25 percentage-point increase from the 62% voting rate in 2016, as Figure 12 shows.

Domestic voting up from 62% in 2016 to 87% in 2020

Figure 12

Domestic voting on the rise



Source: Taiwan Depository and Clearing Corporation

Domestic stewardship lite

Stewardship reports are hard to find and weak on detail

To understand the development of stewardship in Taiwan, we analysed the policies, voting records and disclosure of the five largest domestic asset owners and 10 biggest domestic asset managers. Our first observation is that despite significantly increased levels of voting, domestic investors seldom appear to be voting against anything. Indeed, few disclosed much stewardship information at all. Although most have endorsed the code, their stewardship disclosure to date says little about the priorities and efforts of individual institutions, creating doubts about the sincerity of such statements. In the vast majority of cases, there were no responsible investment reports, which is now standard in developed markets. All that is available are statements of compliance with the Stewardship Code and even these are hard to find - often accessible only through the TWSE CG Center website. This begs the question of how strongly these investors value their code commitments if no mention of them can be found on their own websites!

Most stewardship disclosures lack information about voting policies or records

Once one does find these statements, they typically provide little description of how an entity makes stewardship decisions. They may have an exclusion list of businesses or industries the investor will not invest in, but no information about how they monitor and manage the investments they actually make. As for voting policies, sometimes domestic entities say they exist, but provide no further detail or merely copy and paste from the code. In a few cases, they might say something like, 'we vote against proposals that violate ESG principles'. This seems like a step up except that no detail or voting record is provided. It is therefore not possible to assess the validity of the statement.

Fubon Asset Management is the only surveyed domestic investor to disclose voting at company and resolution level

Tiny sprouts of improved disclosure

For all the frustration and disappointment of reading these stewardship compliance statements, there are some encouraging signs. The most exciting comes from Fubon Asset Management, which was the only asset owner or manager of the 15 we reviewed in Taiwan that disclosed all of its voting records down to the company and resolution level. This is the norm in Japan and we see no reason why institutional investors in Taiwan cannot follow suit.

Three local investors showed evidence of physically attending AGMs

As for physically attending shareholder meetings, only three investors of 15 provided evidence that they attended in person: the Bureau of Labor Funds, Yuanta Securities Investment Trust, and Fuh Hwa Securities Investment Trust. Fuh Hwa was also the only domestic investor we found who provided a specific engagement example with disclosure of the company by name and the topic, ie, implementing solar power use. Capital Investment Trust gets credit for providing some information – numbers and topics - on engagement conversations, and for disclosing and promising to 'humbly accept and reflect on the lessons' of an employee caught trading illegally. Uni-President Asset Management also disclosed a conflict of interest case. Such candour and forthrightness is unusual and refreshing, and is to be heartily encouraged. Indeed, the more transparent investors are, perhaps the more courage listed companies will find to be open in their own disclosures.

One domestic investor provides stewardship leadership, but was too humble in disclosure

One investor that we were surprised to find was short on detail was Cathay Securities Investment Trust. It is associated with the Cathay Financial Holding Company, which has been a visible market leader in promoting responsible investing, particularly around climate change, eg, its CIO chairs the Asia Investor Group on Climate Change. While the company's vision was communicated well, the concrete details of its work did not come through in the report even though there is evidence in public fora and in the media of all that this group has done, including working to entice Foxconn to make net zero greenhouse gas emission commitments.

TWSE evaluation programme should improve disclosure

Stewardship disclosure benchmarking

All of these tendrils of disclosure and frankness point to a dawning awareness among domestic institutional investors of what is being asked of them as they exercise stewardship. Now the thing is for them to learn from each other's best practices both at home and abroad. To hasten this along, the TWSE CG Center has implemented a benchmarking and award programme that mimics its CG Evaluation programme described in the CG Rules section of this report, a good move and one that is likely to work well. We also encourage domestic investors to study stewardship disclosure in other regional markets, notably Australia and Japan, for inspiration.

Existing stewardship practices not yet linked strongly to Taiwan's sustainability plans

Going forward, institutional investors will play an important part in realising Taiwan's goals as outlined in the Green Finance Action Plan 2.0, as highlighted in our Government & Public Governance section. Some specific actions that could support those efforts:

- Measure the sustainability and climate target performance of investment portfolios and disclose it;
- Tie fund manager compensation to that performance;
- Support bold action from investee companies and disclose this support; and
- Engage with companies and regulators to implement ways to exercise investor say-on-transition plans, perhaps via advisory votes.

Code signatories seem to have missed the point on conflict of interest disclosure

Conflicts of interest

Many of the domestic investor stewardship reports we reviewed had statements about managing conflicts of interest, but usually they focussed only on employees and did not demonstrate any awareness that company-level or commercial conflicts of interest might exist and need to be managed. It seems that most domestic investors have missed the point on this issue - something that should be addressed in the next update to the Stewardship Code. A notable exception is First Financial, an ACGA member, which has a policy clearly outlining fiduciary duty and the specific levels at which conflicts of interest could happen. Cathay Financial also addresses this. Information on the governance structure and what conflict of interest challenges a particular investor faces would be helpful. In cases where this statement exists at a different level of an entity, for example at the financial holding company level instead of the asset management level, links should be provided to such policies.

Once again, the SFIPC demonstrates the possibilities of stewardship

SFIPC to the rescue (again)

One shareholder doing admirable work is the SFIPC, the de facto civil regulator described in the Regulators section. It makes a point of attending 50 to 60 shareholder meetings each year, focussing on firms that score in the lowest rankings of the CG Evaluation (see the CG Rules section). It raises questions at AGMs and comments on areas of CG weakness based on the CG Evaluation and its own reviews, and offers recommendations. We encourage more shareholders, domestic and foreign, to follow this example. We also encourage the SFIPC to employ more staff to coordinate collaboration and communication with foreign investors to support collective engagement efforts.

ACGA surveyed its investor members in Q3 2020

The foreign dimension

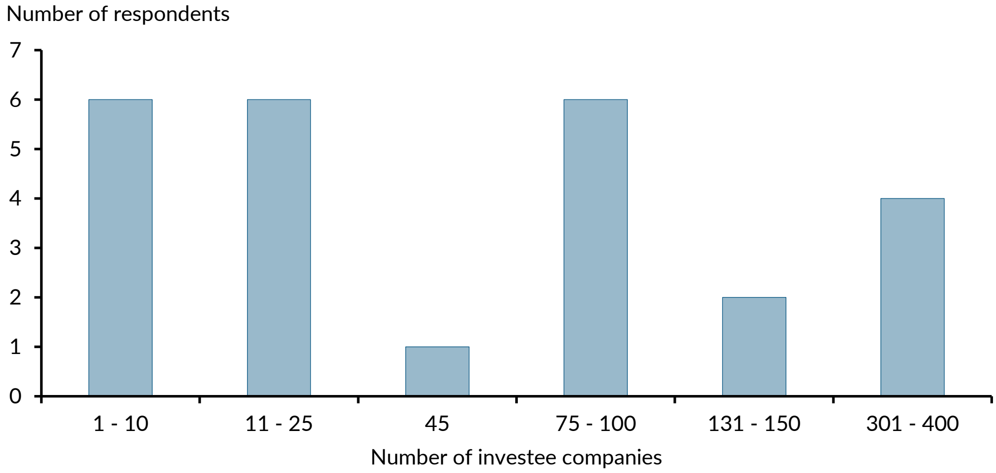
As part of the research for CG Watch 2020, ACGA conducted a survey of our global investor members in Q3 2020 to understand their level of voting and engagement in the 12 Asia-Pacific markets we cover. More than half of ACGA's investor members - 45 out of 92 - responded. At the time of the survey this group managed in aggregate more than US$26 trillion globally. As the responses showed, Taiwan is an important investment destination though somewhat smaller than Hong Kong and Korea:

- Some 89% or 40 respondents indicated that they invest in Taiwan - fourth in the region just below India, China and Hong Kong whose results ranged from 91% to 93%.
- Only 25 respondents answered the question on the exact size of portfolios. They invest in an average of 99 companies each, with a range from one to 390. The average figure places Taiwan at seventh in the region, just below Hong Kong and Korea, and far below Japan and China.

Another way to show the extent of investment in Taiwan is to group portfolios by size. As the following figure shows, while a majority of respondents have portfolios of less than 50 companies, some members invest in more than 300 companies each.

Figure 13

Foreign investors in Taiwan by size of portfolios, 2020



Note 1: Not all respondents answered this question
Note 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points
Source: ACGA Member Survey, September 2020

While a majority of respondents invest in less than 50 companies, some members invest in more than 300 companies

Foreign investors are not afraid to reject resolutions

Respondents take voting seriously in Taiwan, though they voted against fewer management resolutions than some of their peers in the region:

- Most respondents with holdings in Taiwan vote in 100% of their investee-company AGMs. One votes in 90%, one in 35% and one in 29%.
- On average, they voted against at least one management resolution in 27 meetings in 2020. The median figure was nine meetings, with a range from zero to 111, which is in line with India, but below Japan, China, Korea and Hong Kong that range between 55 and 271.
- As a proportion of their holdings, respondents voted against at least one management resolution in 20% to 30% of meetings - higher than Malaysia, Australia and Indonesia and not far below Singapore.

Global investors typically vote against director elections, remuneration and share issuances

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections, which were often linked to independence or diversity issues, followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Most respondents to our survey undertake individual company engagement

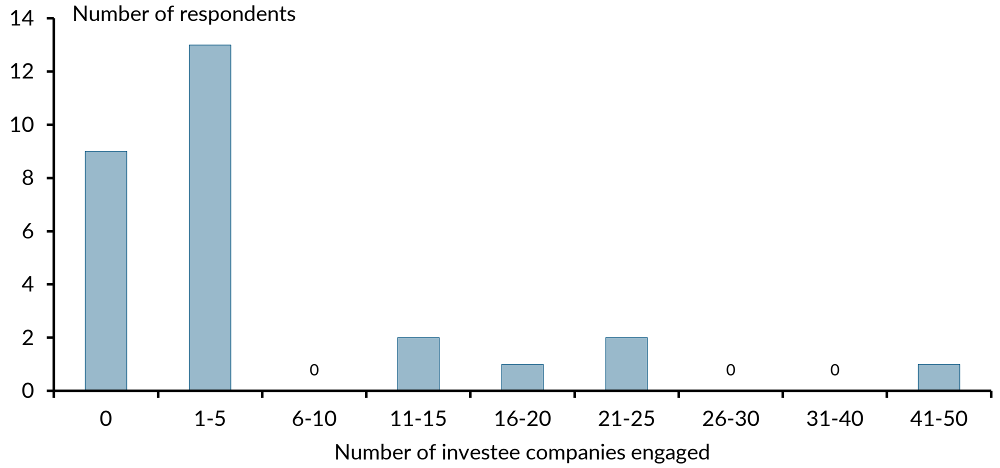
Company engagement

Company engagement on CG and ESG topics is becoming an increasingly important part of foreign investor stewardship activities around the world. Japan absorbs the largest part of foreign-investor engagement energy and budget, followed by China, Australia, Hong Kong, and Korea. Taiwan placed seventh with respondents engaging with an average of seven companies each over 2019 and 2020. Again, a more representative way of illustrating this is to show it as a distribution. As the following figure shows, most of the 28 respondents who answered the question engaged individually with five or fewer firms over the two years, while a few engaged with more than 20.

And most engaged with 10 or fewer issuers over 2019-20

Figure 14

Foreign investor engagement prevalence in Taiwan, 2019-2020



Note: Not all respondents answered this question.
Source: ACGA Member Survey, September 2020

Average result is lower than most markets

In terms of the relative level of engagement in Taiwan, ie, as a percentage of companies invested in, our survey provides some tentative answers. The figure for most of those who answered is 20% or less but rises to 33% for one institution, who is a respondent within the 75-100 band for portfolio size, and 50% for another.

A few foreign investors adapt their global policies to Taiwan

Meanwhile, many respondents indicated that they adopt their global policies for Asian markets and a few adapt them to Taiwan by translating them or aligning them to the local Stewardship Code.

Retail

Retail investors appear to make up the majority of AGM attendance and ask questions of mostly moderate quality

Collecting objective information on retail investor behaviour in Taiwan is a challenge as there is not yet a retail shareholder association, although groups are quick to pop up to voice discontent with misbehaving companies and retail investors do join SFIPC lawsuits. For CG Watch 2020, we conducted a small survey of local listed companies asking about investor behaviour. The response rate was low - only 21 companies provided answers. However, there was still some useful information to be gleaned from their responses. Of the respondents, 14 said that more than half of those present at their AGMs were retail investors, indicating a high degree of attendance. Eleven said that these investors ask more than half of the questions at AGMs. Assessments of the quality of retail investor questions were mixed. Twelve respondents said more than half of the retail investor questions were of moderate quality, five considered more than half of them were of high quality, and three respondents said more than half of the retail investor questions were of low quality.

Next steps

Investors are missing an opportunity at AGMs

Investor should make an effort to attend AGMs in person and ask relevant questions. Disclose on attendance and differentiate between voting and physical presence.

Institutions should have a meaningful voting policy

Institutional investors should set and disclose a meaningful voting policy and disclose voting against down to the company and resolution level, while regulators should add this to the Stewardship Code.

Foreign institutional investors should make market-specific disclosure

Foreign institutional investors should produce market-specific stewardship disclosure.

Address conflicts of interest

Institutional investors, especially domestic ones, should conduct some internal reflection on institutional-level conflicts of interest, eg, does the investment arm of a financial holding company avoid tough stewardship engagement with and voting against the major clients of its parent?

Define engagement and see it as a two-way street

Institutional investors should distinguish between actual engagement and vague conversations and seminars; track and disclose topics and targets of engagement, as well as impacts. They should also be open to engagement from their investee companies as this is a two-way street. One listed company we spoke to said, 'Why do we always have to answer investor emails, but investors never have to answer us?' It is a reasonable question.

Feedback on consultations

All investors should provide feedback on rule consultations and share on their website.

'Violating the spirit and meaning of stewardship'

Taipei prosecutors indicted 12 in an investment bribery scandal

On 8 February 2021, the Taipei District Prosecutors Office indicted 12 people in a scandal that involved bribery and market manipulation charges against an asset management firm for allegedly bribing an employee of the Bureau of Labor Funds (BLF), which oversees pension and worker benefit funds, to manipulate the share price of a local department store.

CEO of PJ Asset Management allegedly bribed a BLF manager to buy stock in Far Eastern Department Store

Prosecutors allege that Daniel Tarng, CEO of PJ Asset Management and fellow executive, Chiu Yu-yuan, sought to manipulate the price of Far Eastern Department Store from May 2019 onwards before planning to sell the shares in 2020. Since the price did not rise as much as expected, they approached the then-chief of the BLF Domestic Investment Division, Yu Nai-wen, and asked him to use the Labor Fund, which had assets of NT$4.45 trillion (US$156 billion), to manipulate share prices. Yu allegedly agreed and is accused of also asking contacts at Uni-President Assets Management, Fuh Hwa Securities Investment and Capital Investment Trust to buy Far Eastern shares at inflated prices. Prosecutors said the scam had allowed PJ Asset and the other firms to obtain criminal proceeds of NT$275m (US$9.8m), including realised profits of NT$184m.

The case came to light due to routine internal audits

Prosecutors said the case came to light due to routine internal audits and that Yu had come under suspicion after NT$9m was deposited into his account from an unidentified source. He also had between NT$150,000 and NT$220,000 per month in credit card spending on a monthly salary of only NT$100,000. Local media reported that the Ministry of Labor had identified Yu as high risk as early as 2016 and there had been discussion of removing him in 2017.

Defendants arrested and most later released on bail

Yu was indeed removed from his post on 18 September 2020 and detained on 27 November along with Chiu Yu-yuan, who was mystifyingly released two days later on NT$300,000 bail, only to be re-detained on 11 December and joined by Tarng and Fuh Hwa Securities Investment Trust chief investment officer, Chiu Ming-chiang, and asset manager Liu Chien-hsien. All but Yu were released on 8 February 2021 on bail of NT$10m for Tarng and NT$5m for the others.

TWSE removes PJ Asset Management from Stewardship Code signatories list

Using one of the few tools at its disposal, the TWSE took the unusual move of announcing on 30 December 2020 that it had removed PJ Asset from the list of signatories of the Stewardship Code. The TSWE said that PJ Asset had sought to rationalise its behaviour as acting in the accordance with the Code! On the contrary, its actions violated the spirit and meaning of stewardship, the TWSE charged.

6. Auditors & audit regulators

Taiwan scores 76% and ranks equal 6th

Taiwan scored 76% and ranked equal 6th with Thailand in this category, behind Malaysia (89%), Australia (86%), Hong Kong and Singapore (both 81%) and Japan (77%). This ranking is similar to its 2018 placement and score of 70%, despite some tangible improvements, particularly in regulator disclosure.

A few of the more obscure international standards are missing

Local accounting and auditing standards are in line with international standards though there are a few time lags in adoption and gaps in coverage. While audit regulators have reasoned that some of the more obscure standards would not likely be needed in Taiwan and thus can be skipped to reduce costs, we encourage them to translate and adopt all standards as quickly as possible for the sake of completeness and to enhance trust in the system.

Audit regulator wields full range of powers

The audit regulator is far down the pecking order, but wields a full range of powers

One curious thing about the audit regulatory regime is that the division responsible for audit oversight is buried pretty far down the food chain within the Accounting and Auditing Supervision Division of the Securities and Futures Bureau under the Financial Supervisory Commission. While this may seem a relatively diminutive position in the hierarchy, the Division has strong powers and a full range of regulatory and disciplinary functions, some of which are delegated in other markets to the local CPA association. Indeed, audit regulators in Taiwan do not tend to be particularly public with their efforts, and keep a low profile. However, auditors describe them as tough and tell us they often take a pre-emptive approach, calling in representatives from the major audit firms for coffee to encourage discussion of solutions to problems before they have a chance to take root and before formal initiatives are announced.

Auditor discipline is slow . . .

Disclosure on disciplinary action is exceedingly terse

Information about disciplinary action is available on the SFB website under the mystifying and misleading heading of Practice Sectors. The disclosure is exceedingly terse, declining to even identify the companies or cases involved. However, it must be said additional information was quickly and unreservedly provided to us upon request. Nevertheless, the current enforcement disclosure approach was costly in the scoring both in terms of timeliness and detail and also assessing disciplinary control. Furthermore, disciplinary results appear to take some time to reach a conclusion: cases resolved in 2020 were for infractions committed in the fiscal years of 2016-2018. Explaining the time lag, the SFB said that there is a full range of rehearings available in disciplinary cases so those must run their course before the result is published. Also, regarding a notable uptick in disciplinary cases in 2020, the regulator said this rise was because it had recently changed its audit firm inspection approach to focus on key audit areas, as well as increasing the number of engagements reviewed during inspections.

. . . and subtle

Financial institutions reject all recent audit opinions of auditors who have been disciplined

Auditors we spoke to offered some insight as to why the regulator might be cautious about revealing the names or details of those facing disciplinary action. They said that Taiwan was a small market and word travelled fast - once a person's name was on the disciplinary list their career was essentially over, so the disciplinary process must be thorough and fair. Furthermore, they said that there was a rule specific to Taiwan whereby once an auditor was disciplined, any audit opinion they had rendered in the past five years would generally be rejected by local financial institutions, affecting the terms of loans for their clients. There is a lot of context that explains what could be perceived as a slow and opaque audit regulator process. It would be helpful if audit regulatory reports could shed some light on these realities and also on the conclusions of cases that have been resolved.

An improving inspection report

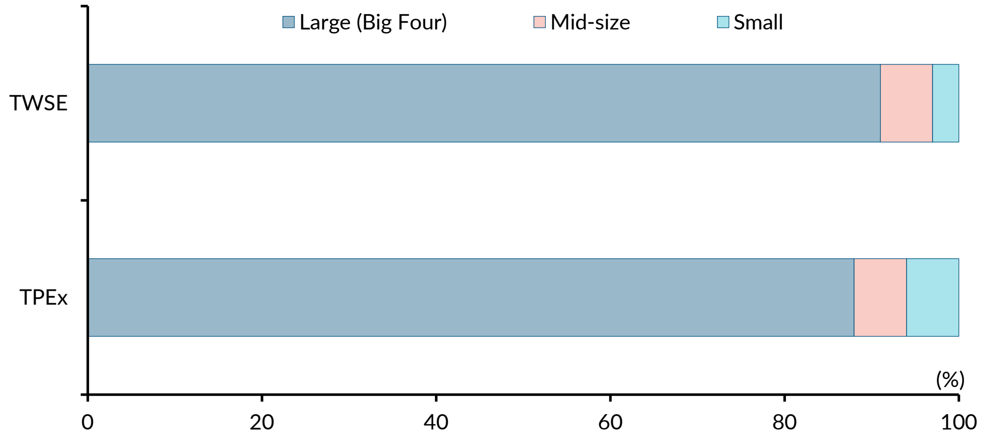
Audit inspection report has significantly expanded

The regulator's audit inspection report, previously called the CPA firm General Inspection Report, has greatly expanded in recent years, growing from 13 pages in 2017 to 21 pages in 2018 and 38 pages in the 2019 edition, which has been renamed the Audit Oversight Report. The inspections alternate each year, with small- and mid-sized audit firms reviewed in even years and large-size, ie, Big Four, firms reviewed in odd years. The 2019 edition reviewed three of the Big Four and included eight audit engagements each. The report described the regulator's inspection programme and provided data on the level of skills and experience in the CPA profession to give a sense of audit industry capacity. Further information on capacity can also be found in Taiwan's CPA Association Accounting Industry White Paper and the FSC's Survey of the Accounting Industry, both of which are only available in Chinese.

A vast majority of listed companies were audited by Big Four firms

Figure 15

Taiwan audit industry at a glance: Market share by size of audit firms, 2019

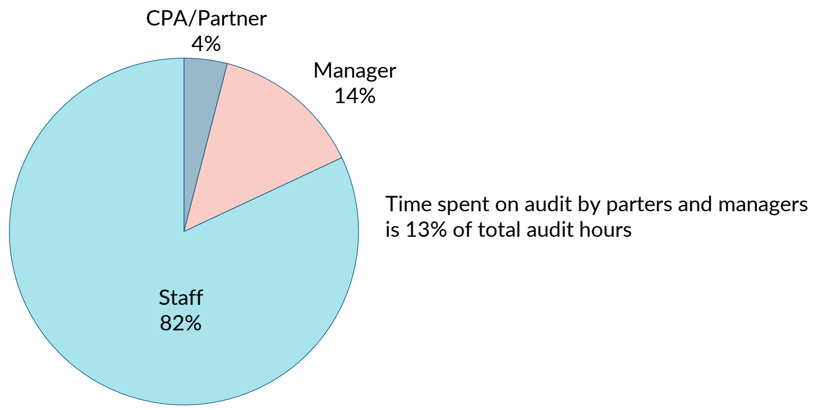


Note: TPEx is the Taipei Stock Exchange. Source: Financial Supervisory Commission, 2019 Audit Oversight Report

Time spent on audit by partners and managers made up 13% of total audit hours

Figure 16

Taiwan audit industry at a glance: Average employee composition of Big Four firms, 2019



Note: "Managers" are defined in the report to be auditors who have more than five years of audit experience, though that is not defined in detail. Source: Financial Supervisory Commission, 2019 Audit Oversight Report

Regulator increases focus on audit quality, with AQIs in the works

The Audit Oversight Report also discusses the challenges in assessing audit quality and reviews its approach in some narrative detail - a welcome development for a regulatory report. Moreover, the latest CG Roadmap aims to implement Audit Quality Indicators (AQIs) by 2023. Currently, the regulator assesses audit quality in its report in terms of independence and professionalism. Independence is gauged in terms of how long the audit firm has held the audit engagement and audit fees. To assess professionalism, the regulator uses these indicators:

- Proportion of managers;
- Proportion of professional consultants;
- Proportion of partner and manager engagement hours to total audit hours;
- Partner level of experience;
- Proportion of audit engagement quality control review (EQCR) hours; and
- Training hours.

The Audit Oversight Report is much improved, but still lacks industry capacity data

The report is greatly improved from previous editions, particularly in terms of organisation, detail and quality of English, and is among the better regulatory reports in Taiwan. However, it is still difficult to get a clear understanding of what is happening in the audit industry solely from reading it. Information on turnover and the number of listed-company audits handled per manager and audit partner would help, as well as partner hours and more detailed definitions of qualifications for staff and manager. The report does make an effort to show trend analyses, though this is hampered by the alternating focus of the report between large and small firms from year to year. It is also not clear if there are recurring problems. There is an attempt to summarise findings, but it is not clear if there are common errors or particularly poorly performing audit firms. The reader is left with no coherent story about the industry or audit quality in Taiwan. Nevertheless, the ongoing improvements to the Audit Oversight Report and the development of AQIs bodes well for more clarity in future.

More fee disclosure please

More disclosure on non-audit fees would be good

Audit fees are disclosed in bands of NT$2m in Taiwan, it would be better if it also discloses exact figures. In 2018, we noted that Taiwan had an unusual rule requiring audit fees to be disclosed and explained if they decreased by 15%. As we suggested, that figure has been reduced to 10%. Non-audit fee disclosure is also unusual in Taiwan since it is only required if the fees exceed 25% of audit fees. One reason this may not have been such a priority is that non-audit fees make up only 16% of auditor firm income in Taiwan as opposed to 63% worldwide. Nevertheless, such fees should always be disclosed regardless of the amount and we encourage regulators to change this rule.

Next steps

Enhance information on CPA industry capacity

We suggest to integrate elements of the CPA Association White Paper into the annual regulator report to show turnover and staffing issues. The annual regulator report should also share more narrative about the context and challenges faced by the accounting profession and approaches to address them.

Expand narrative in Audit Oversight Report

It will be helpful to beef up the narrative in the Audit Oversight Report. The report should explain what changes have been made in the inspection approach and why? What specific issues cropped up and how were they addressed? What trends and challenges do regulators notice? It should also include information on the number of listed-entity audits each auditor handles at varying levels in the hierarchy, as well as information on recurring problems and whether there are any particularly problematic firms.

Disclose details on each audit enforcement case

Regulators should disclose details on audit enforcement cases once they have been resolved, particularly those that figured prominently in the news. Disclosure from audit regulators in Malaysia may provide some inspiration.

Disclose non-audit fees

All audit and non-audit fees should be disclosed, and by dollar amount instead of in bands.

Add strong whistle-blower protection for auditors

Regulators should enact strong whistle-blower protection for auditors.

7. Civil society & media

Taiwan ranks joint 4th with a score of 62%

Taiwan scored 62% in this category along with Japan, sharing equal 4th place behind Australia (80%), India (78%) and Singapore (64%). This score reflects an 11-percentage point increase on Taiwan's 2018 score of 51%. Contributing to the strong performance were increases in the number and activities of civil society groups, as well as a marked uptick in support for ESG efforts.

Civil groups ramp up activity

TCGA continues to host multiple events and is a primary source of research on CG in Taiwan

An important contributor to Taiwan's jump in points is a notable increase in the number of civil society groups and activities. The stalwart of the scene is still the Taiwan Corporate Governance Association (TCGA), which continues to host a wide array of training events and fora with insightful and hard-hitting discussions on challenging topics for people familiar with the issues. With the help of full-time staff, it also produces original research and books, including most recently a reference guide for audit committees as well as a survey of independent directors. At least one TCGA leader has written a book on CG, prominently displayed in local book shops. This organisation continues to serve its long-standing role as a CG resource.

TIDA fills a void

TIDA offers a home for Taiwan's independent directors

Taiwan has finally established a bona fide independent directors association with the Independent Director Association Taiwan (TIDA) filling an important gap in the civil society landscape (see tidatw.org). Not to be confused with other organisations having a similar name, TIDA is a standalone entity with its own small team which has organised training events, including a beginner certificate programme for independent directors, and other seminars. TIDA training sessions that ACGA has attended were conducted by legal experts and were lively, well-researched and practical. Most interestingly, they created a space for candid discussion of basic questions from new directors, a valuable and rare service in what can be a hierarchical society where people often prefer to save face than appear vulnerable. Although only two years old, the organisation offers a much-needed home and support to Taiwan's independent directors.

A new professionals institute

The Governance Professionals Institute Taiwan also holds large-scale events

The Governance Professionals Institute Taiwan, which is affiliated with a Big Four accounting firm, has also held some classes and large-scale seminars, inviting professionals from chartered secretary groups in Hong Kong to share their expertise. Its seminars draw a wide audience and focus on timely issues where Taiwan tends to lag, such as related-party transactions and beneficial ownership disclosure. Although the 2020 pandemic seemed to put a crimp on the Institute's activities, particularly a certificate programme, it intends to do more in 2021.

More comprehensive director training needed

More training guidance is needed

One problem plaguing the board landscape is the shortage of qualified director and independent director candidates, a situation alluded to in the perfect board example in the Listed Companies section. Potential candidates sometimes lack confidence to consider directorships because they are not able to easily plug gaps in their knowledge. Another problem is the difficulty shareholders and those tasked with finding new candidates have in assessing candidate qualifications. The existing scattershot approach to training is hampering resolution to these problems. A comprehensive and well-planned curriculum of general and specialised courses and certifications at differing levels is needed to ensure that new directors have the skills they need and to fill in gaps in knowledge or technical expertise, eg, finance for lawyers. Requiring disclosure in annual reports of each director's level of training would help, as well as their training history.

Support for improved CG has extended to a traditional industry association

Aside from these groups, many organisations have supported ESG efforts, including local chambers of commerce and business associations. Even leadership from the usually traditional Chinese National Federation of Industries has spoken out in support of improved CG efforts, while pointing out some real challenges. Organisations such as the Taiwan Business Council for Sustainable Development and Taiwan Institute for Sustainable Energy (TAISE) continue to make tangible contributions to improved sustainability among Taiwan's businesses.

A central ESG watchdog is missing

Taiwan is missing a strong ESG watchdog to hold companies accountable

One thing missing from the ecosystem is an ESG market watchdog, one that could take listed companies to task if needed. This becomes particularly apparent when reading sustainability reports, which in Taiwan must follow the GRI Core requirements. Among the strengths of the GRI system is its reference to local stakeholder concerns when a company produces its list of material issues. When reading these reports, references to environmental concerns are often vague or crowded out by issues from other stakeholders, for example employees or customers, and one is left wondering just exactly with whom the company has been speaking. An ESG watchdog would provide a much-needed vigilance function that could hold companies accountable and ensure that relevant issues were addressed.

A free media, but concerns lurk

Taiwan enjoys a high degree of press freedom, but . . .

Taiwan boasts an active media scene that is ranked among the freest in Asia, at No. 43 globally in the Reporters Without Borders World Press Freedom Index. Among markets in our survey to rank in the top 100 of that index, Australia ranked No. 26, Korea ranked No. 42, Japan ranked No. 66 and Hong Kong ranked No. 80. Coverage on CG issues tends to be fair and balanced and covers multiple views and the key points, while more nuanced opinion pieces by local experts add depth and context.

. . . pay is low and the churn rate is high . . .

Local reporters told ACGA, however, that there were two troubling features in the media landscape. First, low pay and high churn among reporters. Those with talent, particularly if they have English ability, frequently will leave the profession for something with brighter prospects. This brings limited incentive to develop enhanced reporting skills or to pursue investigative journalism, particularly as there can be the risk of predatory lawsuits. When coupled with the natural Taiwanese aversion to trouble, this results in few reporters or media organisations having the stomach to take on challenging stories even though they are perfectly free to do so and would be unlikely to face government recrimination if they did.

. . . and pay-to-play is rampant

The second concern, somehow related to the first, is on utterly rampant pay-to-play for positive news coverage. One person from the finance industry described a reporter blatantly quoting prices up front for positive coverage depending on the length of the piece. Indeed, the practice appears to be so widespread that in an extreme case even a government official in Hualien was censured for using government funds for it. While the decline of quality journalism is a worldwide phenomenon not restricted to Taiwan, one hopes something is done to address it.

Next steps

The media should confirm articles are not pay-to-play

Media platform should require a signed statement from journalists that articles are not pay-to-play and enforce strictly if that proves not to be true. Regulators may consider digital news legislation that would draw funding from social media for journalism.

More guidance on director training

Regulators and industry organisations should produce more detailed guidance and requirements for director training, and establish longer, more in-depth training programmes with clear paths of progression and requirements for passing. The Listed Entity Director Programme offered by the Singapore Institute of Directors could serve as inspiration.

Form an ESG watchdog

We support the establishment of a strong ESG watchdog group. Such a group should appear by name as a stakeholder in GRI sustainability reports and could help raise reporting standards as well as help companies think through sustainability strategies.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2022:

- ❑ No convincing action on multiple bribery cases among legislators, judges and institutional investors; evidence of lack of cooperation among government agencies on anti-corruption work
- ❑ Judicial bottlenecks that continue to impede economic crime and civil cases
- ❑ Regulatory websites that remain hard to use and fragmented
- ❑ No improvement in the Enforcement Report, such as status updates on major cases, information on prosecutions and court cases, at least five years of data, and adequate narrative explanations
- ❑ Listed companies continuing to produce formulaic CG reports
- ❑ Listed companies continuing to produce sustainability reports that do not address materiality properly, nor provide meaningful targets
- ❑ Domestic institutional investors continuing to produce formulaic stewardship reports and not disclosing voting records or company engagement
- ❑ No improvement in the legal-entity director problem

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ More narrative in the Enforcement Report and Audit Oversight Report
- ❑ Better organisation and disclosure of TWSE enforcement action
- ❑ Invest in training on narrative report writing across all segments of the ecosystem - regulators, investors, listed companies
- ❑ Further develop director training programmes
- ❑ Guidance documents for laws, especially for RPTs
- ❑ Tighten immediate disclosure requirements for RPTs
- ❑ Pass a universal whistleblowing regulation
- ❑ Establish and support an ESG non-profit watchdog

Thailand – Rules face guillotine, protests continue

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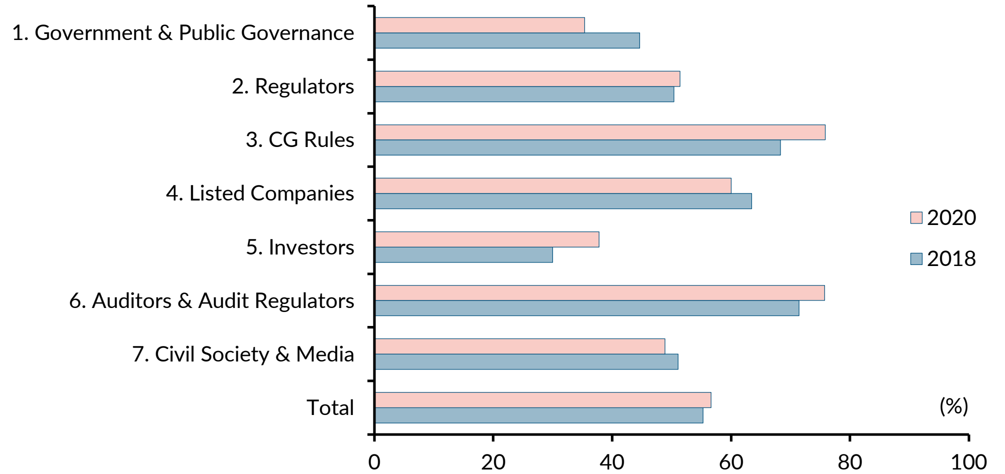
- Public governance challenges continued amid civil protests and corruption concerns
- Thailand's One Report streamlines corporate reporting and requires better disclosure of sustainability and remuneration
- The Capital Market Development Fund was finally launched to support the market and build capacity
- SEC applied regulatory guillotine to remove old laws and create efficiency
- Roles of chair and CEO were separated following new public offering rules
- Investors took strides on stewardship by signing the code and publishing policies
- Thai accounting standards reconverged with international financial reporting standards via adoption of TFRS 9 for listed companies, SOEs remained behind
- Government sought to address use of criminal defamation laws that stifle criticism and reduce corporate accountability

Figure 1

Thailand CG macro category scores (%): 2020 vs 2018



Source: ACGA

Introduction

Thailand falls to 8th place with a score of 56.6%

Thailand increased its score marginally - by 1.6 percentage points - to 56.6% in 2020, but this was below the average increase across all markets of 3 percentage points. Its rank fell by two places to 8th as both Japan and India posted bigger gains to overtake Thailand since our previous survey.

Public governance and press freedom challenges continue

A marked decline in the categories of Government & Public Governance and Civil Society & Media was driven by worsening perceptions of corruption and a continued clampdown on journalists and free speech. This creates a challenging context for ensuring corporate accountability.

Multiple small changes to the CG rulebook

On the positive side, there have been updates to the rulebook and along with our methodological changes this has created a significant boost to Thailand's score in the CG Rules category as well as an increase in rank. The Securities and Exchange Commission (SEC) moved to streamline annual corporate reporting into a new

"Form 56-1 One Report" that also brings increases in transparency on sustainability and remuneration. It also introduced the separation of roles for chairman and CEO. From January 2021, companies making public offerings must have different individuals in these roles, while under Stock Exchange of Thailand (SET) transition arrangements, companies already listed with one person as joint chairman and CEO must split the role when that individual departs.

Other markets catch up with Thai companies on disclosure

There was a small decline in the score for Listed Companies and this led to a fall in rank for this stakeholder group. Thai companies have good disclosure in some areas, such as ESG and risk, but other markets are catching up. Also, as we tightened our methodology and moved to a more automated scoring system, some areas of weakness became apparent, such as board diversity and cost reporting.

Scores improve for investors and on audit

Investors saw continued improvements driven by the adoption of the Investment Governance Code for Institutional Investors (I Code) and enhanced disclosure of policies and votes. The score for Auditors & Audit Regulators also increased partly as Thai Financial Reporting Standards (TFRS) came back into line with International Financial Reporting Standards (IFRS) after a delay in implementing the TFRS 9 standard on financial instruments.

Recapping CG Watch 2018

Some areas of concern are being addressed

There has been some progress on the issues we raised in our previous survey. On the positive side, investor engagement has strengthened, and domestic accounting standards have moved back into sync with international ones for listed companies. But press freedom remains problematic and the reimposition of lèse-majesté laws (insulting royalty) is a concern. However, the government has provided the courts more latitude to dismiss defamation lawsuits that are not made in good faith.

Climate change needs more strategic focus

Strategic sustainability issues are still not being managed well by companies. While there is relatively good disclosure, there are few targets being set and there is little attempt to adjust corporate strategy to the reality of climate change and global efforts to meet the objectives of the Paris Agreement.

Progress since 2018

Figure 2

Thailand: Recap of 2018

	Recommendations	Outcomes
1.	SET to make full history of company information available	Positive: The archive has been extended from two to five years
2.	SET to translate news, civil sanction reports and relevant public hearing documents with longer periods for making submissions	Positive: There are more public hearing summaries in English, but the primary documents and many regulations are not translated
3.	Introduce longer cooling-off periods in the definition of independent director	No change
4.	Improve remuneration disclosure, particularly for senior executives	Positive: The One Report requires more remuneration related information
5.	Address disclosure weaknesses for smaller companies	Neutral
6.	Regulators should work on material issue management, particularly for climate change	Neutral: SEC has become a TCFD supporter, but companies are not adapting their strategies, so more concrete actions and targets are needed
7.	Remove criminal charges from defamation laws	No change

Source: ACGA, ARE

1. Government & public governance

Thailand ranks 8th with a score of 35%

Thailand's score fell by 10 percentage points to 35% in 2020 while it lost its footing by one place to rank 8th. The changes in score reflected both a tightening of methodology and a range of concerns stemming from the 2019 election and the political unrest that has followed.

Thailand has less state ownership than peers . . .

Companies listed on the Stock Exchange of Thailand (SET) typically have a lower level of direct government ownership than markets such as Malaysia, Singapore, China and Indonesia. This is primarily because there was far less progress on incorporating and privatising state-run industries following the Asian financial crisis. Family-controlled businesses still dominate the large-cap indices.

. . . but many firms are under state control

While there are relatively few listed state enterprises in Thailand there are still many companies fully under state control. Many of these are held under the State Enterprise Policy Office, while some are held directly under the Ministry of Finance. The standards that these organisations must follow are often below those of listed companies. For example, the Specialised Financial Institutions that are now primarily supervised by the Bank of Thailand have much longer to implement TFRS 9 on financial instruments.

Good governance is still critical for CG progress

With political turmoil or a regime change, there is not the same upheaval in key statutory positions and appointments you might experience at government-linked companies or state enterprises in these other markets. Yet the state still plays a pivotal role in setting a CG agenda, establishing legal frameworks, and mandating regulatory reforms. And regulators need government backing, or at least an absence of interference, to be able to conduct enforcement efforts without fear or favour. Investors also rely on the government to promote a fair market and address local corruption.

There is progress despite unrest and corruption

Against the backdrop of social unrest and ongoing corruption, there are also positive areas. One is that there is increasing alignment between national economic and social development plans and capital market strategy (see the following Regulators section). Another is that the class-action law is starting to be used by investors.

From coup to election - the latest version

Recent protests are part of a much longer arc of history

Recent protests and clashes with the police, as well as a crackdown on media and dissent, present a challenging backdrop for progress on corporate governance. They are part of a long period of constitutional and political challenges for the country.

Political upheaval is ongoing since becoming a democracy . . .

Thailand has struggled to hold a stable pattern of government over the 20th and early 21st centuries. The country transitioned from an absolute monarchy with its first written constitution in 1932. Since then, there has been a series of coups, attempted coups, rebellions, and new constitutions interspersed with periods of democratic government. There is no definitive list of these changing forms of government. But the *Straits Times* newspaper cites a list of 12 successful coups (including the one in 1932), while the New Mandala, an academic blog, has the same list with the addition of a purge in 1939. The New Mandala also notes a total of eight unsuccessful coups including attempts in 1912 and 1917, while other resources refer to failed rebellions in 1933 and 1935 that are not on the New Mandala list.

. . . and there have been multiple constitutions

New constitutions frequently follow a change in government, with the result that Thailand has had 20 constitutions including the first in 1932 and various temporary charters and interim constitutions, but not counting the revisions. An article from 2017 in the English-language daily, *The Nation*, ruefully notes this has led Thailand to being one of the countries in the world with the highest number of written constitutions-it gave the other leaders as the Dominican Republic (32 since independence in 1844), Venezuela (26), Haiti (24), and Ecuador (20).

Army chief of 2014 coup became prime minister

The most recent coup was in 2014 and it set the stage for the current political scene when a military junta was installed under the leadership of then general Prayut Chan-o-cha. A new constitution was adopted in 2017, which was the governing basis for Thailand's most recent general election on 24 March 2019. A total of 77 parties participated in the election, with Prayut contesting as leader of the Palang Pracharath Party. The official results were announced after some delay on 8 May 2019 and the new parliament selected Prayut as Prime Minister on 5 June 2019.

The courts disbanded popular parties in the election

While the return to democracy was welcomed, it was marred by controversies and the election saw many procedural challenges brought before the courts. One opposition party was dissolved before the election. Then on 21 February 2020, the Future Forward Party, which was a major opposition party with strong support from young voters, was also disbanded with its executives banned from taking part in politics.

Protests followed and turned violent in 2020

The dissolution of the Future Forward Party triggered a range of protests particularly by students. There was a pause following the measures to contain the pandemic, then protests started again in July 2020 with student marches in Bangkok. Later in the year, clashes with police turned violent, media controls were put in place, and lèse-majesté laws were used to incarcerate protest leaders commenting on the role of the monarchy in the country. After a respite in December 2020 and January 2021 due to a spike in Covid-19 infections, the protests started again.

Corruption an ongoing challenge

Corruption is still a major issue and Thailand suffers in global rankings

Corruption remains a major issue in Thailand and indeed it provided legitimacy for the 2014 coup. Back in 2010, Thailand ranked 87th in Transparency International's Corruption Perceptions Index, which tracked perceived levels of public sector graft among 178 countries. The following year it ranked 88th. The rank fell to 102nd place with a score of 35 in 2013 before pivoting to a high of 76th place out of 168 countries with a score of 38 in 2015. The rank worsened sharply afterwards and the 2020 rank of 104th place out of 180 countries is Thailand's worst since the index started in 1995.

STEC bribery case illustrates the challenges

The collapse of the Sino-Thai Engineering & Construction (STEC) corruption case is symptomatic of the overall challenge. In November 2019, the National Anti-Corruption Commission (NACC) accused STEC executives of bribing state officials in relation to a construction project. The company's shares fell 20% in the aftermath of the announcement. The allegations related to a 2013 power plant construction project that STEC and Japan's Mitsubishi Hitachi Power Systems were contracted to build for a subsidiary of Thai power firm, Electricity Generating (EGCO). At the time, NACC secretary-general Voravit Sukboon said STEC executives "assisted in the wrongdoing of state officials, who demanded bribes from the Japanese company". The offence allegedly occurred in February 2015 when three ships carrying equipment were not allowed to dock at a local port. The NACC said four state officials demanded Bt20m to allow them to dock.

Graft proceedings end on a technicality

In December 2020, the NACC announced that it had decided not to pursue the case against STEC following a six to three vote by the anti-graft agency's commissioners. The reason provided was that the company had been charged under the wrong law. The firm was accused of paying bribes, a breach of Section 144 of the Criminal Code. However, the alleged wrongdoing appeared instead to be in breach of Section 149 for assisting state officials in demanding bribes. Instead of filing new charges under the different statute, as might commonly occur in other jurisdictions, the case was dropped altogether.

Investors use class actions

Investor-led class actions make a debut

Class actions became available through changes to the Civil Procedure Code of Thailand in 2015. Initially the law was used for consumer and community cases. There have been two investor class-action cases since CG Watch 2018, one in respect of shares and the other debentures, both in relation to the same failing company. In one case, Rachanee Virayavanich, an ordinary shareholder of Energy Earth, brought an action against Krungthai Bank. She sought damages following a significant drop in Energy Earth's share price after the bank terminated the company's credit facilities. The second case involved Prasit Sywanwittaya and two other debenture holders of Energy Earth, who claimed for payment of the debentures and associated interest following a default by the company. The SEC is looking to improve the availability of class actions as a remedy in consultation with a number of organisations.

Next steps

Removing criminal defamation would help with corporate accountability

Corporate governance and accountability require a free flow of information. The area of legislation that most needs work is to remove the criminal element of defamation as this has a chilling effect on the media and its efforts to hold companies to account. The government has taken some steps on this (see Civil Society & Media section for more).

SOE governance needs to improve

We believe there should be a strengthening of governance at state-linked or state-controlled companies in support of national objectives, and to encourage enhanced CG in the market.

2. Regulators

Thailand stays in 10th place with a score of 51%

Thailand's score increased by one percentage point to 51% in 2020, leaving its rank unchanged at 10th. The score is based on an average of two sub-categories: the first is Funding/Capacity Building/Regulatory Reform and the second is Enforcement. The assessment for Enforcement improved, offsetting a decline in score for Thailand's record on regulatory reform. Although Thailand ranked 8th in both sub-categories it lost places when the scores where combined. The overall score came in narrowly behind that of China, which had 52% and ranked 9th, and behind the 6th equal footing of India, Malaysia, and Korea who all scored 53%. Thailand is well ahead of the Philippines which came 11th with 27%.

SET has a limited enforcement role compared to other markets

Thailand has a different regulatory landscape than most other markets in the region. The Stock Exchange of Thailand (SET) has not demutualised and remains a non-profit entity. This theoretically reduces its commercial incentives and the potential for conflicts of interest in enforcement. However, it also has a more limited enforcement role than stock exchanges in most other markets, with limited powers. For instance, in Malaysia, the stock exchange has the power to fine for breaches of listing rules, such as delayed financial reports. In Thailand, the bulk of responsibility for enforcement and sanctions lies with the Securities and Exchange Commission (SEC).

Thailand ranks 8th with a score of 47%

2.1 Funding, capacity building, regulatory reform

Thailand's score in this sub-category, which considers the structure and funding of capital market regulation, declined by five percentage points to 47% in 2020, placing it 8th in the region-down from 7th previously. India now sits in 7th place with 51%, after a major decline since our last survey.

Less reform compared to the previous busy period

The two-year period up to the publication of CG Watch 2018 was a very busy period for reform and saw a new CG code, the first investment governance code, the introduction of civil sanctions for breaches of securities law, and changes to the audit regime for state-owned entities. Compared to this, the more recent period has seen reduced activity for updating and modernising laws and codes. Consequently, Thailand scored lower on this question.

Resources and investment

Adequate resourcing is critical for regulation

A major objective in this sub-category is to assess whether the level of resources available to securities commissions and stock exchanges is sufficient for their regulatory role. This is a challenging question to answer, especially as there is limited data provided.

The regulator has funds, but no detail on spending

The SEC has a strong financial position, with an asset base of Bt8.7 billion (US$289m) as of 31 December 2019. There has been steady growth in revenues and headcount over the years to Bt1.7 billion (US$55m) in 2019 and 645 full-time employees at the end of the same year. Over at the SET, although it makes a significant surplus every year (which in turn supports the SEC), the overall headcount has not changed recently and there are few details.

The SEC's approach to HR aims for adaptability

The SEC demonstrates an awareness and intention to prepare staff for the challenges ahead, telling us that its HR approach aims to give employees the skills and capabilities they need in an era of technological disruption and also to equip executives with coaching and facilitating skills to better connect with younger employees. While the organisations appear to have sufficient funding, there is limited data on how resources are allocated to different functions, such as enforcement or developing appropriate regulations. The lack of detailed information on expenditure on reduces our scores for these questions.

SEC's Strategic Plans

SEC strategy aligns capital market development with national planning objectives

The SEC Strategic Plan aligns and connects with critical national strategies and plans including the National Strategy, the National Economic and Social Development Plan, the Capital Market Development Plan, and the Ad-hoc Master Plan that addresses Covid-19. The 2021-2023 Strategic Plan sets out five goals and objectives. SEC Secretary-General Ruenvadee Suwanmongkol describes these as addressing "two types of current key issues, namely 1) urgent issues regarding building liquidity, recovery, and strengthening the capital market to support economic growth and competitiveness; and 2) fundamental issues regarding building reliability and resilience of the Thai capital market and robust foundation to support sustainable growth".

This places stronger emphasis on sustainability

The emphasis Thailand places on embedding the capital market strategy within national policy objectives including social development provides a more coherent framing for the role of the capital market than we see in many other jurisdictions. This is reflected in several areas in the goals of the strategic plans. Among the goals are driving capital allocation to activities considering social, environmental, and governance aspects and finding ways to have the capital market support financial inclusion such as for retirement planning and SME financing. This is consistent with a specific focus on sustainability matters in critical codes, such as the Corporate Governance Code and Investment Governance Code.

SEA changes enhance supervision and lead to Capital Market Development Fund

Modernising laws and codes

The main legislative changes since the last CG Watch were a series of amendments dated 12 March 2019 to the Securities and Exchanges Act (SEA). An SEC presentation highlights changes in the following areas:

- **Supervision of securities business:** The rules increase the powers and discretion of the SEC mainly to allow a relaxation of rules, for example so that the SEC can determine when a business is not a securities business.
- **Supervision of mutual fund management and fund voting:** Strengthening of fiduciary duties of asset management companies, including a requirement to have a conflict of interest policy, and improving voting mechanisms for changes to mutual funds.
- **Supervision of the Securities Exchange:** The changes set out or clarify various matters in relation to the SET including regulatory objectives and rules of operation; procedures for modification of rules; and rules for the composition of the SET board.
- **Enhancing competitiveness of the capital market:** Allowing broader access to the market and use of scripless systems.
- **Establishment of the Capital Market Development Fund (CMDF):** See heading below.
- **Effectiveness, clarity, and transparency of the SEC's operation:** This covers disclosure of confidential information by the SEC to allow greater cooperation with other regulators and the requirement to align the SEC's operating plan to the National Strategy and the National Economic and Social Development Plan.

Less direct CG changes this time round

There were fewer major regulatory changes with a direct bearing on CG since our last survey than in the years prior to it. The main initiatives are the introduction of the One Report to streamline reporting requirements and improve ESG disclosure, enhanced remuneration disclosure, a stronger approach to management of inside information, and the separation of the chair and CEO. These are covered in the CG Rules section.

Reducing duplication and wasted effort is an SEC priority

The One Report aligns with the SEC's "Regulatory Guillotine" project which aims to reduce bureaucratic burdens and costs on regulated individuals and entities. Under the scheme, the SEC hopes to amend regulations to shorten processes and procedures and reduce documentation requirements.

There are proposals to strengthen director accountability

The SEC proposed amendments to the Public Limited Companies Act. Under these, companies could no longer forgive directors who fail to perform duties with loyalty and due care for the company's best interests. The SEC also proposed amendments to use electronic systems for delivery of documents, proxies, and advertisements for general meetings. The securities regulator has also made recommendations to strengthen the oversight of auditors and audit firms, which will require amendments to the SEA (see Auditors & Audit Regulators section).

The Capital Market Development Fund

The CMDF is finally in operation

The Capital Market Development Fund (CMDF) was established through amendments to the SEA in 2019 after a long period of discussion over funding. The fund is a legal entity with a mandate to build infrastructure, competency, and knowledge to enhance Thailand's capital market. The fund is overseen by a nine-member Fund Committee led by the chairman of the Stock Exchange of Thailand (SET), with the Deputy Secretary General of the SEC as vice chairman. There are ex officio members from the Ministry of Finance, the Bank of Thailand and the Office of Insurance Commission, and the manager of the SET. The board of the SET appoints three further expert members to the committee.

It has ongoing funding from SET

The CMDF was established with an initial grant of Bt57 billion (US$1.8 billion) and will have an annual contribution of 90% of SET's net income after deduction of expenses, tax, and reserves. The fund will have an annual report and yearly performance evaluation that will be disclosed to the public.

The fund will develop organisations, competency, and knowledge in support of the capital market

The SEA mandates the fund to provide support in four areas within the capital market: developing organisations and infrastructure and boosting competitiveness; improving competency of personnel, including those working in supervision; furthering knowledge and understanding in how the market works among investors, the public and related agencies and organisations; and promoting education, research, training and academic work.

One funded pilot will use technology for corporate bond issuance

One prominent piece of infrastructure supported by the fund is the Distributed Ledger Technology (DLT) platform, created with the long-term goal of using digital technology for issuance, offering, trading, clearing and settlement and to streamline processes and facilitate market accessibility. The SEC introduced a pilot project using the platform in 2019 for corporate bonds.

Websites and databases

The SEC has a helpful website

The SEC has a helpful website. The English-language version includes a description of the organisation, with biographies for the key executives, the latest version of the primary legislation, summaries of all of the major aspects of regulations, a news portal, a searchable database of enforcement actions, and summaries of public hearings.

But public hearings and regulations are not always provided in English

The English version however still does not include a full explanation of public hearings and all of the regulations issued as notifications or forms from the various parts of the SEC, as we highlighted in CG Watch 2018. There are some periods of time where the news is not provided in English. The English versions of summaries, strategic plans, and rules are not always date-stamped, which can make it hard to ensure that the reader is reviewing the correct document. The regulatory search function is confusing as it is not always clear which part of the SEC has issued a rule and sometimes the header for the notification does not help the reader understand the content.

SET now hosts five years of company announcements, up from two

The website of the SET includes useful summaries of the various rules in English. It is a strong positive that the news archive for company announcements has been extended from two years to five years. The next step is to improve search functionality within the news archive which has become more important now that there is a longer back history.

Technology

Check First app allows investors to check product providers are approved

The SEC has strengthened its adoption of technology. In August 2019, the regulator launched a mobile app called Check First aimed at boosting investor protection. Users can search for products, individuals or legal entities approved to operate in the capital market. It also offers a way to send inquiries and to search for unlicensed operators on the Investor Alert system.

The SEC introduces its first digital strategic plan

In July 2020, the SEC introduced the Capital Market Digital Strategic Plan 2020-2022, its first such blueprint to support and promote the development of innovation and utilisation of digital technology. The plan is aligned with the SEC's strategic plan over the same timeframe as well as national development plans. There are seven steps:

- **Open data:** strengthening the collection and provision of information, for example for mutual funds;
- **Artificial intelligence and machine learning**: which looks to strengthen investment and risk analysis and the provision of advice;
- **Crowd empowerment:** primarily crowdfunding, with an emphasis on funding for SMEs;
- **Distributed ledger technology:** (see above on CMDF);
- **Cyber resilience:** addressing cyber-related risks;
- **Data protection:** in line with the Personal Data Protection Act; and
- **RegTech and SupTech:** improving regulatory and supervisory functions including electronic Know Your Client (KYC) and linking to the National Digital ID Project.

The stock exchange has been active in applying technology

The SET has also been active in applying technology and earned an additional point in this year's scoring. Among the developments outlined in its recent annual reports are:

- Developing a robo-surveillance system to enhance efficiency of trading supervision and surveillance;
- Digitising processes and boosting digital infrastructure;
- Linking the capital market with the national digital ID system to improve the system for verifying identity;
- Expanding the number of systems covered by ISO27001 cybersecurity standards, including trading surveillance, securities clearing, and central securities depository; and
- Incorporating big data for investor behaviour analysis and to detect irregularities.

Next steps

Take stronger steps to address climate change

The SEC has become a supporter of the Task Force on Climate-related Financial Disclosures (TCFD). However, the capital markets need to go far further to support Thailand to transition to a low carbon economy in line with the Paris Agreement and to address the physical risks from climate change. Companies are not yet demonstrating how they are adjusting their strategy and generally present very few relevant targets. There needs to be much stronger steps to rise to the level of the challenge. Thailand will need to better understand its decarbonisation pathways and physical risks. One solution is for domestic research support with a much more integrated analysis of climate change risks and strategic responses by companies. There may be benefit in allocating funds from the CMDF to support the required research.

Extend stewardship to other asset classes and enhance ESG reporting requirements and to REITs

The SEC could also facilitate investors to apply investment governance or responsible investment principles in other asset classes, such as bonds, real estate, and infrastructure. One specific area is to extend ESG reporting requirements to REITs.

Enhance search function for rules

The SEC could take steps to make searching for rules easier. Sometimes key rules are not translated and cannot be found using the English version of the search function. The rules themselves do not always make clear what substantive points are covered in the document. While there are English summaries of public hearings, the actual text of proposed rule changes is typically not provided.

Thailand's response to Covid: Tolerance

Thailand allowed wider relief to issuers than other markets

The response to Covid-19 for issuers in Thailand was generous. As with other markets, delays on reporting and the holding of meetings were allowed, and steps were taken to help companies host virtual AGMs. But Thailand went further and offered companies respite in the form of a postponement of income tax returns, and a waiver or reduction on annual registration fees.

Virtual meetings receive the green light

As Covid began to spread around the region in early March 2020, Thailand's Securities and Exchange Commission (SEC) started to discuss alternative AGM arrangements with the government and the Stock Exchange of Thailand (SET). By 25 March, with social distancing orders in place, a set of measures was introduced for issuers: AGMs could be postponed while virtual meetings were permitted, and financial reporting deadlines were extended. However, it was not until mid-April that issuers had clear guidelines on how a 2014 set of rules for conducting electronic meetings would work in practice.

Delays and extended deadlines

Issuers allowed to postpone AGMs without seeking approval, while e-meeting rules updated

By 30 March 2020, issuers in Thailand were able to postpone AGMs without approval from regulators but were required to send a letter to the Ministry of Commerce to give reasons for the delay. But rules on electronic meetings introduced in 2014 needed some revision: the Announcement of the National Council for Peace and Order dated 27 June 2014, which governed the holding of electronic meetings, required that at least a third of the quorum required for the meeting be physically in the same place, and that all participants be in Thailand. The Thai government removed these requirements on 18 April 2020. Meanwhile the Ministry of Digital Economy and Society on 26 May 2020 set out procedures for electronic meetings, notably requiring that attendees be able to vote.

Financial reporting and continuous disclosure

Issuers allowed to postpone audited financials, but had to make a written request

As with AGMs, issuers were able to postpone submission of financial statements -as well as income tax returns. The SEC gave its first extension for financial statements on 21 February 2020: issuers had an additional 90 days, if they put in a written request to the regulator. The SET, meanwhile, put a moratorium on suspensions for delayed financial statement filings. Similarly, if an auditor gave a disclaimer of opinion due to Covid, the exchange would not issue a notice pending statement, as long as the company made disclosure.

Issuers also given more time to file tax returns

The Ministry of Finance in April 2020 also extended the deadline for annual corporate income tax filing, originally due between April and August 2020, until 31 August 2020 for all corporations.

Continuous disclosure is encouraged

The SEC encouraged issuers on 14 May 2020 to keep shareholders abreast of any Covid effects on their bottom line. It also gave guidelines on information that should be continuously disclosed.

Other forms of support

Issuers get a registration fee cut or waiver

Issuers were informed by the SEC on 15 April 2020 that they were in line for a rate cut on their annual registration statement fee for 2020. The annual levy was waived for small caps and issuers of debentures, derivative warrants, and REITs. Medium- and large-caps received a 30% reduction.

2.2 Enforcement

Thailand in joint 8th place with a score of 56%

Thailand ranks joint 8th with India in this sub-category on a score of 56%, which represents an increase of seven percentage points since 2018. Thailand pulled ahead of Malaysia to catch up with India as both of those markets experienced moderate declines.

Civil sanctions, inter-agency cooperation increases

Thailand's performance held steady for most questions, although there were a couple of bumps in score, the largest of which was in relation to regulator powers due to the fuller implementation of the Securities and Exchange Commission's (SEC) ability to impose civil sanctions. The score also benefited from changes in methodology. The market also saw a small increase in score for support from other agencies with the signing of multiple inter-agency agreements.

Disclosure delights . . .

Regulator profiles show just who is doing the SEC's work

The SEC website has some real strengths, particularly around enforcement. First there are helpful profiles on its leadership, including the CVs and education backgrounds of many of the regulators. This aids transparency and trust and could serve as a model for other markets.

SEC website provides historical enforcement information

Another strength is the enforcement section. There is an extensive history of enforcement cases across all types of action (criminal, civil and administrative) and a search function that allows users to quickly and easily find information on individuals, particular companies, and types of misbehaviour. It also provides comprehensive summary statistics. This may also serve as a model for other markets. One possible addition would be to make the information downloadable into a useful information format, such as a CSV or Excel file to allow for analysis.

Details on cases are lacking and there is little explanation of figures

There are however some weaknesses. The main issue is the lack of a narrative explaining the statistics and trends in enforcement activity. This means it is not possible to tell whether the enforcement regime is serving its intended purpose or what the regulator's enforcement philosophy may be. Another weak area is the lack of detail provided on each of the cases. These gaps made it difficult for us to award points on the evolution of the regulators' approach to enforcement.

SEC civil sanctions powers mature

Civil sanctions powers date back to 2016

As outlined in CG Watch 2018, the SEC in December 2016 was given the power to pursue civil sanctions, namely penalties against offenders ahead or instead of, criminal action. It can also pursue sanctions through the civil procedure when parties refuse to pay a criminal penalty. The reforms also strengthened the definitions of market misconduct offences.

The powers provide for a range of penalties

Among the offences covered by this power are cases of unfair securities trading, making false statements/concealing information, failing to perform duties as a director, and using a trading account in another person's name to conceal an identity. Penalties include a fine, disgorgement of profit, a trading ban of up to five years, a prohibition on acting as a director or executive in a securities company for up to 10 years and the reimbursement of investigation expenses incurred by the SEC.

The powers have been used consistently

Civil sanctions have been used primarily for insider trading and market manipulation since their introduction, according to SEC enforcement figures. There were six civil cases in 2020 involving 13 persons and 12 cases in 2019 where 83 individuals were sanctioned. In 2020, five of the six cases related to insider trading, with just one for market manipulation. A total of Bt36m in penalties were imposed in 2020. In 2019, seven of the 12 cases related to market manipulation and the remaining five were in respect of insider trading. A total of 83 individuals were sanctioned in 2019, with fines totalling Bt803m. In 2018 penalties amounted to Bt317m with 135 persons sanctioned in 20 cases: eight related to insider trading, 10 were in respect of market manipulation and there was a civil sanction case for making a false statement and another for failure to exercise a duty of care. In 2017, eight of the 10 cases related to insider trading. A total of 27 individuals faced sanctions of Bt34m.

Internal restructuring at the SEC aims to enhance supervision

The SEC has undergone internal restructuring to enhance the function of its supervising divisions. Changes include implementing risk-based monitoring and reviews; and developing supervision of groups of companies where relationships may create conflicts of interest.

Other developments

Proposed revisions to SEA include broader witness protection

The SEC now has a broader range of tools with civil sanctions being added to criminal penalties. Proposed revisions to the SEA unveiled in October 2020 aim to and enhance the regulator's authority to conduct investigations. The proposed revisions also include extending existing witness protection measures to SEC investigations.

Changes in SET board composition and internal rules beef up SEC oversight

There have been some modest changes to enhance SEC supervision of SET. From April 2019, the terms of SET board members have been extended from two years to three years to ensure continuity of operation. The board ratio is now four SET members to six SEC members. In addition, when issuing, revising, or modifying its rules and regulations, the SET must conduct a hearing session with member securities companies, investors or stakeholders and the changes must be approved by the SEC Board.

Inter-agency agreements aim to strengthen the SEC's hand

There are also new agreements to boost cooperation with other enforcement agencies including: the Legal Execution Department, the Office of the Attorney General, the Central Institute of Forensic Science, the Anti-Money Laundering Office, and the Department of Special Investigation. However, there is as yet no agreement with the National Anti-Corruption Commission.

SET's new alert call goes into action

SET enforcement is mostly limited to warning alerts

The SET has surveillance powers and can issue a narrow range of pre-defined alerts where there are suspicious transactions, or where the company has a poor financial position. These include "H" ("halt"), "SP" ("suspension") and "NP" ("notice pending") warnings, which serve essentially as criticisms. From July 2018, the exchange introduced the new warning sign, "C" for "caution", which is to be used in the following circumstances:

- **Financial position**
  - Shareholders' equity is less than 50% of paid-up capital;
  - Regulator order to rectify financial position or operating result; and
  - Court order accepting a petition for reorganisation of the debtor's business.

❑ **Quarterly/Annual financial position**

- Court order accepting the petition in a bankruptcy action;
- Auditor disclaimer due to scope limitation by the company;
- SEC notification to rectify financial statements; and
- SEC notification to arrange a special audit.

❑ **Business type**

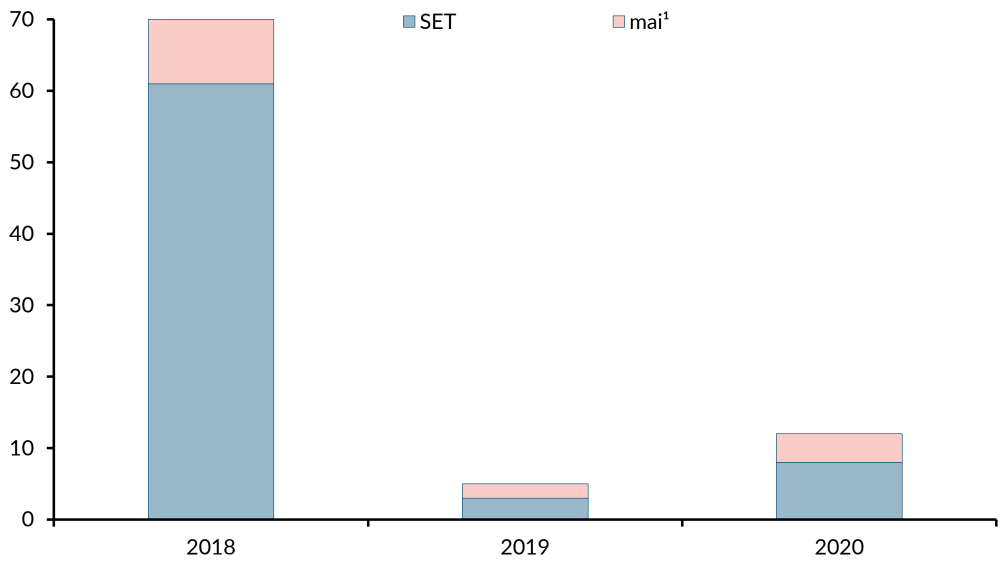
- The listed company is a cash company.

The new "C" sign is widely used since introduction in 2018

The figure below shows the number of times the SET added a new company to the list of companies with a "C" warning since it launched the alerts. The SET provides information on the reasons each company is in breach and this is also searchable through its website. We note that several companies have had warnings posted in multiple years. Consequently, it would be helpful for the SET to undertake an assessment of the effectiveness of its sanction mechanism. This should consider both repeat offenders and whether the mechanism discourages other companies from breaching safeguards.

Figure 3

Posting of Caution ("C") signs by SET and mai



[1] "mai" refers to Market for Alternative Investment board, founded by SET. Source: SET

Next steps

Narrative explanations of statistics would help

A greater narrative to explain enforcement statistics would help investors and others better understand the nature and effectiveness of the SEC's action and approach. Also, there could be more detail on enforcement cases.

Broader witness protection to support investigations

The extension of the witness protection programme to investigations and civil sanction cases would help with information gathering.

3. CG rules

Thailand ranks 3rd with a score of 76%

Thailand's score increased by eight percentage points to 76% in 2020, boosting its rank by one place to 3rd. Overall, scores in this category increased by an average of five percentage points across the 12 markets covered, primarily due to changes in methodology, which involved a more granular assessment. Previously, Singapore and Thailand ranked equal, but Singapore's score increase was lower as it removed quarterly reporting requirements, allowing Thailand to pull ahead. Thailand remains behind Australia and Malaysia.

The basic rulebook is strong

As suggested by its high ranking, Thailand already boasts a strong rulebook, receiving full marks in both 2018 and 2020 in areas such as financial (and in 2020, quarterly) reporting, related-party transaction disclosure, voting by poll, stewardship code, disqualifying directors convicted of fraud, and allowing collective engagement. It also earns high scores for price-sensitive information disclosure and the timing of AGM materials.

New regulations

Smaller steps in recent years

The pace of reform has slowed since CG Watch 2018 when we wrote of Thailand's new CG Code and Investment Governance Code for Institutional Investors (I Code). Nevertheless, there have been several incremental steps forward, including:

- **One Report:** The SEC has introduced the "Form 56-1 One Report" to streamline corporate reporting in Thailand. Previously Thai companies had to provide the annual information form 56-1 to the SEC while the annual report was covered under the requirements for form 56-2. There was significant overlap between the two reports, with some information only available in 56-1, which was often only produced in Thai. This new initiative combines disclosure to the SEC and investors into one form; hence it is known as the One Report. The new specifications also strengthen requirements in some areas, such as approach to sustainable business, remuneration, and insider trading controls.
- **Remuneration disclosure:** The SEC strengthened disclosure relating to remuneration through amendments effective from 1 April 2019 to the annual report, now the One Report, and to the registration form. Companies must now disclose director and executive remuneration policies and methodology, with the structure of each type of remuneration (ie, fixed and variable components of pay). The remuneration committee should also give its opinion on whether the structure incentivises behaviour in line with the company's short- and long-term goals.
- **Blackout period:** The One Report includes a stronger provision on disclosure of internal controls relating to insider trading. Companies will have to disclose insider trading policies and practices, including blackout periods, to ensure inside information is not used for personal benefit. There should also be a monitoring report covering the outcomes of the policies and practices. These steps will apply for annual reports submitted in 2022.
- **Separation of chair and CEO:** The SEC introduced a requirement for all public offerings that the roles of chairman and CEO should not be combined. The rule is embedded into relevant notifications from the SEC's Capital Market Supervisory Board and implemented through a change in SET listing rules. The rule came into force on 1 January 2021.

Where Thailand waned

Scores are low for informing market on changes in controlling shareholders and director holdings

Scores remained low in 2020 in a few areas including the following:

- **Changes in substantial shareholders:** Substantial shareholders are required to notify the SEC when a holding reaches 5% of the total voting rights of the company and when it moves through a multiple of 5%. The disclosure must be made three business days after the change in registration. In ACGA's view, the requirements are limited. We awarded full points only to markets that require disclosure each time voting rights cross a 1% increment above the initial 5% and require reporting at least three business days from trade date, not from the settlement date. This ensures that market participants can act in an informed manner when a substantial shareholder increases its level of control in a listed company.
- **Changes in director holdings:** For directors and executives the disclosure requirement in Thailand for changes in shareholding is "within seven working days from the date of purchase, sale, transfer or acceptance of transfer of securities". We view this as a long disclosure period and only gave full marks where the rule required disclosure within three business days of the trading date. In other words, reporting should be tied to the trading timeline, not the settlement timeline.
- **Disclosure of share pledges:** Currently there is no requirement to inform the market where shares are pledged as collateral for a debt obligation. This could give rise to situations where a party takes possession of a significant stake as payment for a debt, leading to a change of control or leading to a stock overhang if the party then wishes to sell the shares.
- **Definition of independent director:** The current definition of independent director provides a cooling-off period of two years for former executives and former advisors. ACGA only gave full marks where markets have a five-year cooling-off period. In contrast, this has recently been extended to three years in Malaysia. In Malaysia there is also a subjective test: in assessing independence, even if a director passes the specific disqualifications, the board "must still apply the test of whether the said director is able to exercise independent judgment and act in the best interests of the applicant or listed issuer as set out in the said definition". Also, minorities are given a stronger voice in the assessment of independence for Malaysian companies where directors have been on the board for a long time.

Next steps

There is much further to go to address climate change risks and opportunities

Thailand could go further in addressing the strategic implications of climate change. Although Thailand is a regional leader for the sustainability reporting of its companies, the discussions are rarely strategic and there are few targets. The SEC could include sector specific reporting requirements, introduce mandatory reporting for some KPIs, and strengthen the emphasis on the strategic implications of climate change. REITs should also have a stronger ESG disclosure regime.

Make regulatory searches easier

Make the SEC regulatory search function easier to use. Further, many notifications and rules are not available in the English version of the search. It is hard to identify changes to the rules, particularly if either the new or the old version of a notification or form is not available in English.

Faster disclosure of changes to insider shareholdings would help

Core disclosure changes would be welcome, such as faster provision of information to the market on changes in holdings by directors and by controlling or substantial shareholders. Also, there could be improvements to the autonomy of independent directors by introducing stricter definitions and giving minority investors a greater say.

4. Listed companies

Our company survey is a collaboration with ARE

Our company survey in CG Watch 2020 aimed to be as objective as possible and was focussed on publicly available information from 15 selected large-caps and 10 mid-caps for the 2019 calendar year (or financial years starting in 2019). Undertaken in collaboration with Asia Research & Engagement (ARE), an ACGA partner organisation based in Singapore, the survey comprised 16 high-level questions with 51 sub-questions for large-caps, and four high-level questions with 25 sub-questions for mid-caps. The aggregate scores for the high-level questions can be found in Appendix 2.

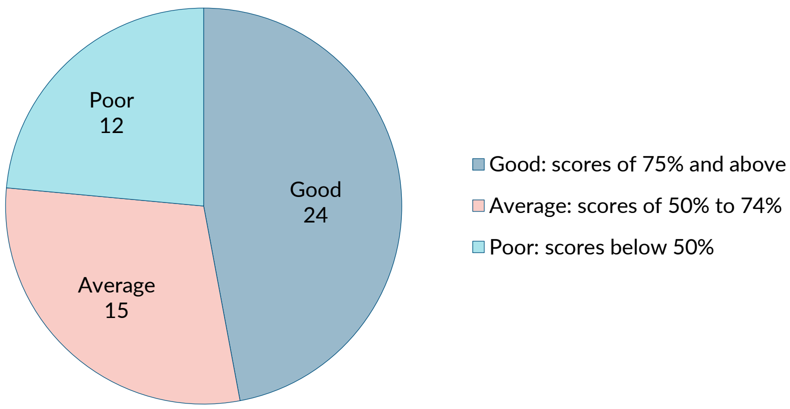
Thai companies rank 5th with a score of 60%

Thailand's score for this category declined slightly by three percentage points to 60% in 2020 and its rank dropped from equal 2nd with Singapore in 2018 to a less impressive 5th place. There are notable positives in terms of disclosure from Thai companies, such as for risks and for ESG, and there have been some improvements. Nevertheless, the scores declined in several areas where we tightened the methodology and adopted more automated scoring. Our aggregate results showed that large-caps performed well in 24 of 51 questions, averagely in 15 and poorly in 12 (see the Figure below).

Large-caps performed well in half of our questions

Figure 4

Thailand: Large-cap aggregate results for CG performance (51 questions), 2020



Source: ACGA, ARE

Scores changed in line with other markets

Factors where scores decreased on average in Thailand and across all the markets included: the assessment of financial disclosure for large and mid-cap stocks; the assessment of small and mid-cap ESG disclosure; the score for board diversity; the credentials of directors serving on audit committees; and the assessment of internal control and risk management processes. Similarly, the rating for Thai companies improved along with the average across all markets for: the assessment of timely disclosure by mid- and small-cap companies; disclosure of director training; presence of lead independent directors; assessments of remuneration; and the presence of anti-corruption policies.

But India, Taiwan, and Malaysia pulled ahead

The small decline in Thailand's score led to a large decline in rank as markets such as India, Taiwan, and Malaysia saw improvements in corporate disclosure, while Thai corporate disclosure did not improve enough to offset the negative scoring adjustments. We hope to see Thai companies improve in future following the One Report initiative, which consolidates into one report the disclosure requirements to the SEC through the form 56-1 with the requirements for annual reporting to shareholders.

Where Thailand does well

General meeting circulars are readily available ahead of AGMs

Annual reports and company announcements are readily available for SET-listed companies through company websites while the SET only provides a limited history. All 15 large-caps provided up-to-date information on substantial shareholders, although three of these presented nominee names with no detail of the underlying owners. In addition, companies provide director attendance details and AGM circulars typically provide relevant information in advance of meetings: 13 of the 15 large-caps provided detailed voting results with records of investor discussions.

Risk disclosure is a notable positive

There is good disclosure of most critical balance sheet items including details for trade receivables and payables and different types of debt. Thai companies continue to provide risk reporting that in many cases includes risks that are specific to the company with specific remedies, rather than generic risks such as changes in foreign exchange or interest rates.

Policies on whistleblowing and public codes of conduct are extensive

Company policy disclosures to address corruption are broadly positive. These have been spurred through corporate initiatives, most notably the Private Sector Collective Action Against Corruption (CAC). Nine of the 15 Thai companies provided detailed whistleblowing policies, five provided less specific policies, and only one did not provide a public policy on whistleblowing. And when it comes to codes of conduct, 14 of the large-caps provided a public code of conduct, seven of which extended it to suppliers, and only one of the large-caps did not provide a code.

Where Thailand performs averagely

ESG disclosure is better than many other markets, but not sufficient to meet sustainability challenge

Thai companies are generally better than companies from other markets at providing ESG disclosure and have performed well in international ratings. But our assessment still shows that companies are not acting in a manner commensurate to the challenge of addressing sustainability issues. For example, when it came to stakeholder engagement, 12 companies referred to communications with different groups, but the disclosure was generic and not specific to the year. Thai companies typically provide lists of material ESG issues, yet only two of the 15 large-caps set out how the issues were determined with limited linkage to business strategy. Most companies discussed their approach to managing issues and most provided comprehensive metrics to track their progress. However, few companies provided targets for addressing issues.

Disclosure on training and board evaluations are detailed, but not always linked to each other

Thai companies typically provide corporate governance and board committee reports. These typically cover standing items and terms of reference but provide little information that is specific and substantive for the reporting year. There are some distinctive positive features of Thai CG reporting, including specific disclosure relating to director training: companies provide induction and ongoing training to executive and non-executive directors with most of the 15 large-caps disclosing training details by director. Furthermore, board evaluation reports extend to giving scores for each thematic area assessed. However, only one of the 15 large-caps specified an action plan from its board evaluations to review CG principles. It would be helpful to understand more about actions taken following a board evaluation.

There is little information on the structure of senior management pay

Although disclosure on the remuneration of board directors is good, there is little information about pay for senior management, especially where the individuals are not on the board. One common feature of fee structures for non-executive directors in Thailand is a variable component linked to the size of the dividend. We are concerned that this could provide a distorting incentive for independent directors, particularly where it may be necessary to make a significant adjustment to the dividend for a particular year. On the other hand, the structure does provide some alignment of interests with shareholders and is generally less problematic than providing options to independent directors.

Where Thailand does poorly

Companies provide limited IR contact information

Thai companies still have further to go in terms of the provision of basic contact information. From the 15 larger companies, seven only provided generic IR contacts, making it harder for investors to reach out to listed businesses. While many MD&As are detailed, there are gaps in the background and operating context including the breakdown of operating costs and in the rationale for mergers, divestments, or acquisitions, both of which scored poorly for Thai large-caps.

Thai companies need to strengthen board composition

Thai companies should take steps to strengthen their approach to board composition, both to ensure appropriate independence and an appropriate mix of skills. There is a need for greater independent representation on the board at senior levels to reassure investors that decisions reflect their interests and to provide for an appropriate channel to raise concerns. Out of the 15 large-caps, six had chairmen designated as "independent", although three had been in the role for 12 years or more. Of the remaining nine companies, four had a lead independent director and five did not.

None of the 15 large caps have plans to improve board diversity or skills

Although some companies mention board diversity in their reporting, none of the 15 disclosed any plans for improvement. Only four companies provided a list of skills for each director and another four disclosed skills in director biographies. However, none of the Thai companies showed whether and how director skills and experience matched the needs of the board in overseeing business strategy. Nomination committees should be more structured in their thinking. Furthermore, we noted that there were only three companies for which it was clear that most of the audit committee had financial management or accounting expertise.

Strategic thinking on sustainability is lacking

The boards of Thai companies will also need to strengthen their approach to understanding the strategic implications of sustainability issues. It does not make sense to identify the issues as material in the sustainability report and then ignore them when formulating the business strategy or identifying significant risks. One enabling step is to ensure that the board strengthens its approach by appointing a committee with a specific remit and terms of reference to address sustainability. Another important step is to ensure that the nomination committee factors in experience in managing sustainability as a requirement for new board appointments.

Where Thai companies could improve

Figure 5

Helicopter view: Rating Thailand's CG disclosure and governance, 2020

Good	Average	Poor
❑ Company announcements readily available ❑ Ownership data typically available ❑ Detailed director attendance statistics ❑ Relevant information in AGM circulars with records of investor discussion ❑ Detailed disclosure of balance sheets items: trade receivables and payables, and loans ❑ Informative risk reporting ❑ Policies on whistleblowing and gifts, but could extend codes of conduct to suppliers ❑ Specific disclosure relating to director training	❑ Companies do not provide named IR contacts ❑ Many useful MD&As but sometimes brief or miss important information ❑ Details on ESG approach with performance metrics for material issues, but limited discussion on materiality process ❑ Committee reporting generally not specific to year ❑ Scoring often provided by theme for board evaluations, but reporting could be improved ❑ Good disclosure of director remuneration, but little for senior management	❑ Limited breakdown of operating costs ❑ Little discussion for mergers, divestments or acquisitions ❑ Few independent chairs, otherwise often without a lead INED ❑ Very few companies provide a board skills matrix and none linked to business needs ❑ Audit committees lack financial expertise ❑ Few companies provide targets for material ESG issues

Source: ACGA, ARE

Next steps

Key advocacy suggestions for listed companies in Thailand

Key advocacy points following on from the above discussion include:

Quick wins

- ❑ Disclosure of beneficial owners
- ❑ Extend public codes of conduct to suppliers
- ❑ Provide IR contacts
- ❑ Provide information on corporate actions including M&A and divestments
- ❑ Better disclosure on operating costs with minimal aggregation of "other expenses"; if the latter are aggregated, they should be explained
- ❑ Strengthen committee reporting to cover substantive discussions during the year
- ❑ Provide further information on results of board evaluations
- ❑ Remuneration disclosure should cover the structure of incentive packages for senior management
- ❑ Produce skills matrices for board directors and link skills to business

Medium to long-term challenges

- ❑ Proactive shareholder and stakeholder engagement
- ❑ ESG/sustainability reports to include substantive discussion of the materiality process and set meaningful quantifiable targets that are commensurate with challenges
- ❑ Nomination committees should strengthen assessments of board skills and experience requirements and include climate change/sustainability as part of the required mix
- ❑ Boards should continue to strengthen independence, disclosing appropriate policies and seeking independent chairman or ensuring that lead independent directors have no relationships with management

AGMs during the pandemic: Keeping it (mostly) physical

Public-gathering limits forced a rethink on AGM venues

By mid-March 2020 issuers who had already announced AGMs for the following month were scrambling to find alternative meeting venues as decrees were put in place limiting public gatherings. Judging by stock exchange filings, many firms shifted meetings back to their offices and invited shareholders to grant proxies to independent directors, as recommended by the SEC.

Electronic meetings hinge on issuer articles

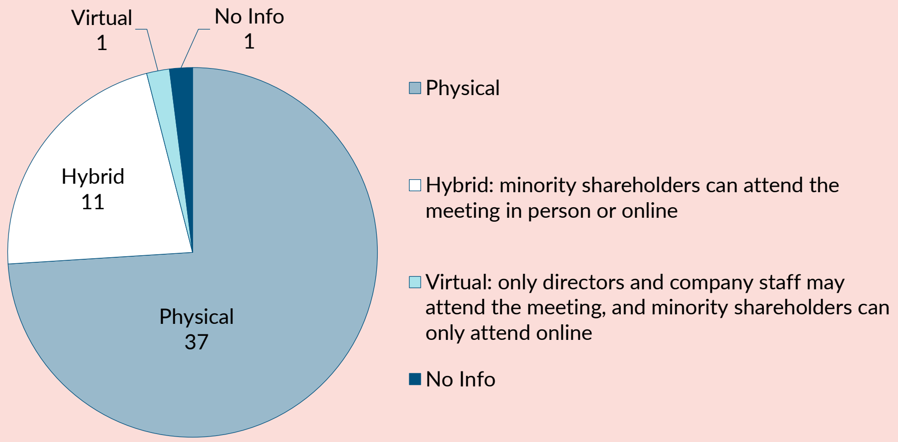
Under existing rules, Thai companies can hold electronic shareholder meetings if their articles of association allow for them. AGMs can be broadcast, and shareholders may submit questions in advance. The answers in turn are recorded in detailed meeting minutes (one of the strengths of the Thai AGM system). It has been common in the past for foreign shareholders to vote by proxy through Thai custodians, while the SEC encouraged shareholders to vote either online or by proxy.

But most large caps held physical meetings in 2020

While hybrid and virtual meetings are permitted in Thailand, ACGA found that more than 70% of the AGMs of the top-50 public companies by market value were physical events (37 meetings), as the figure below shows. Of the remainder, 22% were hybrid (11 meetings), one was virtual, and one had yet to disclose information on its 2020 AGM even as late as March 2021.

Figure 6

AGM modes in Thailand: Top 50 issuers by market cap, 2020



Source: Company websites, ACGA analysis

Most physical AGMs took place in June/July 2020

Of the 37 physical meetings, only one was held before the pandemic took hold - Airports of Thailand on 30 January 2020. The others took place between April and August, with most in June and July. AGM notices did refer to seating limitations and precautionary measures.

Hybrid AGMs via websites

Of the 11 companies that conducted hybrid meetings, these were mostly held via live transmissions on company websites. Shareholders who could not attend were encouraged to vote by proxy.

More SMEs hold virtual meetings than large caps

According to the Thai Investors Association, 26 small- and mid-caps hosted virtual or hybrid meetings in 2020. But among Thailand's top-50, Total Access Communication was the only one to hold a virtual meeting. Its AGM provided capacity for up to 3,000 attendees, comfortably exceeding the actual 963 shareholders who attended via electronic devices in-person and by proxy. Questions and comments could be submitted in advance or on the day. While Thailand does have e-voting systems, service providers must be certified by the Ministry of Digital Economy and Society and the number of shareholders they are capable of servicing is not large.

5. Investors

Thailand ranks equal 7th with a score of 38%

Thailand's score in the Investor category rose by eight percentage points to 38% in 2020. This was enough to catch up to Taiwan, resulting in both markets ranking equal 7th. The increase in score reflects both genuine improvements in investor practices and adjustments due to changes in our research and scoring methodology.

Stewardship code adoption spurs investor policies, vote disclosure

The main improvement came from widespread adoption by domestic investors of the local version of the stewardship code, known as the Investment Governance Code for Institutional Investors (I Code). This has also resulted in disclosure of related policies and voting disclosure by many institutional investors.

Limited state involvement in the public-equity market

Few government-linked investment companies

The institutional investor landscape in Thailand features many asset managers linked to financial groups, but with less involvement by state-linked investment vehicles than in neighbouring markets. This is because of differences in the evolution of state holding companies and because the pension system has a different structure in Thailand.

Many state industries are still fully state-owned

The stock exchanges of Indonesia, Malaysia, and Singapore have numerous national champions with high levels of state ownership. In Thailand, the State Enterprise Policy Office (SEPO) owns many assets outright, in contrast to Temasek in Singapore and Khazanah in Malaysia that retain controlling stakes in many companies where a sizeable proportion, sometimes a majority, of shares are listed on the local exchange.

There are only two major pension and social security asset owners

There are two main state-linked institutions with significant holdings in the Thai market. The Social Security Office of Thailand (SSO) administers funds to provide social security and compensation for workers, while the Government Pension Fund (GPF) administers the pension for civil servants. Private-sector pensions are provided through employer-based provident funds, which typically outsource the fund management to an external asset manager. There are multiple insurance providers and asset managers, with many of the asset management houses part of larger financial groups.

Stewardship code detailed and widely applied

Stewardship code now has 71 signatories

The market has seen continued improvement in stewardship efforts. For domestic firms the driver has been adoption and implementation of the I Code, which was launched in February 2017. SEC-regulated entities must sign the I Code or explain why they have not. This has led to broad adoption and there are now 71 signatories compared to 53 when we wrote CG Watch 2018. The increases have been due to more securities firms and provident funds, particularly organisations with strong links to the state, signing up.

I Code is detailed, specific and strong on ESG

The I Code is clearly written, and its principles are very specific in some cases. It is one of the strongest codes in the region in relation to ESG. Signatories must follow the code on a "comply or explain" basis and provide a report on their websites how they have applied each principle of the code. The code also specifies disclosure of voting policy and voting results to clients, but not to the public.

Asset owners stepping up

GPF has adopted a leadership position on ESG

The GPF has taken deliberate steps to provide leadership on ESG for the investment industry in Thailand. Disclosure on the Thai version of its website includes its Investment Governance Policy, Voting guidelines, Responsible Investment Policy, Guidelines for its ESG Focus Fund, a list of companies that meet the Focus Fund criteria, the criteria for institutional investors to place a company on the negative list, and its 2019 ESG Report. The GPF has also disclosed policies to prevent corruption and address potential conflicts of interest.

GPF and AIMC members engaged with Jasmine International on insider trading controls

The fund provides two examples of actions taken in line with the rest of industry. One is the collaborative engagement organised with the Association of Investment Management Companies (AIMC), the lead local investment industry body, to strengthen internal controls relating to inside information at Jasmine International, a listed company providing telecommunication services. This followed an insider trading case at the company resulting in civil sanctions and the resignation of its CEO. In the other case, investors restricted purchases of Sino-Thai Engineering & Construction as it was placed on the negative list while it faced allegations of bribing state officials (see Government & Public Governance section above).

GPF has moved forward since 2018, but could go further on climate change and voting disclosure

The GPF's overall approach shows a strong step forward in terms of responsible investment ambition since CG Watch 2018. Areas that could be strengthened include disclosure of the reasons for voting against resolutions at individual companies and setting out a statement on climate change. Given the significance of the climate issue and the international adoption of the Task Force on Climate-related Financial Disclosures (TCFD), it would make sense for GPF to become a supporter of TCFD and develop an overall position on climate change, thereby strengthening the fund's emphasis on proactive and positive engagement. Furthermore, GPF's approach is based primarily on equity holdings, whereas ESG integration and active ownership can cover other asset classes such as fixed income, real estate, and infrastructure investment.

The SSO website now includes an Investment Governance section

The SSO has a section of its Thai website on Investment Governance that includes downloads of its declaration of compliance with the I Code, its Investment Governance Policy, voting guidelines, and summaries of voting results for 2018, 2019 and 2020. The Investment Governance Policy mainly covers internal arrangements, but includes principles in relation to voting policy and monitoring and analysis of investee company ESG performance. The voting summaries provide numbers of against votes broken down by the type of resolution, but do not show the names of the shares at which there were against votes.

The SSO could also provide more detailed voting disclosure and step up on climate change

The SSO's public documentation shows a marked increase in the level of disclosure compared to previous years. The next steps include providing voting disclosure for the individual companies, which is common across the market. Also, the SSO could go much further in relation to ESG. At a minimum this should be in line with its mandate, for instance exercising strong stewardship with companies that have low standards of health and safety. It should also take a view on the effects of climate change to its portfolio and build this analysis into its investment and engagement strategies.

Asset managers finding their voice

Most asset managers provide voting records

Thai asset managers have also been strengthening their approach to stewardship, basing their activity on the principles of the I Code. We reviewed the disclosure of 13 domestic asset managers selected mainly by size. All of them had signed the I Code and 12 provided related information based on its principles. Many of the firms disclosed guidelines for how they vote. Nine of the asset managers published voting records and one gave only a summary of voting but not the details. Some firms produced specific ESG policies in addition to policies for investment governance.

Many asset managers have policies on conflicts of interest and graft

Many of the leading asset managers are associated with large financial groups, including banks. Some run listed REITs which creates the potential for a conflict of interest. The I Code has specific principles relating to this and some of the asset managers publish their related policies and provide details of the AGM votes where they had potential conflicts. Some of the funds also have detailed policies relating to their anti-corruption efforts and a few of them participate in the Private Sector Collective Action Against Corruption.

Kasikorn AM's annual stewardship review is the stand-out report of its kind in Thailand

Less impressively, Thai investor reports on the implementation of the I Code are often based entirely on compliance. They outline the principles of the I Code and, in some cases, have a tick box to confirm adherence to each principle. One interesting exception is Kasikorn Asset Management's Investment Governance Code 2019 Annual Review. It provides a summary of voting patterns for general meetings both domestically and internationally, some data on meetings with companies, and a detailed discussion of ESG-related engagements with 20 examples. Many of these involve single companies, but there is also a broader discussion of engagement with the REIT sector, which typically provides low levels of ESG information.

The foreign dimension

Our survey of global investor voting and engagement-results for Thailand

As part of our research for CG Watch 2020, ACGA conducted a survey of our global investor members to gather baseline data on their level of voting and engagement in the 12 Asia-Pacific markets we cover. Almost half of ACGA's investor members - 45 out of 92 - responded. At the time the survey was conducted, in September 2020, this group managed in aggregate more than US$26 trillion globally. As the responses showed, most respondents invest in Thailand but as expected for a smaller market the number of investments held is considerably fewer than in larger markets:

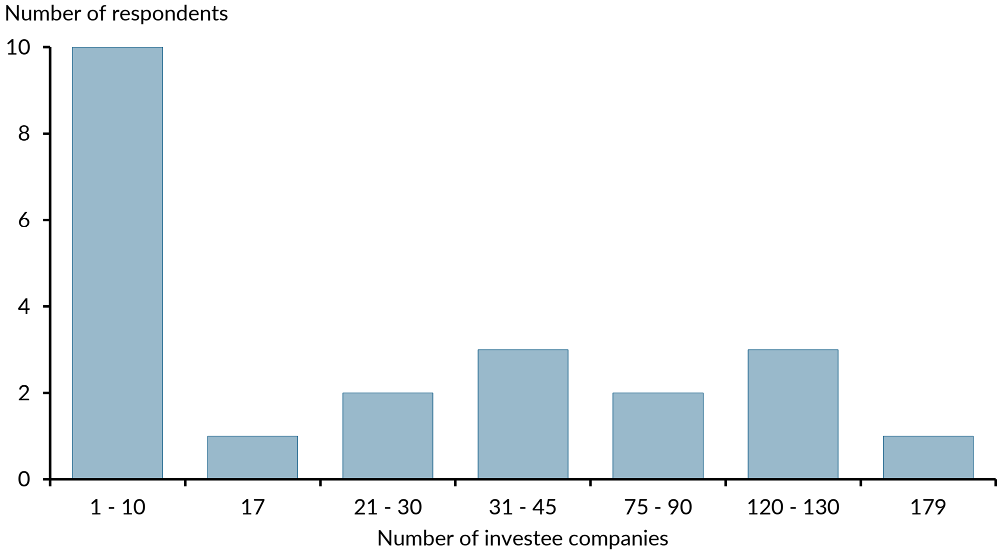
- 37 or 84% of foreign investor respondents invest in Thailand-a result in line with Australia, slightly below Indonesia and Japan at 86%, and slightly higher than Singapore at 82%.
- Only 22 respondents answered the question on the exact size of portfolios. The average number of Thai investee companies held per respondent was 44, with a range from one to 179. The average figure is notably higher than the Philippines, slightly below Indonesia, Malaysia, and Singapore, well below the range of 100 to 130 that most funds hold in Korea and Taiwan, and far below the average number of holdings for China and Japan.

Another way to show the extent of investment in Thailand is to group portfolios by size, across the 22 respondents for this question. As the following figure shows, while a few ACGA members invest in more than 100 companies each, most have portfolios of less than 50 companies and a large proportion own less than 10 stocks.

Most respondents own less than 45 companies, several hold 10 or less

Figure 7

Foreign investors in Thailand: By size of portfolios, 2020



Note: 1: Not all respondents answered this question; 2: Ranges were chosen to reflect figures provided; ranges omitted if they contained no data points. Source: ACGA Member Survey, September 2020

Foreign investors take voting seriously in Thailand, and vote against something in about a third of meetings

Although Thailand, like other Southeast Asian markets, is a relatively small market from the perspective of global institutional investors, respondents still take voting seriously. They also vote against a reasonable number of management resolutions:

- Nearly all respondents with holdings in Thailand vote in 100% of their investee-company AGMs. One votes in around 50% of meetings, one in 20% of meetings, and one votes in zero.
- On average, they voted against at least one management resolution in 14 meetings in 2020. The median figure, which is arguably more representative, was 10 meetings. This means that these investors are voting against something at one-third to half of their investee-company AGMs in Thailand.

As our survey was an initial attempt to gain a basic understanding of the behaviour of global investors, we did not delve deeply into why and what they are voting against at the market level. We did, however, ask a general question about the type of resolutions investors typically vote against across the region. The most common answers referenced director elections (often linked to independence or diversity issues), followed by director/executive remuneration, share issuances, and auditors. In future surveys we intend to explore market-specific responses as well.

Company engagement

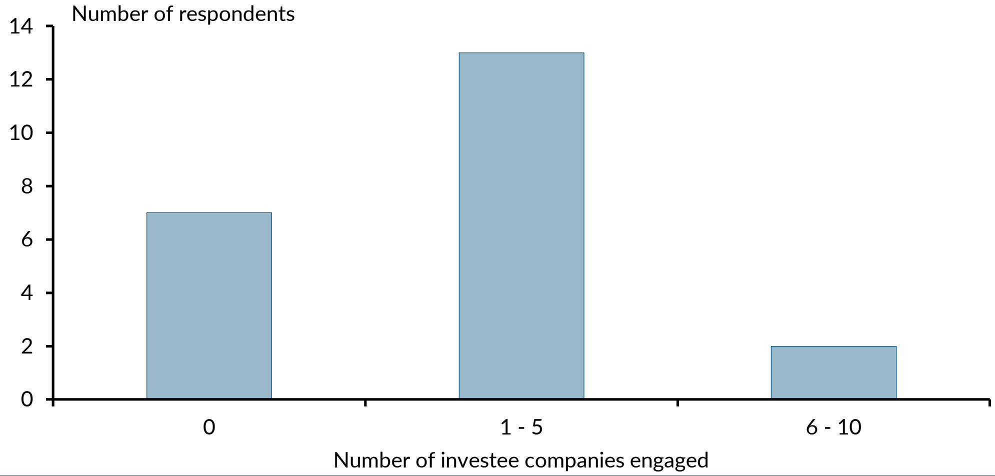
Individual engagement in Thailand is tiny compared to other markets

While foreign investors do engage individually in Thailand, the absolute level of engagement is tiny compared to larger markets like Japan, Australia and China, and even smaller than the rest of Southeast Asia. Of the 37 respondents who indicated they invest in Thailand, 22 answered our question on company engagement. Of these, seven said they undertook no engagement at all in Thailand over 2019 and 2020. Of the remaining 15, one engaged with 10 companies and most of the remainder with five or fewer, as the following figure shows.

Most respondents engaged with five companies or fewer over 2019 to 2020

Figure 8

Foreign investor engagement prevalence in Thailand: 2019-2020



Note: Not all respondents answered this question. Source: ACGA Member Survey, September 2020

Most respondents engage with 15% or less of their investee companies

In terms of the relative level of engagement in Thailand (ie, as a percentage of companies invested in), our survey provides some tentative answers. The figure for most of those who answered is 15% or less but rises to 22% for one firm and 67% for another. Interestingly, the 22% ratio applies to a large asset manager that own 45 stocks in Thailand. It is important to emphasise that these results do not include foreign-owned asset managers in Thailand that are locally managed and, in some ways, operate more like domestic investors, such as Aberdeen Standard. Other respondents are predominantly foreign institutions based outside of the country.

Next steps

Make voting disclosure with reasons the norm

Make disclosure through websites mandatory for all votes and for the reasons for voting against.

Climate change risk management is needed

Investors should strengthen the approach they take to addressing climate change risks and opportunities, and to engaging with investee companies.

Apply RI to multiple asset classes

Responsible investment (RI) can be applied to multiple asset classes, including stronger steps for fixed income, real estate, and infrastructure.

More forward-looking research would help

The Thai market has organisations that provide CG and ESG ratings but does not have a domestic organisation providing more integrated analysis into corporate sustainability and governance issues, rather than checklist-based assessments. Also, there is no domestic proxy advisory firm. An organisation dedicated to more forward-looking analytical work could support sustainable development objectives across the capital market.

6. Auditors & audit regulators

Thailand ranks joint 6th with a score of 76%

Thailand's score improved by five percentage points to 76% in 2020, although it dropped in terms of rank, now sitting in joint 6th place with Taiwan. Although Thailand's score increased, this was true for many markets and both Japan and Taiwan saw larger increases since our previous survey.

SEC and TFAC are the main scrutineers of audits

The main parties involved in ensuring the quality of audits are the SEC, which regulates audits for listed companies through its Accounting and Auditing Supervision Department, and the Thailand Federation of Accounting Professions (TFAC), the professional body formerly known as the Federation of Accounting Professions (FAP).

Poor preparation of accounts remains an issue

Account preparation

Over the years and across multiple markets we have heard from auditors of the challenges they face when they are presented with accounts that are not adequately prepared. This is also a challenge in Thailand. Our assessment for mid-cap companies shows an increase, which was largely for methodological reasons. The focus of our question was tightened to look only at mid-caps, not small- and medium-sized enterprises (SMEs) as in the past, and an uptick was warranted since the mid-cap universe contains some quite large and professionally run companies.

SEC and TFAC support capacity and expertise

The SEC and TFAC are both working to improve account preparation, frequently in coordinated efforts. There is capacity building both for preparers and auditors often in the form of events and professional development activities. These include providing certificates for forensic accounting and educating CFOs on developing and updating accounting knowledge, including on listed company regulation. There was also a special forum held in 2020 on accounting education to develop teachers and lecturers in the profession. Another initiative is a project funded by the Capital Market Development Fund to support alignment between domestic and international financial reporting and auditing standards, develop new CPAs and audit firms to provide services in the capital market, and provide training for engagement quality control reviewers.

Thailand is now in line with global standards

Accounting standards

The Thai Financial Reporting Standards (TFRS) are based on International Financial Reporting Standards (IFRS) and are usually adopted with a one-year delay. We noted in CG Watch 2018 that the Thai implementation of IFRS 9 was delayed by a further year and only became mandatory from 1 January 2020. The standard includes stricter recognition of impairments of financial instruments. There were competing views as to whether it was necessary to have a further delay in implementation. This standard is particularly relevant for banks and higher provisions duly reduced the reported profits of Thai banks in 2020. We increased the score for this question as local standards are now harmonised with international standards. We believe the market would be better served if it can keep to the usual schedule in future, which will aid users in comparing Thai accounts with those of international peers.

There are limited sanctions for auditors

Audit industry oversight

In CG Watch 2018 we noted the only enforcement actions taken against auditors mentioned in the 2016 and 2017 audit inspection reports were warnings. In 2018 there were no sanctions imposed, and in 2019 there was one suspension. Overall, this is a limited public record of enforcement action compared to other markets.

Proposals in play to increase sanctions for audit quality failure

In response to questions posed by ACGA, the SEC said it has sought to strengthen oversight of auditors and audit firms operating in the Thai capital market. Following a study, the SEC is considering adopting the following measures through changes to the Securities and Exchange Act, including:

- Registration of audit firms in the capital market;
- Setting out expected conduct for audit firms and auditors;
- Defining sanctions within the Act for firms that fail to maintain audit quality control; and
- Broaden the range of sanctions beyond monetary penalties.

SOEs are now permitted to appoint SEC-approved auditors

Audits of state-owned enterprises

In the past the State Audit Office of the Kingdom of Thailand audited state-owned enterprises (SOEs). This has changed in the last few years as SOEs have been allowed to appoint SEC-approved auditors instead. All listed SOEs are now audited by Big Four accounting firms. Non-listed SOEs, including ones that issue debt instruments, are still audited by the State Audit Office of the Kingdom of Thailand.

Listed SOEs are now audited by the Big Four

Figure 9

Listed SOEs and their auditors

SOEs	Auditor
Thai Airways International	Deloitte
Airports of Thailand	EY
Bangkok Commercial Asset Management	EY
Krungthai Bank	EY
PTT	EY
MCOT	KPMG
PTT Exploration and Production	PwC

Source: SEC, company websites

Financial reporting at state banks still lags global standards

Oversight is particularly important for Specialised Financial Institutions (SFI), a category which includes a range of fully state-owned banks. The IMF estimated that SFIs accounted for 16% of finance sector assets in 2018, making them significant in terms of macro-prudential risks. Oversight of these institutions was transferred from the Ministry of Finance (MOF) to the Bank of Thailand (BOT) following a cabinet decision in December 2014. However, the MOF still has some approval authority. For instance, in 2019 it gave SFIs a five-year grace period to adopt the new financial instruments standard, TFRS 9. The BOT has recently consulted to identify the appropriate standards for SFIs.

The Big Four auditors will likely enhance SFI reporting

The delayed TFRS 9 implementation and the need to define standards indicate that SFIs will have to undertake significant process changes to strengthen their financial and reporting functions. We believe the well-resourced larger auditors will likely have much to offer in terms of expertise to ensure that SFI accounts have been appropriately prepared in future.

Next steps

Strengthen sanctions for auditors and audit firms

Changes to the Securities and Exchanges Act to enhance disciplinary processes and the enforcement of auditing practices would be welcome.

Raise capacity in the accounting and audit markets

Continue to address capacity considerations in the audit market. This includes through ensuring the best audit expertise is available for audits of state entities that are systemically important, or which raise capital from the public.

Ensure timely adoption of international standards

Ensure the timely adoption of financial reporting standards and auditing standards to maintain alignment between domestic and international accounting and audit standards.

7. Civil society & media

Thailand ranks 7th with a score of 49%

Overall, there has been a modest two percentage point decline, with Thailand scoring 49% in 2020. Its rank dropped from equal 6th with Taiwan to 7th place. Since the previous CG Watch we have taken a more positive view on the training for company secretaries but reduced the score for the contribution from professional associations to better align with the activities seen in other markets. Our assessment of media capability has also declined in part due to the reduction of English-language news and the ongoing challenges for press freedom in the country.

The critical role of the Thai IOD . . .

The Thai IOD continues to play a critical role

The Thai Institute of Directors (IOD) continues to play a strong role in strengthening the corporate governance ecosystem in Thailand. As of 2019 it had 4,258 members, up 2% over the previous year, and by 2018 it had provided training for more than 25,000 directors.

The CGR shows improved corporate disclosure

The IOD provides research on CG, which is helpful as there is comparatively little relevant research from academics in Thailand. The institute's work includes the Corporate Governance Rating (CGR), which completed its twentieth year in 2020, and which is used by many investors as a baseline scoring system for ESG-oriented funds. The CGR has had ongoing reviews to strengthen the assessment overall, enhance its focus on sustainability, and better align it with investors' needs. The IOD has also expanded the CGR's coverage so that it now includes 692 listed companies-essentially all listed companies aside from those where a controversy has resulted in the suspension of the CGR rating. The average scores from the rating have shown a steady increase over the years.

Big Four auditors make most of the fees

The IOD also undertook research on audits in 2020. This showed that the Big Four audit firms received 71% of audit fee revenue for all listed companies, with a higher proportion of revenues from SET-listed companies at 77% than the proportion for companies listed on the SME market, the Market for Alternative Investment board or "mai", which was 45%. Median audit fees were highest for financials and lowest for consumer product companies.

CAC has 1,000 members with 450 certified

Among its other projects, the IOD forms the secretariat for the Private Sector Collective Action Against Corruption (CAC), which is the focal point for the business community's efforts to address rampant corruption in the country. The CAC was established in 2010 by a group of leading associations representing business and private-sector interests. Its network includes local and international peer organisations, capital market regulators, and public-sector anti-corruption agencies. More than 1,000 companies have joined CAC and more than 450 have been certified.

. . . and TLCA

IOD and TLCA provide corporate secretary training

Training for corporate secretaries is provided by both the Thai Listed Companies Association (TLCA) and the IOD. Both organisations offer a range of courses with certificates. The IOD runs a range of programmes such as the Company Secretary Program, Anti-Corruption in Practice, Board Reporting, Effective Minute Taking, Company Reporting, Corruption Risk & Control. TLCA also runs the Corporate Secretary Club, which supports the development of the company secretary profession.

Press freedom has declined during the unrest

Press freedom declines

The corporate governance ecosystem requires a free flow of information to ensure that companies and their directors and officers can be held accountable for their actions. There needs to be a well-funded media, with journalists and citizens that can voice opinions on business and governance matters without fear. Unfortunately, the political context in Thailand continues to make this challenging. Thailand's ranking in the World Press Freedom Index by Reporters Without Borders declined from 136 in 2019 to 140 in 2020 out of 180 countries. Market forces have also created a more challenging context for journalism in recent years, with English daily, *The Nation*, publishing its last print edition on 28 June 2019 and becoming an online news website.

The political context has reduced freedoms

There are multiple laws that restrict the ability of journalists to perform their function and for citizens to speak up about concerns relating to companies. These challenges were made worse when actions taken against opposition parties following the 2019 election resulted in protests across the country that in turn led to a crackdown in 2020, multiple investigations into media coverage and a return to using lèse-majesté (insulting the monarchy) laws.

Lèse-majesté and defamation laws create major challenges

The range of laws that make it harder for journalists to report also create a chilling effect on free speech and corporate accountability mechanisms. Problematic laws include the world's strictest lèse-majesté laws, the Computer Crimes Act, anti-sedition laws, and criminal defamation laws. Specific cases include:

- **Criminal Defamation and SLAPPs:** The conviction of Thai journalist Suchanee Cloitre is an example of the use of a Strategy Litigation Against Public Participation (SLAPP) and shows how criminal defamation law is a barrier to corporate accountability. In 2017 Suchanee sent out a tweet criticising a poultry farm that had been ordered to pay compensation for labour violations. In December 2019, the Lopburi court sentenced Suchanee to two years in prison for the tweet. The conviction was overturned on appeal in October 2020. The same poultry company has brought at least 37 complaints against 22 human rights defenders since 2016. The defamation law is set out in sections 236 to 333 of the Thai Criminal Code and has penalties of up to two years in prison and a maximum fine of Bt200,000.

  Other notable cases include that of human rights defender, Andy Hall, who contributed to a report on alleged labour violations at pineapple processing company, Natural Fruit. He has faced a series of lawsuits since 2012 when he contributed to a report alleging poor working conditions at Natural Fruit. In 2016 he was found guilty of criminal defamation and given a suspended three-year prison sentence before the conviction was overturned on appeal. Civil litigation is ongoing.

  On 29 October 2019, the Thai cabinet approved the country's first National Action Plan on Business and Human Rights. This proposed an amendment to Section 161/1 of Thailand's Criminal Code to allow courts to throw out cases that are brought in bad faith, but human rights defenders have said this is not clearly defined.

- **Lèse-majesté laws:** Thailand has some of the world's strictest laws to prohibit insulting the monarchy. This is stated in Section 112 of the Thai Criminal Code as: "Whoever, defames, insults, or threatens the King, the Queen, the Heir-apparent or the Regent, shall be punished with imprisonment of three to fifteen years." There have long been concerns that a wide interpretation of the rule was used to squash dissent. However, there were no cases for three years until 19 November 2020 when Prime Minister Prayut ordered the use of "all laws and articles" against Thai protestors. Since then, there have been reports of more than 60 cases. Notable examples include that of retired civil servant Anchan Preelert, who was sentenced to 87 years in prison, halved to 43.5 years when she pleaded guilty. She had shared audio clips on YouTube and Facebook deemed critical of the royal family. There were 29 counts each attracting a three-year penalty. In other recent cases, activists have been detained prior to trial and denied bail and have also been charged with sedition under section 116 of the Criminal Code. The United Nations Office of the High Commissioner for Human Rights has also expressed concerns about the use of the lèse-majesté laws, including in the case of a minor.

Next steps

Legal reform is needed to ensure accountability

Reform of laws restricting free speech are necessary to ensure corporate accountability mechanisms work in the country. Authorities could also go further to protect workers' rights.

Professional associations could contribute more

There are many civil society organisations that contribute to the corporate governance agenda and do constructive work. We believe however that some of the professional associations could go further to strengthen the CG ecosystem, including the associations for investment and financial analysts, accountants, and internal audit.

What to avoid

Downgrade watchlist

Factors that could force the market score to fall in CG Watch 2020:

- ❑ There need to be strong steps by investors and companies to address the causes and risks from climate change. There should be strong supporting action by regulators including the SEC and BOT to ensure this happens
- ❑ Continued harassment of journalists for reporting corporate misdeeds and any failure by courts to implement the measures the government introduced to waive criminal defamation
- ❑ The SEC has set out strategic plans with strong areas proposed for reforms. There could be a downgrade if these proposals are blocked for weak reasons or if the regulatory guillotine removes important investor protections
- ❑ The emergency conditions of the pandemic meant that the regulators had to remove investor protections to allow companies to manage related challenges. A failure to restore protections and rights would lead to a downgrade

What to fix

Quick fix list

Issues to address as soon as possible:

- ❑ Make disclosure of all votes and the reasons for making them mandatory for all institutional investors
- ❑ Greater narrative explanation of SEC enforcement statistics, and more details on individual cases, would help stakeholders better understand the effectiveness of the enforcement regime
- ❑ Support domestic research with more integrated analysis of climate change risks and strategic responses by companies
- ❑ Support investors to extend responsible investment approaches into multiple asset classes, including through stronger ESG reporting requirements for REITs
- ❑ Improve the mechanisms for appointing independent directors
- ❑ Quicker provision of information to the market for disclosure of changes in holdings by directors and by controlling or substantial shareholders

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Appendix 1: About ACGA

The Asian Corporate Governance Association (ACGA) is a non-profit membership association dedicated to promoting substantive improvements in CG and ESG in Asia through independent research, advocacy and education. ACGA engages in a constructive dialogue with regulators, institutional investors and listed companies on key CG/ESG issues and works towards making improvements.

ACGA Research

The CG Watch series of biennial reports, co-published with CLSA, is now into its 10th edition. It is the premier analysis of corporate governance across 12 markets in the Asia-Pacific region. CG Watch 2020 is the first edition to appear in the form of companion reports, making it easier for readers to digest the wealth of information contained in the markets report written by ACGA and the sectoral report written by CLSA.

This latest market ranking report features a more in-depth analysis of data gathered by our research team, including a survey of ACGA's global investor members on their engagement, voting and AGM attendance in the 12 markets we cover. At more than 500 pages, it is the most ambitious CG Watch report to date.

ACGA is also known for a major report published on China in 2018, titled "Awakening Governance: The evolution of corporate governance in China". It provides an independent and objective review of the history, nature and trajectory of CG in China. It seeks to explain China's unique system of corporate governance to foreign investors and the relevance of emerging global CG/ESG best practices to China-listed companies and domestic institutional investors. Available in both English and (simplified) Chinese versions, a pdf version can be downloaded on www.acga-asia.org/thematic-research.php/

For more details on ACGA's activities and a database of information on CG in Asia, see our website: www.acga-asia.org/

Membership network

ACGA is funded by a membership base of 110 highly regarded organisations based in Asia and other parts of the world, including:

- Many of the world's largest asset owners and managers. ACGA investor members manage more than US$40 trillion globally and hold significant stakes in Asian companies.
- Highly regarded listed companies, professional firms, and financial intermediaries based in Asia.
- Two major multilateral banks.

For a full list of our members, see the "Members" page on www.acga-asia.org/

Founding Sponsor

CLSA is one of the original Founding Corporate Sponsors of ACGA and continues to support the Association's work. We have been honoured to work with CLSA since 2001.

Appendix 2: ACGA Market-ranking survey

1. Government & public governance

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
1.1	To what extent does the current government administration (executive branch) have a clear and credible long-term strategy for promoting corporate governance reform to support capital-market and business-sector development?	2020	2	1	1	2	1	3	4	0	2	2	4	1
		2018	2	1	0	1	0	3	3	2	0	1	4	2
1.2	To what extent does the government provide consistent political support for the policy and enforcement work of financial regulators (ie, securities commissions and stock exchanges)?	2020	2	2	3	2	1	3	4	1	1	3	4	2
		2018	2	2	2	1	0	2	3	3	0	2	4	3
1.3	To what extent has the central bank or equivalent financial authority set effective guidance for the governance of banks?	2020	3	2	4	3	2	2	3	4	3	4	3	2
		2018	3	3	4	1	2	4	3	3	3	4	2	3
1.4	Is there a coherent structure to the regulatory system governing the securities market, including the IPO regime? (ie, one without clear conflicts of interest involving either the securities commission or the stock exchange; without fragmentation and disagreement between different regulatory authorities; and where there is a clearly definable securities commission or bureau taking the lead on enforcement)	2020	4	3	3	3	2	4	3	2	3	4	4	4
		2018	4	2	3	3	2	3	3	3	3	3	3	3
1.5	Is the securities commission formally and practically autonomous of government? (ie, not part of the ministry of finance; nor has the minister of finance or another senior official as chairman; nor unduly influenced by government)	2020	3	0	3	2	2	2	1	1	1	1	2	2
		2018	3	0	4	3	2	2	1	1	2	1	1	3
1.6	Is the securities commission funded independently (eg, a levy on securities transactions) and not dependent on an annual budgetary allocation from government?	2020	3	0	5	4	4	2	5	5	1	0	5	5
		2018	2	0	5	4	3	1	4	4	1	1	2	4
1.7	Is there an independent commission against corruption (or a group of agencies) with broad powers to tackle public- and private-sector corruption?	2020	3	0	3	1	2	2	3	1	0	4	2	0
		2018	2	1	4	1	3	1	1	1	0	4	2	2
1.8	How far advanced is the government in tackling public- and private-sector corruption?	2020	3	1	3	1	1	3	2	0	1	3	2	0
		2018	3	2	3	2	1	2	2	1	1	3	3	1
1.9	To what extent has the government sought to achieve and maintain high standards of civil service ethics and accountability?	2020	4	1	3	2	1	4	5	1	1	3	4	1
		2018	4	1	3	1	1	4	3	1	0	4	4	1
1.10	To what extent is the judiciary seen to be independent and clean in relation to company and securities cases?	2020	5	1	5	2	1	4	2	1	1	5	4	0
		2018	5	1	5	2	1	5	3	2	0	4	4	1
1.11	To what extent is the judiciary skilled in handling company law and securities cases?	2020	5	2	5	3	1	4	3	3	2	5	3	2
		2018	5	2	5	3	0	3	3	3	2	5	3	2
1.12	Does the legal system allow minority shareholders and other stakeholders fair and efficient access to courts to settle disputes? (ie, in terms of the cost of going to court and the range of legal remedies available)	2020	4	3	1	2	1	3	2	1	1	1	3	2
		2018	4	2	0	2	1	3	3	0	2	0	4	1
1.13	Does the government follow best practice standards as regards listed SOE governance? (ie, it requires them to follow the same governance standards as private-sector issuers, refrains from interfering in their governance, and so on)	2020	na	3	3	2	1	3	2	1	1	4	4	2
		2018	na	3	3	1	1	3	2	3	1	4	3	3
	2020 category score (out of 65)		41	19	42	29	20	39	39	21	18	39	44	23
	Category percentage		68	29	65	45	31	60	60	32	28	60	68	35
	Rank		1	11	3	7	10	4	4	9	12	4	1	8

Source: ACGA

2. Regulators

Funding, capacity building, reform			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
2.1	Is the securities commission sufficiently resourced in terms of funding and skilled staff to carry out its regulatory objectives?	2020	4	1	5	3	2	4	4	3	1	2	4	4
		2018	3	1	5	4	2	3	4	4	2	3	3	5
2.2	To what extent has the securities commission been investing in surveillance, investigation and enforcement capacity and technology over the past two years?	2020	4	4	4	3	2	3	3	3	0	2	3	4
		2018	3	4	5	4	2	2	3	3	1	3	3	4
2.3	Is the stock exchange (or exchanges) sufficiently resourced in terms of funding and skilled staff to carry out enforcement of the listing rules?	2020	3	1	3	2	2	4	1	3	2	4	3	3
		2018	3	2	4	3	2	3	2	4	2	4	2	3
2.4	To what extent has the stock exchange been investing in surveillance, investigation and enforcement capacity and technology over the past two years?	2020	1	1	1	2	1	2	1	3	1	3	3	2
		2018	1	2	1	3	1	1	1	3	1	3	2	1
2.5	Has the government and/or securities commission been modernising company and securities laws over the past two years to improve corporate governance and address relevant local CG problems?	2020	3	1	2	3	2	3	4	1	4	3	5	2
		2018	3	1	2	3	1	3	4	4	1	2	5	5
2.6	Has the stock exchange been modernising its listing rules and best-practice codes over the past two years to improve corporate governance?	2020	3	2	4	1	0	3	2	3	2	4	5	2
		2018	3	2	1	1	0	1	4	3	0	1	3	3
2.7	Do financial regulators (securities commissions and stock exchanges) undertake public and written market consultations prior to major rule changes?	2020	5	1	5	2	1	2	1	3	1	3	2	2
		2018	na	na	na	na	na	na	na	na	na	na	na	na
2.8	Do the securities commission and stock exchange have informative websites with English translations of all key laws, rules and regulations easily accessible?	2020	5	5	5	5	1	4	3	5	3	5	3	5
		2018	5	4	5	5	1	4	4	5	2	4	3	3
2.9	Does the stock exchange provide an efficient, extensive and historical online database of issuer announcements, notices, circulars and reports archived for at least 15 years and in English?	2020	5	4	5	2	3	1	2	5	1	4	1	2
		2018	5	3	5	2	2	1	3	5	2	2	2	1
2.10	Has the stock exchange or another organisation developed an open electronic voting platform (“straight through processing”) for investors?	2020	0	3	0	5	3	5	4	0	0	0	5	0
		2018	0	4	0	5	0	5	3	0	0	0	5	0
2.11	To what extent does the current IPO listing regime (including rules, guidance, support of investment bank sponsors) prepare companies to implement an effective and meaningful corporate governance system prior to listing?	2020	1	0	0	0	0	1	0	0	0	1	0	0
		2018	1	1	2	0	0	1	0	0	1	2	2	1
	2020 subcategory score (out of 55)		34	23	34	28	17	32	25	29	15	31	34	26
	Percentage		62	42	62	51	31	58	45	53	27	56	62	47
	Rank		1	10	1	7	11	4	9	6	12	5	1	8
Enforcement														
2.12	Do financial regulators in your country have a reputation for vigorously and consistently enforcing securities laws and regulations?	2020	3	2	3	2	1	2	3	2	1	3	3	2
		2018	2	2	3	2	1	2	2	2	1	2	3	1
2.13	Have their efforts improved and evolved over the past two years?	2020	4	3	3	3	1	3	4	1	1	4	3	3
		2018	3	3	4	4	1	2	3	3	1	3	4	3
2.14	Does the securities commission have robust powers of surveillance, investigation, sanction, and compensation?	2020	5	4	5	5	1	3	4	5	3	5	5	5
		2018	4	4	5	4	2	3	4	3	2	3	4	3
2.15	Has the government and its law enforcement agencies had a successful track record prosecuting all forms of market misconduct over the past two years, including insider trading, market manipulation, fraud, embezzlement, and false disclosure?	2020	3	4	5	2	0	3	3	2	1	4	3	3
		2018	3	4	5	3	0	2	3	3	1	3	3	3
2.16	Does the securities commission disclose multi-year data on its enforcement activities, with explanations as to what the data means and detailed announcements on individual cases?	2020	5	4	5	4	0	4	2	3	0	3	4	3
		2018	5	3	5	4	0	4	3	3	1	3	1	3
2.17	Does the stock exchange (or related agencies) have an effective range of powers to sanction breaches of the listing rules?	2020	3	3	3	3	3	5	4	4	3	4	4	3
		2018	3	3	3	3	3	4	3	5	3	4	3	3
2.18	Has the stock exchange (or related agencies) had a successful track record enforcing breaches of the listing rules over the past two years?	2020	2	3	3	3	1	3	2	3	1	3	3	2
		2018	2	3	3	3	1	3	2	3	1	3	3	2
2.19	Does the stock exchange disclose detailed data on and explanations of its enforcement activities?	2020	2	4	5	1	1	3	3	3	1	2	3	2
		2018	1	4	5	1	1	3	2	3	1	3	2	2
2.20	Have the government and regulatory authorities taken steps to minimise and control conflicts of interests between the commercial and regulatory functions of the stock exchange?	2020	3	2	2	2	0	3	2	2	1	3	3	3
		2018	2	3	2	2	0	2	2	3	1	2	3	3
2.21	Do financial regulators receive efficient and committed support from other national enforcement agencies and institutions (ie, the police, attorney general, courts)?	2020	4	3	4	3	0	4	4	2	1	4	4	2
		2018	4	3	3	3	1	4	3	2	1	4	4	1
	2020 subcategory score (out of 50)		34	32	38	28	8	33	31	27	13	35	35	28
	Percentage		68	64	76	56	16	66	62	54	26	70	70	56
	Rank		4	6	1	8	12	5	7	10	11	2	2	8
	2020 category score (out of 105)		68	55	72	56	25	65	56	56	28	66	69	54
	Category percentage		65	52	69	53	24	62	53	53	27	63	66	51
	Rank		3	9	1	6	12	5	6	6	11	4	2	10

Source: ACGA

3. CG rules

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
3.1	Do corporate and financial reporting standards (ie, rules) compare favourably against international standards? (ie, on frequency and timeliness of reporting; robust continuous disclosure; detailed MD&A; sufficient narrative and notes to the P&L, balance sheet, cashflow; and so on)	2020	5	4	5	4	2	4	4	4	3	5	4	5
		2018	5	4	5	4	3	4	4	4	4	5	4	5
3.2	Do CG reporting standards compare favourably against international standards? (ie, requirements for a Report of the Directors; CG statements or reports; board and committee disclosure; director biographies; internal controls and audit; discussion of risk factors)	2020	5	2	4	4	2	3	3	4	3	3	3	5
		2018	5	2	4	4	3	3	1	4	4	4	4	4
3.3	Do ESG/sustainability reporting standards compare favourably against international standards? (ie, stock exchange ESG reporting rules; a sustainability section in the annual report; a separate GRI or Integrated Report; a company law provision that directors have a responsibility to report on environmental and social/stakeholder matters)	2020	4	2	4	2	1	3	1	4	1	5	5	5
		2018	1	2	3	2	1	1	2	4	1	4	4	4
3.4	Is quarterly reporting mandatory, is it consolidated, and does it require P&L, Balance Sheet, and Cashflow statements with an explanation of the numbers?	2020	1	4	1	3	4	5	4	5	4	1	4	5
		2018	2	4	1	3	4	5	4	5	4	5	5	5
3.5	Is timely disclosure of "substantial ownership" required (ie, when investors acquire a 5% stake or sell down below 5%) as well as "creeping" increases/decreases of one percentage point?	2020	5	5	5	4	4	4	4	4	3	5	1	2
		2018	5	5	5	4	3	5	5	5	2	5	0	2
3.6	Must directors disclose on-market share transactions within three working days?	2020	3	5	5	5	2	2	3	5	3	5	5	2
		2018	4	5	4	5	1	0	3	4	2	4	5	3
3.7	Must controlling shareholders disclose share pledges in a timely manner?	2020	2	5	5	3	1	3	0	0	0	3	4	0
		2018	4	5	5	4	1	0	0	0	1	1	4	0
3.8	Is there a closed period (a "blackout") of at least 60 days before the release of annual results and at least 30 days before interim/quarterly results during which directors cannot trade their shares?	2020	5	3	5	5	0	2	0	2	3	5	0	0
		2018	4	5	5	5	1	1	0	2	3	3	2	0
3.9	Are there clear rules on the prompt disclosure of price-sensitive information?	2020	5	4	5	4	2	4	4	4	5	5	5	4
		2018	5	4	5	4	4	5	5	5	5	5	5	4
3.10	Are there clear rules on the timely and meaningful disclosure of related-party transactions, calibrated for the size/materiality of transactions, and that allow minority shareholders to approve major RPTs?	2020	4	4	5	3	0	3	3	5	1	5	1	5
		2018	3	3	5	3	1	1	2	5	1	3	2	5
3.11	Are there clear rules prohibiting insider trading, with strong deterrent penalties?	2020	4	4	5	3	0	3	4	5	2	5	3	5
		2018	4	3	5	3	1	3	4	4	3	4	4	3
3.12	Is voting by poll mandatory for all resolutions at general meetings, followed by disclosure of results within 1 day?	2020	4	4	4	3	1	3	1	4	1	5	4	5
		2018	4	5	5	4	1	4	0	5	1	5	4	5
3.13	Is there an up-to-date national code of best practice--and accompanying guidance documents--that takes note of evolving international CG standards and is fit for purpose locally? (ie, addresses fundamental CG problems in the domestic market)	2020	5	3	3	3	2	4	3	4	3	3	4	5
		2018	4	1	3	3	2	3	3	3	2	3	3	4
3.14	Is there a stewardship code (or codes) for institutional investors based on the "comply or explain" standard and that seeks investor signatories?	2020	5	0	2	4	0	5	5	4	0	1	4	5
		2018	4	0	2	2	1	5	5	5	0	1	5	5
3.15	Is there a clear and robust definition of "independent director" in the code or listing rules? (ie, one stating independent directors should be independent of both management and the controlling shareholder; that does not allow former executives or former professional advisors/auditors to become independent directors after short "cooling-off" periods, nor people with business relationships)	2020	3	2	2	2	2	3	3	3	2	3	3	2
		2018	4	1	2	2	1	1	2	2	1	2	2	3
3.16	Must companies disclose the exact remuneration of individual directors and at least the top five key management personnel (KMP) by name?	2020	5	3	4	4	2	1	3	3	1	2	2	4
		2018	5	3	4	3	2	1	2	4	1	2	3	3
3.17	Are fully independent audit committees mandatory and given broad powers to review financial reporting and internal controls, and communicate independently with both the external and internal auditor?	2020	4	3	4	3	1	2	4	4	2	4	3	4
		2018	4	3	4	4	2	2	3	4	2	4	2	5
3.18	Are largely independent nomination committees mandatory and given broad powers to nominate directors?	2020	4	2	2	4	2	1	3	4	1	4	2	4
		2018	4	1	3	3	2	1	2	2	1	3	1	3
3.19	Can minority shareholders easily nominate directors?	2020	4	2	2	4	2	3	5	3	2	3	5	3
		2018	4	0	1	4	1	0	0	1	2	1	3	0
3.20	Is there a statutory or regulatory requirement that directors convicted of fraud or other serious corporate crimes must resign--or are removed from--their positions on boards and in management?	2020	5	4	3	3	3	4	1	5	5	5	3	5
		2018	3	4	3	3	0	4	0	2	5	5	2	5
3.21	Are pre-emption rights for minority shareholders—their right to buy any new shares issued by the company on a pro-rata basis—firmly protected? (ie, new shares issued for cash must keep to strict caps of no more than 5-10% of issued capital and a 5-10% discount to the current share price; shareholders can approve the extension of such placement mandates at each AGM; and/or measures have been introduced to allow for much faster rights issues)	2020	3	1	2	1	2	1	1	3	1	3	2	2
		2018	4	1	2	1	1	1	0	3	1	2	1	2
3.22	Must companies release their AGM proxy materials (with final agendas and an explanatory circular) at least 28 calendar days before the date of the meeting?	2020	5	3	4	4	3	2	3	4	3	2	3	4
		2018	4	3	4	4	3	2	3	3	2	2	4	4
3.23	Are there clear and robust rules for the protection of minority shareholders during takeovers and voluntary delistings (taking companies private)?	2020	3	3	4	3	1	2	2	4	2	4	4	5
		2018	3	0	4	3	1	2	1	3	1	3	2	3
3.24	Are institutional shareholders free to undertake collective engagement activities without an undue burden from concert-party rules?	2020	5	3	5	5	3	2	3	5	3	4	5	5
		2018	5	5	5	5	2	2	3	5	2	5	5	5
	2020 category score (out of 120)		98	75	90	83	42	69	67	92	54	90	79	91
	Category percentage		82	63	75	69	35	58	56	77	45	75	66	76
	Rank		1	8	4	6	12	9	10	2	11	4	7	3

Source: ACGA

4. Listed companies

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
4.1	Does large-cap reporting on key financial metrics—operating costs, acquisitions/divestments, receivables/payables, and loans—compare favourably to international best practice?	2020	4	4	3	3	3	2	3	3	4	3	4	2
		2018	4	3	4	4	4	4	4	3	5	4	4	3
4.2	Does mid-cap reporting on key financial metrics—operating costs, acquisitions/divestments, receivables/payables, and loans—compare favourably to international best practice?	2020	2	4	3	2	2	2	0	2	3	2	4	2
		2018	4	3	3	3	3	4	2	3	2	4	3	3
4.3	Do the CG reports of large-cap companies compare favourably against international best practice?	2020	4	3	3	4	2	2	2	3	2	3	3	3
		2018	4	2	3	3	2	2	2	2	2	3	3	3
4.4	Do the CG reports of mid-cap companies compare favourably against international best practice?	2020	3	4	3	3	1	2	0	2	2	2	3	1
		2018	3	2	3	2	3	2	0	2	2	3	2	1
4.5	How effectively do large-cap companies address the issue of materiality in their ESG/sustainability reports?	2020	4	1	3	2	1	3	3	3	2	2	3	4
		2018	3	2	2	3	2	3	4	3	1	4	4	4
4.6	How effectively do mid-cap companies address the issue of materiality in their ESG/sustainability reports?	2020	3	0	3	0	0	1	0	2	3	2	2	0
		2018	2	1	2	1	3	2	0	1	2	3	2	1
4.7	Do large-cap companies provide comprehensive, timely and quick access to information for investors?	2020	4	4	4	4	3	3	4	4	4	4	4	4
		2018	4	4	4	4	3	3	2	4	3	4	4	4
4.8	Do mid-cap companies provide comprehensive, timely and quick access to information for investors?	2020	4	4	4	4	2	3	2	4	3	4	4	4
		2018	3	3	3	4	3	3	1	2	2	3	2	3
4.9	Do companies undertake annual board evaluations, either internally or using external consultants?	2020	2	0	0	4	1	1	1	3	1	3	1	3
		2018	3	0	1	3	1	2	1	3	1	3	2	3
4.10	Do companies disclose and implement credible board diversity policies?	2020	4	0	3	2	1	1	2	2	2	2	3	1
		2018	5	0	3	2	1	0	2	3	2	3	3	2
4.11	Do companies disclose whether they provide induction and ongoing training to their directors (executive and non-executive)?	2020	3	0	3	3	1	3	2	4	3	3	4	4
		2018	3	1	4	3	2	0	2	4	2	3	3	3
4.12	Do companies generally have an independent chairman and/or lead independent directors?	2020	5	0	0	1	1	1	1	3	2	3	0	2
		2018	5	0	1	3	1	1	1	3	0	3	0	0
4.13	Does the company disclose total remuneration of each member of the board of directors?	2020	5	5	5	5	2	1	3	5	2	5	3	5
		2018	na	na	na	na	na	na	na	na	na	na	na	na
4.14	Are the independent directors paid with stock options or restricted share awards?	2020	4	4	3	5	5	3	5	5	4	3	5	5
		2018	5	4	4	2	2	2	3	4	2	4	1	4
4.15	Are audit committees (or an equivalent) independently led and competent in financial reporting/ accounting matters?	2020	5	4	3	3	3	1	3	3	2	2	1	3
		2018	4	3	3	3	4	2	3	4	2	4	3	4
4.16	Does the company show sensitivity to the issue of auditor independence?	2020	4	0	4	2	2	5	4	4	3	4	5	3
		2018	na	na	na	na	na	na	na	na	na	na	na	na
4.17	Do companies state they have internal audit departments that report to the audit committee?	2020	5	5	4	5	2	2	3	5	4	5	5	5
		2018	5	2	4	5	2	4	2	5	4	5	4	5
4.18	Do listed companies provide adequate and credible disclosure of their internal-control and risk-management processes?	2020	4	4	3	4	3	4	3	4	4	4	4	4
		2018	4	4	4	4	3	3	4	3	4	4	5	5
4.19	Do listed companies provide detailed explanation of their executive remuneration policies?	2020	5	5	3	5	1	2	4	1	1	2	2	1
		2018	5	2	2	3	0	1	1	1	1	3	3	0
4.20	Do companies have clear and credible policies for mitigating corruption?	2020	5	0	2	4	2	2	3	4	4	2	3	4
		2018	3	0	2	2	2	2	2	3	2	2	2	3
	2020 category score (out of 100)		79	51	59	65	38	44	48	66	55	60	63	60
	Category percentage		79	51	59	65	38	44	48	66	55	60	63	60
	Rank		1	9	7	3	12	11	10	2	8	5	4	5

Source: ACGA

5. Investors

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
Institutional														
5.1	Are domestic institutional investors (asset owners and managers) working to promote better corporate governance through publicly announced policies?	2020	4	1	2	5	0	4	3	2	1	1	3	3
		2018	5	1	1	4	1	3	1	3	1	1	2	3
5.2	Are foreign institutional investors (asset owners and managers) working to promote better corporate governance through publicly announced policies?	2020	3	2	5	2	1	4	3	2	1	4	3	3
		2018	2	1	4	2	1	3	2	1	1	2	1	0
5.3	Do a majority of domestic institutional investors exercise their voting rights, including voting against resolutions with which they disagree?	2020	5	1	2	4	1	5	3	2	1	1	3	3
		2018	5	2	2	4	3	4	2	3	2	2	3	3
5.4	Do a majority of foreign institutional investors exercise their voting rights, including voting against resolutions with which they disagree?	2020	5	3	5	4	3	5	5	3	3	5	5	3
		2018	4	3	4	3	3	4	4	2	2	4	4	1
5.5	Do domestic institutional investors attend annual general meetings?	2020	1	1	1	1	2	1	1	2	2	1	2	1
		2018	1	1	0	0	2	2	1	3	2	1	3	3
5.6	Do foreign institutional investors attend annual general meetings?	2020	0	0	1	1	2	1	1	1	1	1	1	1
		2018	1	0	1	0	1	1	1	1	1	1	0	0
5.7	Do activist funds exist that seek to address specific company issues or transactions?	2020	2	0	2	1	1	5	3	1	0	0	0	0
		2018	1	0	1	0	0	5	2	0	0	1	0	1
5.8	Do domestic asset owners (in particular state pension and investment funds) play a leadership role in prompting responsible investment and investor stewardship?	2020	5	1	1	1	0	3	3	3	0	1	2	2
		2018	5	1	0	0	0	3	1	3	0	1	0	1
5.9	To what extent do domestic institutional investors engage in regular individual or collective engagement with listed companies?	2020	5	0	1	3	0	3	2	4	0	1	2	2
		2018	4	0	0	3	0	3	0	2	0	0	2	2
5.10	To what extent do foreign institutional investors engage in regular individual or collective engagement with listed companies?	2020	3	1	3	2	2	2	3	2	2	3	2	1
		2018	1	1	3	1	1	2	2	1	1	2	1	0
5.11	Are domestic investors effectively disclosing how they manage institutional conflicts of interest?	2020	3	0	2	2	2	3	1	2	1	1	0	2
		2018	3	2	3	2	2	2	1	2	0	2	1	2
5.12	Do domestic institutional investors disclose voting down to the company level, and give substantive reasons for voting against?	2020	3	0	0	5	0	4	5	0	0	0	0	5
		2018	5	0	0	5	0	5	4	0	0	0	0	4
5.13	Do any proxy advisory services operate locally?	2020	5	2	0	5	0	4	3	4	0	3	0	1
		2018	5	1	0	5	0	3	2	2	0	0	0	0
	2020 subcategory score (out of 65)		44	12	25	36	14	44	36	28	12	22	23	27
	Percentage		68	18	38	55	22	68	55	43	18	34	35	42
	Rank		1	11	7	3	10	1	3	5	11	9	8	6
Retail														
5.14	Do retail shareholders see the annual general meeting as an opportunity to engage with companies and ask substantive questions?	2020	4	1	2	1	2	3	1	3	2	4	3	2
		2018	4	1	2	1	3	3	0	4	2	5	3	4
5.15	Have retail shareholders formed their own (ie, self-funded) associations to promote improved corporate governance?	2020	5	0	0	1	0	0	0	3	3	4	0	3
		2018	5	0	0	0	0	1	2	3	4	3	1	3
5.16	Do retail shareholders or individuals launch public activist campaigns against errant directors or companies?	2020	3	1	3	1	0	3	1	2	1	5	3	1
		2018	1	0	1	1	0	1	2	2	1	3	4	0
5.17	Do retail shareholders (or government agencies acting on their behalf) undertake lawsuits against errant directors or companies?	2020	3	2	1	1	1	3	2	0	1	0	5	1
		2018	4	2	1	1	0	3	2	0	1	1	5	0
5.18	Do retail shareholder associations (or organisations formed by government and working on their behalf) collaborate with institutional investors?	2020	0	0	0	0	0	1	0	3	0	0	0	0
		2018	1	0	0	0	0	0	1	2	1	0	0	0
	2020 subcategory score (out of 25)		15	4	6	4	3	10	4	11	7	13	11	7
	Percentage		60	16	24	16	12	40	16	44	28	52	44	28
	Rank		1	9	8	9	12	5	9	3	6	2	3	6
	2020 category score (out of 90)		59	16	31	40	17	54	40	39	19	35	34	34
	Category percentage		66	18	34	44	19	60	44	43	21	39	38	38
	Rank		1	12	9	3	11	2	3	5	10	6	7	7

Source: ACGA

6. Auditors & audit regulators

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
6.1	Are local accounting standards fully converged with International Financial Reporting Standards (IFRS)?	2020	5	4	5	3	3	4	5	5	4	5	5	5
		2018	5	5	5	3	5	5	5	5	5	5	5	4
6.2	Are local auditing standards fully converged with International Standards on Auditing (ISAs)?	2020	5	3	5	3	3	4	4	5	4	4	4	5
		2018	5	4	5	4	5	5	5	5	5	5	4	5
6.3	Has the government or accounting regulator enacted effective rules on the independence of external auditors? (eg, by introducing limits on the non-audit work that external auditors can do; requirements for audit-partner rotation; whistleblower protection for auditors; a positive duty for auditors to report fraud; and so on)	2020	5	2	4	2	3	4	3	5	3	4	3	4
		2018	4	3	3	3	3	3	4	3	3	3	4	3
6.4	Is disclosure of audit and non-audit fees paid to the external auditor required, with accompanying commentary sufficient to make clear what the non-audit work is?	2020	5	2	5	4	3	4	5	4	5	4	4	5
		2018	5	2	5	3	3	4	3	4	5	5	4	4
6.5	Are extended auditor reports focussing on "key audit matters" (KAMs) required?	2020	5	5	5	4	0	2	4	5	5	5	5	5
		2018	5	5	5	1	0	0	4	5	5	5	5	5
6.6	Are large listed companies well prepared for their annual audit? (ie, the auditor does not need to assist with final account preparation; management assumptions underlying complex accounting treatments, such as in valuation of assets or transactions, are clear; the CFO has up-to-date knowledge of new accounting standards)	2020	5	3	5	3	4	5	5	4	4	5	5	4
		2018	5	3	5	3	4	5	4	4	4	5	4	4
6.7	Are the audits of large companies of high quality and in line with international best practice? (ie, the audit firms follow proper quality control standards; audit partners spend sufficient time supervising audits; there is evidence of auditors pushing back on overly flexible interpretation by management of accounting standards; audits are done by a single firm)	2020	4	3	4	2	4	4	4	4	4	4	4	3
		2018	4	3	4	3	4	4	4	4	3	4	4	4
6.8	Are medium-sized listed companies well prepared for their annual audit? (ie, the auditor does not need to assist with final account preparation; management assumptions underlying complex accounting treatments, such as in valuation of assets or transactions, are clear; the CFO has up-to-date knowledge of new accounting standards)	2020	4	2	4	3	3	4	4	4	3	4	4	4
		2018	4	2	3	3	3	3	3	3	3	3	3	3
6.9	Are the audits of medium-sized companies of high quality and in line with international best practice? (ie, the audit firms follow proper quality control standards; audit partners spend sufficient time supervising audits; there is evidence of auditors pushing back on overly flexible interpretation by management of accounting standards; audits are done by a single firm)	2020	3	2	3	2	3	3	3	3	3	3	3	3
		2018	3	2	3	2	3	3	3	3	3	3	3	3
6.10	Has the government established an independent audit oversight board (AOB) with clear and independent powers of registration, inspection, investigation, sanction (over both auditors and audit firms) and standard setting?	2020	4	0	3	3	3	3	3	4	2	3	5	4
		2018	4	2	1	1	4	3	4	5	2	3	4	4
6.11	Does the audit regulator exercise effective and independent disciplinary control over the audit profession?	2020	3	1	3	3	4	3	3	3	2	2	3	2
		2018	4	1	2	0	3	2	3	5	2	2	2	2
6.12	Does the audit regulator disclose its enforcement work on a timely and detailed basis?	2020	5	2	5	3	3	5	2	5	1	4	2	2
		2018	4	2	5	0	2	4	3	5	1	3	2	3
6.13	Does the audit regulator publish a detailed report on its inspection programme, audit quality, and audit industry capacity (ie, the level of skills and experience in the CPA profession) every one to two years?	2020	5	1	4	2	2	5	1	5	1	5	3	4
		2018	4	1	3	0	1	5	0	5	1	4	2	4
6.14	Does the audit regulator proactively promote capacity, quality and governance improvements within audit firms? (This could include, among other things, requiring firms to meet a set of "audit quality indicators". Or creating an "audit firm governance code". Or pushing small firms to consolidate.)	2020	2	0	2	1	3	4	3	4	1	5	3	3
		2018	3	0	3	1	3	4	3	3	2	5	3	2
	2020 category score (out of 70)		60	30	57	38	41	54	49	60	42	57	53	53
	Category percentage		86	43	81	54	59	77	70	86	60	81	76	76
	Rank		1	12	3	11	10	5	8	1	9	3	6	6

Source: ACGA

7. Civil society & media

			AU	CH	HK	IN	ID	JP	KR	ML	PH	SG	TW	TH
7.1	Is there a high quality provision of director training in the market, particularly through an institute of directors?	2020	5	2	4	3	3	5	0	4	4	5	3	5
		2018	5	1	4	2	4	4	0	2	3	4	3	5
7.2	Is there an institute of company secretaries (or equivalent) actively engaged in company secretarial training?	2020	5	1	4	5	4	1	0	5	0	4	2	5
		2018	5	1	4	5	3	2	0	5	0	4	1	2
7.3	Are other professional associations—of accountants, financial analysts and so on—helping to raise awareness of good corporate governance and ESG?	2020	4	2	3	3	1	3	1	1	2	3	2	0
		2018	4	2	3	2	2	3	1	1	2	3	3	3
7.4	Are business associations - chambers of commerce, business federations and investment industry bodies—working with their members to improve corporate governance and ESG?	2020	2	0	1	3	1	1	0	0	1	2	3	4
		2018	0	0	0	3	1	1	0	0	1	1	1	2
7.5	Are other non-profit organisations working to raise standards of corporate governance and ESG?	2020	5	0	3	5	2	5	5	3	2	1	5	1
		2018	5	0	2	3	2	5	5	3	2	1	2	1
7.6	Are these groups also involved in public policy discussions and consultations on corporate governance?	2020	4	0	5	5	2	3	4	2	2	3	3	3
		2018	5	0	5	5	2	3	2	2	2	5	3	3
7.7	Are professional associations and academic organisations carrying out original and credible research on local CG practices?	2020	5	2	3	5	2	4	4	1	1	4	3	1
		2018	5	2	3	5	2	3	3	1	2	4	3	2
7.8	Does the media actively and impartially report on corporate governance policy developments and corporate abuses?	2020	3	1	2	4	1	3	1	2	2	3	4	2
		2018	3	2	3	4	2	4	1	4	2	3	4	2
7.9	Is the media sufficiently skilled at reporting on corporate governance?	2020	3	2	2	2	1	3	1	2	2	4	3	1
		2018	3	2	3	3	2	3	2	3	3	3	3	3
	2020 category score (out of 45)		36	10	27	35	17	28	16	20	16	29	28	22
	Category percentage		80	22	60	78	38	62	36	44	36	64	62	49
	Rank		1	12	6	2	9	4	10	8	10	3	4	7

Source: ACGA

Notes

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